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November 30, 2015

Hon. Monica Lindeen
Commissioner of Securities and Insurance
840 Helena Avenue
Helena, Montana 59601

Dear Commissioner Lindeen:

Montana State Fund (MSF) wishes to express our thanks to the Commissioner of Securities and Insurance (CSI) and to Financial Risk Analysts (FRA) for their review of MSF loss reserves as of June 30, 2015 and rates effective for the period July 1, 2015 through June 30, 2016. We appreciate the opportunity to provide MSF's perspective to the findings and recommendations contained in the report. Our overall response to the findings and recommendations are contained in the following paragraphs. We have included the more technical response and comments from the MSF independent consulting actuary, Towers Watson (TW), since the FRA report is a review of the work performed by TW.

MSF is pleased and agrees with FRA's findings that MSF reserves are reasonable and rates are neither inadequate, excessive, nor unfairly discriminatory. FRA's findings provide additional assurance that MSF is likely to have adequate funding to meet its financial obligations to injured Montana employees for claims incurred on or after July 1, 1990. Montana State Fund works diligently to ensure that our financial obligations to injured Montana employees will be met and that Montana employers have reliable access to fairly priced workers compensation insurance in a stable rate environment.

The following summarizes MSF's response to the specific FRA recommendations as found on pages 29-30 of their report:

- We concur that MSF should continue to carefully consider the elevated level of uncertainty in estimating reserve liabilities. MSF books its loss and loss adjustment expense reserves in the upper range of our consulting actuary's central estimate to insure that MSF is more likely than not to have the strength to meet its financial obligations, at least partly in consideration of the findings of third party actuarial reviews. Section 39-71-2311, MCA requires that, when uncertain, MSF shall use assumptions which result in predictions more likely rather than less likely to cover the cost of future claims. We have confidence in our consulting actuary's central estimate as a reasonable estimate of the point at which the risks of being over reserved or under reserved are balanced. The fact that Towers Watson's central estimate is below the simple average of the various analytical indications merely reflects their appropriate judgment regarding the relative strengths and weaknesses of the various actuarial methods.

- We do not concur with FRA's recommendation that MSF rates be set at a level which results in zero growth in equity. MSF rates are currently set essentially at cost, with no target contribution to equity (profit margin). The growth in MSF's equity in recent years has largely been driven by investment returns, particularly realized and unrealized gains in equities. In order for MSF to set rates which result in no further growth in equity, MSF rates would have to be set well below cost, at levels that would be deemed actuarially inadequate. This would have a highly destabilizing impact on a competitive workers compensation insurance market and would affect Montana employers' choice in the marketplace. Moreover, if and when investment returns inevitably diminish or turn negative, MSF rates would be subject to highly destabilizing increases.

Montana statute gives the MSF board of directors the plenary powers to manage the MSF business in the best interests of its policyholders, Montana employers. The board has various levers at their disposal to appropriately manage the business. These levers include both rates and dividends. Given the fact that MSF rates currently do not materially add to the growth of equity and the fact that the growth in equity we have been experiencing is largely being driven by volatile investment returns, we think the dividend program is part of an appropriate mix of means for the board to manage MSF's financial position under current conditions to ensure MSF remains a financially strong insurance company for Montana employers.

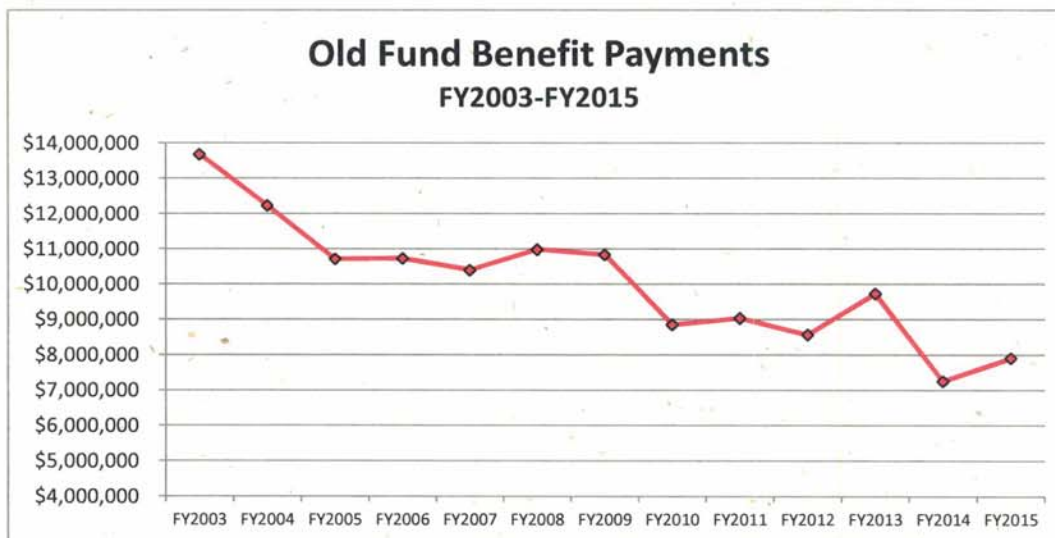
- MSF management is already considering whether to recommend adjusting the level of the provision for adverse loss deviation in its rate structure but we believe that some provision for uncertainty in expected losses is reasonable, appropriate, and is required by Montana law. As previously referenced, Section 39-71-2311, MCA requires that, when uncertain, MSF shall use assumptions which result in predictions more likely rather than less likely to cover the cost of future claims. AMI Risk Consultants, who also reviewed MSF rates and reserves for the Montana Legislative Audit Division opined in their latest report that, "We believe that the provision is reasonable given the historical variance between the expected and current loss ratio estimates." FRA, in their report dated September 5, 2014, stated, "We recommend that MSF and its actuaries continue to include a provision for adverse loss deviation in its rate level indications, particularly in light of the continuing uncertainty regarding the actual savings that will insure from HB334 relative to the adjustments made by TW to estimate the impacts of these savings."

We would partially concur with FRA's recommendation in that it may be appropriate for the board to consider adjusting this provision. We would note that this provision in MSF's rate structure is not a significant factor driving MSF's financial results at this time. We would also note that, insofar as FRA concludes that MSF rates are reasonable and are neither excessive, inadequate, nor unfairly discriminatory, inclusion of this provision in MSF's rate structure is well within regulatory standards.

- We appreciate FRA's support of MSF's implementation of the recommendations of Deloitte Consulting, Inc. in their review of MSF claims handling. MSF is committed to

following and adopting developments in best industry practices and is open to the advice of industry experts.

- We concur with FRA that “Old Fund” liabilities are more likely to fall within the upper end of Towers Watson’s range. We appreciate FRA’s findings as to the risk that Old Fund (OF) liabilities may exceed Towers Watson’s central estimate. The estimates of OF liabilities that will be paid out over the next several decades are subject to a very high degree of uncertainty as is generally noted by FRA in their report as well as documented by TW in their analysis. The unknowns at play include anticipating life expectancies and what kinds of medical conditions will arise and be treated in the meantime, uncertainties that are particularly pronounced for the OF given the statutory benefit structure and operational environment in effect when these claims arose. The annual benefit outlays for the OF will likely continue to diminish over time. The graph below shows the history of declining annual claims payments over time as claims are closed in the OF. Over the past thirteen fiscal years, annual benefit payments have declined from \$13.7 million in FY 2003 to \$7.9 million in FY 2015. In FY 2015, about \$1 million in medical settlement payments were processed for OF claims which is expected to cause future benefit payments to decrease more quickly than would otherwise be the case.



The uncertainty and differences in the actuarial estimates is over how fast benefit payments will taper off before the last dollar on the last claim is finally paid. Insofar as OF liabilities are being paid on a pay as we go basis by the state General Fund, the actuarial estimates are informative regarding the range of likely ultimate liabilities. That said, they are merely estimates that will be adjusted from year to year, but we have confidence that the amount needed to pay outstanding claims will continue to decline over time.

We agree with FRA's statement how excess policyholder equity is used is not an actuarial issue. While FRA states they offer no opinion on this question, we do not agree with FRA that MSF's equity is "taxpayer funds". As a nonprofit, independent, public corporation MSF receives no

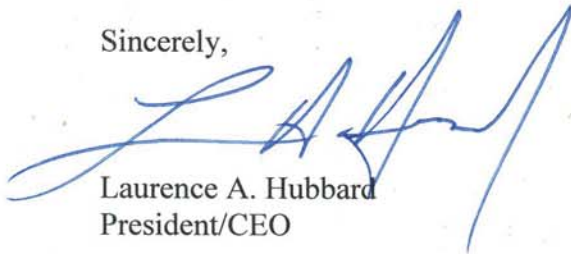
taxpayer funds and is supported only by the premiums charged to Montana employers insured with MSF in risk transfer insurance transactions. MSF premiums are no more taxpayer dollars than premium charged by private insurers that provide workers' compensation insurance. MSF agrees that its solvency is a matter of public interest, however.

We would also note the laws governing surplus and dividends applicable to both MSF and CSI. MSF's Board of Directors has the authority to declare dividends when there is an excess of assets over liabilities, including necessary reserves and appropriate surplus, §23-71-2323, MCA. CSI's role as to the declaration of dividends or the amount of a dividend is limited by §33-16-104, MCA, which states that nothing in the laws governing rates is to be construed to prohibit or regulate the payment of dividends by insurers to policyholders. Second, CSI has the critical responsibility in Title 33, Chapter 2, Part 19 to determine if an insurer is retaining a sufficient level of surplus to avoid insolvency. As part of SB 123, MSF must retain higher levels of capital than private insurers to add an additional level of confidence in the overall solvency of MSF.

The report of FRA will be provided to the MSF Board of Directors and the recommendations discussed with them. MSF appreciates the perspectives of expert third party independent reviews such as FRA's and the dialogue that it creates to enhance our business thinking. We find that FRA's perspectives on MSF's financial condition and business strategy are largely in alignment with our own though we may respectfully differ on matters of business tactics.

As always, MSF is prepared to discuss these or any other issues to provide additional information to assist in providing greater understanding of MSF procedures and practices.

Sincerely,

A handwritten signature in blue ink, appearing to read 'L. A. Hubbard', is written over the typed name and title.

Laurence A. Hubbard
President/CEO