

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members
FROM: Diedra Murray, Performance Auditor
CC: Laurence Hubbard, President
Patti Grosfield, Internal Auditor
DATE: January 2016
RE: Performance Audit Follow-Up (15SP-10): Workers' Compensation Insurance
Premium Review (13P-05)
ATTACHMENTS: Original Performance Audit Summary

Introduction

The *Workers' Compensation Insurance Premium Review* (13P-05) report was issued to the Committee in January 2014. The audit included eight recommendations to Montana State Fund (MSF). In November 2015, we conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

Audit work determined Montana State Fund could strengthen controls and clearly document decisions regarding the calculation of premiums and returns to ensure consistency, accuracy, and equity among policyholders. Our performance audit contained eight recommendations to MSF. Based on our follow-up work, MSF has implemented all eight recommendations.

Background

MSF is a nonprofit, independent public corporation that is the guaranteed market for workers' compensation insurance. The MSF Board of Directors, comprised of seven members appointed by the Governor, is responsible for oversight of MSF. In addition to oversight, the board reviews and approves factors included in the premium calculations, premium discounts, and premium returns. In policy year 2015, MSF issued over 25,000 policies totaling \$171.9 million in final premiums. Small businesses are the majority of MSF's policyholders; however, medium and large businesses make up the majority of total premium dollars.

Audit Follow-up Results

Our performance audit report contained eight recommendations to MSF. As part of our follow-up work, we examined amended administrative rules, MSF Board of Director meeting minutes, updated policies

and procedures, and policyholder accounts. The following summarizes information relating to follow-up work completed and the implementation status of recommendations.

RECOMMENDATION #1

We recommend Montana State Fund:

- A. Comply with existing policy regarding documentation of rate tier overrides,**
- B. Clarify underwriting policy and procedures to ensure rate tier overrides are applied equitably across policyholders, and**
- C. Work with the Board of Directors to determine whether revisions to Administrative Rule 2.55.311 are necessary to ensure equitable treatment of policyholders.**

Implementation Status – Implemented

As part of the premium calculation, each policyholder is assigned to a rate tier based on several factors. While the assignment of a rate tier is typically system generated using multiple factors, there are some circumstances in which staff can override the assignment to better reflect the policyholder's experience. In response to the audit, MSF updated its process for rate tier overrides and included this process in the underwriting guide. The guide outlines three types of rate tier overrides that can occur and when these exceptions would be applied to a policyholder. Additionally, the guide outlines two reviews that the overrides must go through. The first review occurs prior to an override being applied to an account. The calculation for the override is reviewed by a customer service specialist or underwriter and approval is documented within the Policy Holder System. On a monthly basis, team leaders conduct a sample of 20 to 25 percent of rate tier overrides to ensure overrides comply with policy. We reviewed 15 policies and determined controls are in place for rate tier overrides.

MSF worked with the Board of Directors to determine whether revisions to Administrative Rule 2.55.311 were necessary to ensure equitable treatment of policyholders. The June 2014 meeting minutes indicated the rule was reviewed by management and general counsel and they determined it did not need to be amended. The Board of Directors determined that the steps taken by MSF to clarify the rate tier override process and monitor compliance with the process have addressed the audit concerns and no amendments were necessary.

RECOMMENDATION #2

We recommend Montana State Fund comply with existing policy by establishing additional controls to ensure the first experience modifier for a policy period is applied when calculating policyholder rate tiers.

Implementation Status – Implemented

The experience modification factor is determined by the National Council on Compensation Insurance (NCCI). This factor is calculated by NCCI by comparing a policyholder's business loss experience with the expected loss experience of all other businesses in that type of business. MSF updated policy to eliminate removing or applying experience modification factors as a reason for a rate tier exception. As part of our work, we examined 15 policyholders with experience modification factors applied in the system. Based on NCCI letters, these factors were correctly applied. We also reviewed 15 policyholders that did not have a factor applied in the system and determined that these policyholders either did not receive a letter from NCCI because they did not meet eligibility requirements or received a letter from NCCI stating that they no longer met the premium eligibility requirements for experience rating.

RECOMMENDATION #3

We recommend Montana State Fund:

- A. Strengthen controls over its Construction Industry Premium Credit Application process, and**
- B. Comply with Administrative Rule 2.55.327A(2)(b) and Montana State Fund policy by only accepting construction premium credit applications if they are submitted by the stated due date.**

Implementation Status – Implemented

The construction premium credit was developed, in part to recognize the premium inequities that can occur in the construction industry. There can be a wide range of wages paid in this industry. Because premiums are based on payroll, employers paying higher wages pay higher premiums. However, the higher premiums do not necessarily correspond to higher risk, so the credit is offered to employers paying wages that are higher than the weekly wages for class codes in the construction industry. MSF amended Administrative Rule 2.55.327A(2)(b) and updated policies and procedures regarding processing construction premium credit applications. The amendment to administrative rule allows policyholders to submit construction premium credit applications within seven days of the stated due date. This change provides time for mailing or other delays. Also, MSF strengthened controls over the application process with the addition of a review process. Customer service specialists review the construction credit information entered into the system to ensure accuracy and approval is documented.

RECOMMENDATION #4

We recommend Montana State Fund:

- A. Comply with policy that requires documentation of scheduled rating factors, and**
- B. Clarify policy regarding what is required in documenting supervisory review and approval.**

Implementation Status – Implemented

Scheduled rating factors are applied to certain accounts to increase or decrease a policyholder's premium to acknowledge special characteristics of a business (e.g. automated work environment, safety officer on staff, etc.) not reflected elsewhere in its experience. MSF updated policies and procedures for documenting and reviewing scheduled rated policyholders. These types of policyholders must be reviewed by customer service specialists and this review and approval is included as a note in the Policy Holder System. Additionally, on a monthly basis, team leaders conduct a sample of 20 to 25 percent of scheduled rated policies to ensure they are reviewed and documented according to policy.

RECOMMENDATION #5

We recommend Montana State Fund develop written procedures for the Extract, Transform, and Load (ETL) process.

Implementation Status – Implemented

MSF has two systems, the Policy Holder System and the Insurance Intelligence system. Policy Holder System data is extracted, transformed, and loaded (ETL) into MSF's Insurance Intelligence system on a recurring basis. In response to the audit, Montana State Fund developed written operational procedures for the ETL process. This document provides information regarding how the parts of the ETL process work together. Additionally, there are regular reviews of this process in place every six months.

RECOMMENDATION #6

We recommend Montana State Fund strengthen controls over the risk evaluation tool to ensure:

- A. Application of scheduled rating factors is restricted to staff assigned the authority, and**
- B. Notes are mandatory and included in the risk evaluation tool for policies with a scheduled rating factor.**

Implementation Status – Implemented

The risk evaluation tool is an electronic application outside of the Policy Holder System used, among other things, to apply scheduled rating factors to policies. MSF restricted access to the 'issue' button in the risk evaluation tool to staff that have the authority to apply scheduled rating factors. Underwriters and operations team leaders are the only staff that have authority. MSF has also updated the underwriting guide to include a two-step review process for scheduled rated policies. The first step includes a review, by a customer service specialist, of the scheduled rating worksheet and the underwriting notes in the risk evaluation tool. The second step includes a monthly review, by team leaders, of scheduled rated policies to ensure teams are complying with the review process. Team leaders review 20 to 25 percent of scheduled rated policies.

RECOMMENDATION #7

We recommend Montana State Fund establish procedures for documenting retrospective rated plans and obtaining approval from the President/CEO.

Implementation Status – Implemented

Retrospectively rated plans allow policyholders to retain some of the risks associated with workers' compensation insurance, so they can potentially pay lower premiums than the premiums paid by traditional workers' compensation plans that guarantee the coverage of the cost of claims. A policyholder may receive a premium return if losses are managed and kept low or pay additional premiums if losses are high. The MSF Board of Directors approves the factors used for retrospectively rated plans and allows the adjustment to one factor, the expense ratio, provided it is approved by the president. MSF updated its underwriting guide to include the need for president approval for this factor. We reviewed seven plans retrospectively rated in policy year 2016, none of which required president approval.

RECOMMENDATION #8

We recommend Montana State Fund clarify policies and procedures for group business plans to establish responsibilities regarding reviewing eligibility requirements upon renewal.

Implementation Status – Implemented

Group business plans are typically formed by an agreement between group associations and MSF. All group plans have established business rules that policyholders must meet to be included in the group. There is an evaluation of losses at an established period of time to determine if a portion of premiums can be returned. MSF updated its underwriting guide to include additional information on the group plans. The guide provides information on which group plans MSF is responsible for analyzing policyholder eligibility upon renewal of the plan. As of the January 2015, MSF was responsible for determining eligibility for three group plans on an ongoing basis.