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Montana State Fund History
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Montana State Fund's complex history tends to generate colorful phrases. A compendium written by the Montana State Fund for the SB304 study committee, staffed by the Montana State Fund in the 2003-2004 interim, began: "It was the perfect storm" then proceeded to describe how a growing inability to cover the liabilities for claims being paid by the Montana State Fund predecessor, a state agency, during a late 1980s economic downturn led to the creation of the Montana State Fund.

This report includes the following:

- origins of Montana State Fund;
- financial history, including the flow of money into and out of the so-called Old Fund;
- contract issues;
- concerns and potential options related to dealing with the Old Fund liability;
- an overview of Montana State Fund's regulation as a state agency;
- differences with private insurers; and
- potential options and concerns related to dealing with Montana State Fund restructuring.

Overview

The subtext of this report is the adage:
"We have met the enemy and the enemy

Table 1: Timeline

Pre-1987	The Montana State Fund of today (Plan 3) did not exist then in the same form. Instead, a unit of the Department of Labor and Industry wrote policies as did private insurers (under Plan 2) and employers who self-insured (under Plan 1).
1987	The Legislature enacted a payroll tax on employers to help pay down a liability that arose in part because premiums were artificially held low while claims rose.
1989	The Legislature created the State Compensation Insurance Fund, which was intended to operate as a domestic mutual insurance company and regulated by the Insurance Commissioner.
May 1990	A triple-topic special session of the Legislature included dealing with mounting liabilities for State Fund workers' compensation claims that politically and realistically could not be met by increasing premiums.
July 1, 1990	The laws enacted in the special session went into effect and separated the liabilities for claims occurring before July 1, 1990, into the Old Fund and those occurring on or after July 1, 1990, into the New Fund. The State Fund name was changed to the State Compensation Insurance Fund, which no longer was under the State Auditor's Office but remained a state agency that in essence is operated as a private firm that has some different regulations (no premium tax, more audits).

is us". Another adage, "the perfect" being "the enemy of the good" is also germane. This report is not about "fault" but seeks to explain a history in which a state agency, created by the legislature, has been a business that is both a strength of the Montana workers' compensation system and inadvertently one of its own worst enemies as a state agency that doesn't look like other state agencies and partly through its success has become a tempting focus of the state's appropriating authority, the Legislature.

Now for the dry stuff. The Montana State Fund (MSF) was created by the legislature and is often confounded by the legislature. MSF operates as a business in many ways but has more interference from the legislature than most businesses because MSF remains a state agency. Yet MSF also has less oversight from an entity that oversees other insurance companies -- the State Auditor's Office -- because of various decisions made 20-plus years ago when MSF was created. And while the legislature itself nominally has oversight, the attention has its good and bad aspects.

The timeline (Table 1) and the information below will provide more explanation of this hybrid entity and its financing as the 2013-2014 Economic Affairs Interim Committee reviews whether MSF's structure ought to change or remain the same. The Economic Affairs Committee decided at its first meeting that the study of Montana State Fund's structure should not include a review of all that would be required for complete privatization of the Montana State Fund, which would end MSF's status as a state agency and require complicated assessments of the status of its employees and their state-provided benefits as well as the value of its other assets, including its building in downtown Helena.

To be addressed later in this report is the question of what a "restructuring" would look like; does restructuring have to do with treating Montana State Fund less like a state agency and more like a private business in terms of regulatory oversight, budgetary independence, or a combination of these? The early part of the report includes history related to the Old Fund as background information as the Economic Affairs Committee seeks to determine whether to recommend to the full legislature a payment to shift liability from the general fund to Montana State Fund.

MSF Origins

Even the date of Montana State Fund (MSF) creation is part of the discussion. Was Montana State Fund created in 1989 or in 1990? Technically, the enactment of the statute describing the officially designated State Compensation Insurance Fund's creation was in 1989 (Session Laws of 1989, chapter 613, section 4). At that time the name was the State Compensation Mutual Insurance Fund and the entity was to operate with some exceptions as a domestic mutual insurer under the state laws that regulate domestic mutual insurers. According to 39-71-2314, MCA, the excepted regulations included those regarding formation, bonding requirements, participation in an insolvency safety net called the insurance guaranty association, and the termination authority if the insurance commissioner determined unfunded liabilities made the State Fund insolvent.

Montana State Fund considers its creation as of 1990,¹ after the May Special Session of the Legislature distinguished the financial liabilities for "Old Fund" claims before July 1, 1990, and "New Fund" claims that arose on or after July 1, 1990. Partly because of this distinction Montana State Fund generally considers itself synonymous with the New Fund. But many of the statutes² applying to the State Fund pre-date 1990, some going back to 1915 when Montana's workers' compensation laws first took shape. The 1990 separation of accounts, codified as 39-71-2351, MCA, still required Montana State Fund to manage both accounts, or "funds". However, one indication of the separate considerations for the two accounts was that section 2 of the 1990 Special Session

¹The Montana State Fund website "About Us" page states in its short history: "Montana State Fund was created by the legislature in 1990..."

²These include the following, all enacted in 1989: 2-15-1019, MCA, creating the Board of Directors of the State Compensation Insurance Fund; 39-71-2311, MCA, providing the intent of what is termed Plan 3, the State Compensation Insurance Fund; 39-71-2312, MCA, providing definitions; 39-71-2313, creating the State Fund; 39-71-2314, MCA, stating the State Fund is subject to laws applying to state agencies; 39-71-2315, MCA, describing management of the State Fund and powers and duties of the board; 39-71-2316, MCA, outlining powers and duties of the board; 39-71-2317, MCA, describing appointment of the executive director and management staff; 39-71-2318, MCA, excluding personal liability of the board, the executive director, and employees; 39-71-2319, MCA, describing the assets and liabilities of the prior State Fund being transferred to the State Fund; and 39-71-2337, MCA, requiring submission of notice of coverage within 30 days. All other statutes in Title 39, chapter 71, part 23, the section of law specific to Montana State Fund, were either enacted in 1915 and amended in or after 1990.

Laws allowed Montana State Fund to charge up to \$3 million a year to administer the Old Fund (the amount as of 1999 was limited to no more than \$1.25 million a year).

What difference does the date make? Perhaps none. Certainly the entity that oversaw the "insurer of last resort" has morphed from the state agency that it was prior to the big rewrite of workers' compensation laws in 1987 to the "nonprofit, independent public corporation" first described in 1989 Session Laws, ch. No. 613, Section 4. The significant debate involves both questions about the liability for the Old Fund and a history of budgetary and political intersection with the Montana State Fund.

A Murky Financial History

At first the Old Fund liability issues were clear. Even before the separation into Old Fund and New Fund, the legislature acted to fund and create an account to help address the unfunded liability that had accumulated under the agency then called the state fund. The 1987 Legislature imposed a 0.3% payroll tax on all employers with workers required to be covered by workers' compensation under 39-71-401, MCA, and set up a statutorily appropriated account to address the unfunded liability. The payroll tax began with the quarter ending Sept. 30, 1987.³ Even with the unfunded liability growing, a special session of the 1990 Legislature reduced the payroll tax to 0.28%. Three years later the unfunded liability of what soon would be called the Old Fund had reached \$400 million or more and the Legislature increased the employer payroll tax to 0.5% and imposed a 0.5% payroll tax on employees and others receiving compensation.

The financing for paying off the Old Fund liability relied on the payroll tax and bonds that were to be paid off by the payroll tax. Beyond that specific designation, however, the 1990 legislation provided many indications that lines between Old Fund and New Fund accounts were not clear. For example, under 39-71-2319, MCA, "the state fund shall assume liability for all outstanding claims and indebtedness of the previously existing state fund". Another example is a statute enacted in the 1990 Special Session, codified

³For details on the Old Fund liability see Kris Wilkinson's report, "Workers' Compensation: Old Fund Analysis", prepared by the Legislative Finance Committee, Nov. 3, 2007.

as 39-71-2353, MCA, which provided for loans to pay Old Fund claims using the New Fund's "reserves accumulated from premiums paid to the state fund based upon wages payable on or after July 1, 1990...". That statute was repealed just months later by the 1991 Legislature but replaced with a similar yet more cumbersome statute later codified as 39-71-2354, MCA. The 1991 statute retained the revenue source as premiums paid based on wages payable on or after July 1, 1990. The language inserted the budget director into the process by saying that a shortfall in funds intended to pay claims for injuries from accidents that occurred before July 1, 1990, first had to be certified by the budget director before the Board of Investments would "finance the amount certified by the budget director" in the form of a loan or a bond issue using as revenue "reserves accumulated from premiums paid to the state fund based upon wages payable on or after July 1, 1990".

Other provisions allowed money from the New Fund account to be moved to the Old Fund account. A loan from the New Fund to the Old Fund helped pay claims after the payroll bond money was exhausted in February 1993. Another loan came in late 1993. The SB 67 preamble in 1997 elsewhere noted that the "State Fund"⁴ would be transferring \$63.8 million to the Old Fund account "to pay old fund claims to allow direct payment of dividends to policyholders". The hopeful preamble language projected that the Old Fund would be adequately funded by June 30, 1999. As a result, SB 67 provided a series of money transfers and statutory changes that ended the connection between dividends and the unfunded liability of the Old Fund. Montana State Fund's ability to pay dividends had been hamstrung first with language that said the state fund could not pay dividends "until the unfunded liability of the state fund is eliminated and adequate actuarially determined reserves are determined". That language, part of 39-71-1316, MCA, changed in the May 1990 session to remove the requirement that the unfunded liability be eliminated. Dividends were still unlikely because, until the 1997 changes, any money that could be put into dividends first had to go toward paying Old

⁴Nomenclature is confusing because the definition section governing the Montana State Fund statutes in Title 39, chapter 71, part 23, states that "state fund" means the state compensation insurance fund provided for in 39-71-2313. The statute was enacted in 1989. Generally this report will refer to Montana State Fund for all references to the current "state fund" unless paraphrasing legislation, as in this case.

Fund claims for injuries from accidents that occurred before July 1, 1990. The 1997 changes also provided for a contingency determination by the Montana State Fund, to be certified by the budget director, that would lead to a declaration that the Old Fund had adequate reserves, which allowed the contingent termination of the payroll tax.

As allowed by SB 67 in 1997, the budget director responded to Montana State Fund's board of directors declaring that the Old Fund liability was adequately funded and on Sept. 16, 1998, certified that the Old Fund liability tax would terminate as of Jan. 1, 1999. The rationale provided in the letter from Dave Lewis, budget director for Gov. Marc Racicot, was "that there will be adequate funding for benefits, claims administration, and a contingency reserve of 10% of outstanding liability of claims for injuries resulting from accidents that occurred before July 11, 1990."

The actuaries who prepared the estimate on which the Montana State Fund board of directors made the determination of adequate Old Fund reserves cautioned that "there can be no guarantee with respect to estimates of the Old Fund's future financial condition". The actuaries recognized the following requirements⁵ for adequate funding, based on language defining "adequately funded" in SB 67, enacted in 1997 and amending 39-71-2505, MCA:

- the present value of the total cost of future benefits remaining to be paid;
- the present value of the cost of administering the claims; and
- the present value of an additional amount equal to 10% of the total of the above amounts (the contingency).

The new language provided that the old fund liability tax would terminate on either January 1 or July 1 of the year in which Old Fund claims were projected to be adequately funded. Tillinghast-Towers Perrin provided the projections listed in Table 2.

⁵The definition of adequately funded was moved to 39-71-2352, MCA, when 39-71-2505 was repealed.

Table 2: Tillinghast-Towers Perrin Estimates in 1998 of Old Fund Liability

Payment/ Evaluation Period	6 mo. benefit payments	Estimated overall unpaid claims	Claims admin. costs: part year, overall	Estimated present value at 5.25% discount	Present value, discounted, + 10% contingency
7/1/1998 to 12/31/1998	\$8.28 mil.		\$0.95 million		
12/31/1998		\$166.07 mil.	\$19.1 million	\$131.4 mil.	\$144.54 million
1/1/1999 to 6/30/1999	\$7.79 mil.		\$0.90 million		
6/30/1999		\$158.28 mil.	\$18.2 million	\$126.0 mil.	\$138.6 million

Source: Tillinghast-Towers Perrin letter to Carl Swanson, President of the State Compensation Insurance Fund, Sept. 15, 1998. Highlighted area for 12/31/1998 and 6/30/1999 combined are the unfunded liability.

The actuaries at Tillinghast-Towers Perrin also noted that the amounts in the first columns were not discounted, nor did the statute say to discount the amounts. However, Tillinghast-Towers Perrin noted that Montana State Fund's management had selected a discount rate of 5.25% for the periods after June 30, 1998, to account, in part, for anticipated long-term investment yields, "which management expects to be earning on the Old Fund's assets...". The actuaries also noted that 5.25% was slightly less than the anticipated rate of return.

In terms of Old Fund assets, the letter from the actuaries to then Montana State Fund President Carl Swanson projected the Old Fund invested assets plus receivables, including a \$102 million dividend from the New Fund (see Table 3) to be \$149.48 million, with the discounted present value of liabilities at \$144.54 million, which yielded a projected positive Old Fund balance of \$4.94 million.

As seen in Table 3, not long after the projected "adequate funding" was announced and the payroll tax ended, the Legislature tapped into more than the \$4.94 million estimated to be potentially excess. Even though HB 167 from 1999 had a flowback provision if the Old Fund ended up being inadequately funded, which referenced drawing on the premiums paid on or after July 1, 1990, there were incursions into Old Fund financing in 2001 and 2002. The combined amounts transferred from the Old Fund to the New Fund

in those years equaled \$14,172,512. By June 2002 the Old Fund equity was an estimated \$24,866,000.⁶ Within three months, at an August 2002 Special Session, SB 19 stripped \$4 million from the Old Fund to put into the general fund and first stated that the general fund would be on the hook to pay Old Fund claims.

Table 3: Cash Flows to and From the Old Fund, 1989 through 2004 and FY2011 through FY2013

Fiscal Yr.	General Fund	Old Fund	New Fund
June 1989	(\$20,000,000)	\$20,000,000	
May 1990		(\$12,000,000)	\$12,000,000
Feb. 1993		\$13,000,000	(\$13,000,000)
July 1993		\$5,000,000	(\$5,000,000)
Aug. 1993		\$1,000,000	(\$1,000,000)
Sept. 1993		\$1,000,000	(\$1,000,000)
Oct. 1993		\$1,000,000	(\$1,000,000)
Oct. 1993		(\$21,321,007)	\$21,321,007
Sept. 1996		\$102,300,000	(\$102,300,000)
June 1997	\$10,000,000		(\$10,000,000)
July 1997		\$63,800,000	(\$63,800,000)
June 1998	\$10,000,000		(\$10,000,000)
July 2001		(\$6,765,000)	\$6,765,000
July 2002		(\$7,407,512)	\$7,407,512
Aug. 2002	\$4,000,000	(\$4,000,000)	
June 2003	\$18,268,000	(\$18,268,000)	
June 2004	\$815,605	(\$815,605)	
2011	(\$50,000)	\$50,000	
2012	(\$10,047,517)	\$10,047,517	
2013	(\$10,640,749)	\$10,640,749	

⁶This information was included in a Legislative Audit Division response to a request for information in September 2002.

Parentheses means an outflow.

Source: Kris Wilkinson, "Workers' Compensation: Old Fund Analysis", report prepared for the Legislative Finance Committee, Nov. 30, 2007, for 1989 through 2004, except that initial \$20 million listed jointly for Old Fund and New Fund in 1989. Updated financial report for more recent years.

The fiscal troubles that resulted in the 2002 Special Session continued into 2003. As part of a major legislative attempt to grab more money from "the state fund" but also ensure against further incursions, SB 360 in the 2003 Session deleted the language specifying payments to the general fund and also required MSF's policies to state that funds were restricted to claims for injuries from accidents occurring on or after July 1, 1990 (amending 39-71-2316, MCA). (See next section for more details on the implication of the policy statements.)

While SB 360 was significant, the biggest long-term impact from 2003 came with HB 363, which removed a requirement for maintaining reserves for the Old Fund claims. That bill also moved money from the Old Fund to help balance the state budget in 2003. The impact to the state's general fund was not felt until 2011, when a \$50,000 transfer from the general fund took place. In subsequent years annual transfers have topped \$10 million.

The transfer from the general fund to Montana State Fund to pay Old Fund obligations creates a situation in which the legislature never votes on appropriating this amount. Interestingly, the situation now has evolved to one that did not exist when Attorney General Mike Greely was asked in 1987 whether the unfunded liability of the claims against the state fund for injuries resulting from accidents before July 1, 1990, created a state debt within the meaning of Article VIII, Section 8, of the Montana Constitution, which requires a two-thirds vote of the legislature. Greely replied that the unfunded liability had "arisen not by conscious act of the Legislature but from a combination of circumstances which resulted in a mismatch between liability incurred and trust fund deposits".⁷ He further stated that "there is no debt or liability created [citation omitted]

⁷Attorney General Mike Greely, Opinion No. 46, Volume 42, Dec. 29, 1987.

when there is cash on hand or revenue provided by the legislature for the biennium to meet the appropriation".... And finally he noted that "even if the term 'state debt' in article VIII, section 8 of the Constitution did encompass the State Fund's inability to satisfy its legally-due obligations, no such state debt has yet occurred or will likely occur this biennium..." and for that reason he would not speculate on a future insolvency. He also suggested that if a bona fide dispute exists as to the State's responsibility upon such insolvency" then an Attorney General's opinion might be sought at that time. When the 2002 Legislature voted to put the general fund on the hook for Old Fund liability, there remained money in the Old Fund account, so the situation posited by AG Greely's opinion did not occur until 2011. A Financial Compliance Audit of Montana State Fund for the biennium ending June 30, 2012, noted:

The total Old Fund estimated claims liability at June 30, 2012 was \$59,161,706. Because the claims are an obligation of the General Fund, Old Fund liabilities are no longer reflected in the MSF financial statements.

As a result, the audit recommended "recording the current portion of the estimated claims liability on the state's accounting records in accordance with state law"⁸. This raises the question of whether a state debt now exists that has not been voted on and whether, in fact, the debt needs to be voted on and what would happen if a vote failed.

Hands Off, The Money Is Mine (not Yours, not Ours)!

There is a statute, 39-71-2320, that is often referenced to emphasize that Montana State Fund's money, properties, and securities are only for the MSF's use. As originally enacted in 1989, the statute included two exceptions, one requiring any excess of state fund assets over liabilities to be transferred to help meet the unfunded liability for claims for injuries from accidents that occurred before July 1, 1990, and the other allowing money from premiums paid on wages payable on or after July 1, 1990, to be used to pay off loans also intended to diminish the unfunded liability for pre-July 1, 1990 injury claims. An even larger exception occurred in 1997, when the legislature that year siphoned off \$10 million in 1998 and again in 1999 to the general fund. Based on the preamble to SB 67, the \$20 million combined payment was in recognition of the \$20

⁸Montana Legislative Audit Division, "Montana State Fund Financial Compliance Audit for the Two Fiscal Years Ended June 30, 2012", 12-05A, December 2012.

million general fund "appropriation received by the State Fund" in the June 1989 Special Session. The preamble also noted that the money was going to the general fund "to remove any perception that the State Fund remains a burden on the general fund...".

To guard against further legislatively engineered raids on MSF funds, SB 360 added the following underlined words to 39-71-2320, MCA:

"The money collected by the state fund for claims for injuries occurring on or after July 1, 1990, may not be used for any other purpose and may not be transferred by the legislature to other funds or used for other programs. However, state fund money must be invested by the board of investments provided for in 2-15-1808, and subject to the investment agreement with the board of investments, the earnings on investments are the sole property of the state fund as provided in this section."

This language must be read in combination with a specific directive in SB 360 amending 39-71-2316, MCA, to require "a provision in every policy of insurance issued pursuant to this part that incorporates the restriction on the use and transfer of money collected by the state fund as provided for in 39-71-2320". As a result, if the legislature subsequently attempts to tap the Montana State Fund's "New Fund" account, the effort could be challenged as a constitutional violation of contracts. Because of the contract language, legislative attempts since 2003 to divert some MSF funds to address Old Fund liabilities have sought to clarify a difference between income earned off of premiums or other assets and the income specifically generated from premiums. The efforts also have sought to reinforce the concept that the Old Fund is not a separate entity from Montana State Fund but that Montana State Fund consists of both the Old Fund and the New Fund, described as "accounts" in statute. This distinction is one that Montana State Fund argues against, contending that Montana State Fund is only the "New Fund".

Old Fund Liability Concerns and Options

A key question regarding the Old Fund is who has the liability to pay Old Fund claims. The back-and-forth financial provisions in earlier statutes suggested the New Fund

occasionally could make loans to the Old Fund, always with the thought that the payroll tax or other Old Fund assets would reimburse the New Fund. After 2002, the liability became that of the state's general fund. Is there anything wrong with that? The state created the promise to workers' compensation claimants prior to July 1, 1990, that their claims would be covered. Employers and employees contributed between 1987 and 1999 to retiring the unfunded liability as part of a political agreement that the payroll tax offsetting the unfunded liability would help to stabilize the business environment and keep workers' compensation premiums from skyrocketing and jeopardizing Montana employers' competitiveness with businesses in other states yet still fund the promised benefits to injured workers and their beneficiaries.

The pay-as-you-go option currently being used for Old Fund claims creates a long-term drain on the treasury, estimated out to roughly 2050, with decreasing amounts of money needed to be transferred each year as the fewer than 900 remaining Old Fund claims are either settled or ended as claimants die. This option avoids estimating a present value or even a discounted value (to account for investment income) for claims that still can be affected by increasing medical costs as well as court decisions that might be retroactively applied. There are questions related to either retaining the pay-as-you-go option or attempting to hand Montana State Fund a cash infusion in the hopes that the issue is finally resolved by Montana State Fund assuming the liability.

- Does the pay-as-you-go option create a state debt that did not get approval from two-thirds of the legislature?
- If the legislature were to calculate the unfunded liability and pay that amount to Montana State Fund to invest and pay all future Old Fund claims, would the situation be any different than in past years when the legislature borrowed that money, thus possibly creating business uncertainty for Montana State Fund?
- If the legislature miscalculated the amount paid to Montana State Fund and the money and investment income ran out, would the state still be liable for Old Fund claims because, after all, the Montana State Fund remains a state agency?
- Would the issue return to the legislature under the previous scenario of a depleted Old Fund and legislators expect Montana State Fund to pay Old Fund claims with New Fund assets, contrary to 39-71-2352, perhaps by rewriting 39-

- 71-2352 to provide exceptions, as has happened in the past?
- Does it make sense for the Montana State Fund to have the liability for Old Fund claims since MSF has the ability to deny Old Fund claims to the extent that there is a question on whether a claim must be paid under the laws in effect at the time? And, if denied, would a claimant increase the costs by going to court to get satisfaction?

The following options are among those the Economic Affairs Committee might want to consider as they review what to do with the Old Fund liability and whether they want to restructure Montana State Fund.

- Option 1: Do nothing. This would continue to make the General Fund the payor for the Old Fund claims and administrative costs, which means that investment income remains in the General Fund until needed to pay claims or administrative costs. This also raises the question of whether a state debt has been created without the appropriate two-thirds vote.
- Option 2: Require Montana State Fund to use its assets from investment income or nonpremium income to make payments for Old Fund claims, as posed by the initial version of SB 173 in the 2013 session. This approach would put the Old Fund claims burden onto the Montana State Fund without compensation for the assumption of the costs. Possible outcomes include more denied claims, higher court costs, or an increase in settlements to finally put all claims to rest.
- Option 3: Calculate the cost of settling Old Fund claims and make one lump sum payment. A lump sum payment could address the present value of money and be discounted accordingly based on projections for inflation and investment earnings.
- Option 4: Calculate the cost of settling Old Fund claims over a set period, for example 5 years, and make a partial payment that attaches incentives for the Montana State Fund to handle claims and settlements as a

modification of Option 3. After 5 years the partial payment could be recalibrated to meet changes in medical costs and other influences affecting claims, which would provide a vote but not necessarily a "state debt" vote because the money would be transferred to a state agency.

Regulatory Differences Related to Montana State Fund's Structure

Montana State Fund is different from other state agencies and from other workers' compensation insurers in this state. Although not alone among state compensation insurance funds as a state entity, only about 12 other states also require the public compensation insurer to be the market of last resort.⁹ In an analysis of how other state funds operate, a consultant for the Department of Labor and Industry noted that Montana alone among states in the region used for comparison (including some that are monopolistic state-based insurers) put the overall liability on the citizens of the state. Among other states studied by the consultant, the responsibility for covering claims if an insolvency developed was either put on all employers with policies written by the state fund or on an insurance guaranty fund.¹⁰

The following discussion will provide differences first for Montana State Fund as a state agency and then among other workers' compensation insurers.

Montana State Fund as a State Agency

The Montana State Fund currently exists as a nonprofit, independent public corporation¹¹, which is intended to operate as a business with the "management and control" vested solely in a politically appointed board. The board hires the chief executive officer, who in turn hires the management team. Many duties are specifically

⁹This information is from a document provided to the Economic Affairs Committee in January 2010 from a consultant hired by the Department of Labor and Industry. See: http://leg.mt.gov/content/Committees/Interim/2009_2010/Economic_Affairs/Meeting_Documents/ClaytonStateFundRegulations1-10-10.pdf.

¹⁰*Ibid.*

¹¹The definition is in 39-71-2312, MCA. The management and duties of the board are primarily outlined in 39-71-2315 and 39-71-2316, MCA.

stated in statute, which is typical of state agencies but less so for private insurers.

Although a state agency, Montana State Fund has successfully separated itself from many typical state agency provisions but not from state pension or health insurance benefits, standards of conduct for state employees, open meetings laws, the Montana Procurement Act provisions, or the Legislative Audit Act. Among Montana State Fund exemptions from state agency laws are:

- the definitions, pay classification, leave provisions, and grievance provisions that affect other state employees (2-18-103 and 2-18-601, MCA);
- parts of the Montana Administrative Procedure Act (limited by 39-71-2316, MCA, to the initial setting of premium rates for classifications but excluding the contested case rights and provisions);
- the Legislative Finance Act and the budget provisions in Title 17, chapter 7, parts 1 through 4, except that the state fund may use the debt collection procedures provided for in Title 17, chapter 4, part 1 (39-71-2363, MCA). While the Montana State Fund's budget is not subject to executive branch or legislative branch approval but only to its board's approval, the Montana State Fund does provide a copy of the approved budget to the governor and the legislature. Montana State Fund also submits no later than October 1 of each year an approved annual budget for review by the Legislative Finance Committee and also submits an annual financial report to the governor and to the legislature containing a statement of the estimated liabilities of the Montana State Fund as determined by an independent actuary.
- public record laws (39-71-2314, MCA);
- the false claims procedures as related to workers' compensation claims filed with the Montana State Fund (17-8-403, MCA);
- printing contracts through the Department of Administration (18-7-101, MCA);
- the Insurance Code, unless specifically included (33-1-102(5), MCA). Montana State Fund is included for the workers' compensation classification review committee and work comp rating organization statutes in Title 33, chapter 16, part 10.

In addition, Montana State Fund is mentioned in Article VIII, Section 13, of the Montana Constitution, based on a referendum submitted to voters in 2000 to allow state compensation insurance fund assets to be invested in private corporate capital stock, but not more than 25% of the book value of its total invested assets. By being mentioned in the Constitution, Montana State Fund could not be dissolved as to its title of "state compensation insurance fund" without a constitutional amendment to change or delete the reference.

Differences between Montana State Fund and Private Insurers

Montana's workers' compensation coverage can be provided by one of three "plans":

- Plan 1, which represents self-insured companies like Plum Creek or associations like the Montana Association of Counties;
- Plan 2, which represents private insurers; and
- Plan 3, which is the state compensation insurance fund also known as Montana State Fund.

Self-insured companies do not always have to pay premiums, so the Plan 1 coverage often is not included when indicating market share. The 2012 Workers' Compensation Annual Report, prepared by the Department of Labor and Industry, listed Montana State Fund as having 57% of the market in Calendar Year 2012, compared with the private insurers' 43% share. In terms of reported claims by Plan, which does include Plan 1 insurers, Plan 1 had 26% of the reported claims in Fiscal Year 2012, compared with 34% by private insurers, and 39% by Montana State Fund.

All plans follow the same statutes regarding benefits and response to claims, but the pricing mechanisms can vary. For Montana State Fund, the following issues separate it from private insurers:

- Montana State Fund must provide insurance to all requestors, unless the requestor has an outstanding workers' compensation bill due with Montana State Fund. This is the guaranteed market or "insurer of last resort" provision that allows many other workers' compensation insurers to "cherry pick" from the best risks and leave the more accident-prone risks to Montana State Fund.
- Montana State Fund does not pay a premium tax that private insurers pay.

Exemption from paying the 2.75% tax on written premiums often has been considered one way of offsetting the burden of the guaranteed market.

- Montana State Fund has no oversight by the Insurance Commissioner regarding rate setting. For private insurers, the Insurance Commissioner determines whether rates are excessive, inadequate, or unfairly discriminatory. Montana State Fund's requirement is set in statute to be
"sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of the state fund, and to amass and maintain an excess of surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer". See 39-71-2330, MCA.)
- Montana State Fund may use a limited number of special class codes. This allows farmers, state agencies, and certain others a different class code to recognize special circumstances in Montana.
- Montana State Fund may modify the loss costs developed by the state's rating organization, the National Council on Compensation Insurance, Inc., based on credible data and the fact that many of Montana State Fund's accounts are small companies that have little to no experience rating.

Options regarding Montana State Fund's Structure

The work plan for House Joint Resolution No. 25, which included a study of the structure of the State Compensation Insurance Fund, suggested addressing whether Montana State Fund:

- could have a greater degree of independence from the legislative process and oversight by altering the oversight requirements and perhaps revising funding obligations of the Old Fund claims;
- should pay premium taxes as other insurers do.

As mentioned in the introduction to this report, there are questions regarding what "restructuring" would look like:

- Does restructuring mean treating Montana State Fund more like other private insurers in terms of premium regulation, while still allowing carveouts for certain occupations much like currently happens for farmers and some state agencies?
- Under a restructuring, should Montana State Fund still be guaranteed the business of all state agencies (except its own work comp business which is handled by another insurer to avoid conflicts of interest)? The guaranteed business from state agencies has been a concern of other insurers who would like to bid for the lowest-risk state entities.
- Would the cost of imposing a premium tax, if that were part of restructuring, be less burdensome if the premium tax were gradually increased from a minimum starting point to the standard 2.75% over a multiple-year period?
- Would reducing the number of actuarial reviews required of Montana State Fund offset the business costs of making Montana State Fund more like private insurers? Currently, Montana State Fund pays the cost of a statutorily required actuarial audit hired by the Legislative Audit Division. In FY 2010 the cost for a review was \$8,500, while Montana State Fund's contracted actuarial costs were \$206,052. A review of the Montana State Fund's actuarial report now also is handled by the Insurance Commissioner's Office, which received \$75,000 for each year of the biennium for a review of the actuarial report.

Montana State Fund is likely to make suggestions for restructuring, as will private insurers. This draft report will be revised with their suggestions before it is completed.