MONTANA STATE FUND 2011 BUDGET ANALYSIS OLD FUND AND NEW FUND

A Report Prepared for the

Legislative Finance Committee

By

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EXECUTIVE SUMMARY

The Montana State Fund (MSF) provides employers with an option for worker's compensation insurance and occupational disease insurance and guarantees available coverage for all employers in Montana. The management and control of MSF is vested solely in the Board of Directors (board).

The following provides an executive summary of the budget analysis of MSF. Further detail is provided in the accompanying report.

Rates

Overall MSF manual premium rates will decrease an average of 4.0 percent from those established for FY 2010. The board adopted the National Council on Compensation (NCCI) estimates on the costs of providing indemnity and medical benefits to workers injured in FY 2011 as the beginning of the rate determinations. NCCI estimates an average 6.4 percent decrease in these costs when compared to FY 2010. The board then adopted a multiplier to provide for the costs of the operating MSF, investment income results, and additions to equity. The multiplier added 2.4 percent to the costs resulting in an overall average decrease to manual premium rates of 4.0 percent.

Several factors may lead to continued amounts set aside above current loss reserves, which can put upward pressure on the rates, including:

- Higher medical costs as estimated by the MSF contracted actuary
- FY 2010 actual increases in loss reserves significantly higher than estimated both for medical and indemnity payments and administrative costs
- Historical trends showing actuarially required increases to loss reserves of $121.1 million in the last 5 years
- The component of premium rates attributed to contribution to equity which is used to support increased loss reserves increased from 5.4 percent in FY 2010 to 7.5 percent in FY 2011
- Increased personal service costs affecting the administrative component of loss reserves. 15 FTE were reduced in comparison to the FY 2010 budget. Employee group insurance benefit costs increased 8.2 percent per eligible employee and are the primary reason for the increase in the personal services budget in FY 2011

Budgetary Risk Improved

The major budgetary risk associated with the funds of MSF is that the net earned premiums collected in a year may not be sufficient to pay all benefits, claims, and operational costs associated with worker's injuries over the long period the benefits and claims are paid out. To monitor this risk in the New Fund, the budget analysis has focused on reserve to equity ratio targets. The MSF has achieved a reserve to equity target of 3.3 to 1.0 in FY 2010, a significant improvement from the target of 4.24 to 1.00 and the first time since at least FY 2003 that the target was achieved. The reserve to equity target for FY 2011 as adopted by the board in the FY 2011 strategic business plan is 3.05 to 1.00.

General Fund Transfers to the Old Fund

The state's general fund is responsible for the payment of claims and related administrative costs of the funds at the time they are due once the current resources of the funds are exhausted. For the Old Fund this is estimated to occur at the end of the current year. The general fund costs of benefits, claims, and administration in the 2013 biennium are estimated to be $18.1 million. This is an increase of $1.6 million since the FY 2010 estimate.

INTRODUCTION

The Montana State Fund (MSF) provides Montana employers with an option for worker's compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. The management and control of MSF is vested solely in the Board of Directors (board).

Due to significant unfunded liabilities associated with workers' compensation in Montana, the May 1990 Montana Special Legislative Session separated funding and accounts for claims and injuries resulting from accidents occurring before July 1, 1990 (Old Fund) and claims occurring on or after July 1, 1990 (New Fund). Statute requires that MSF present the board approved budgets for the Old Fund and New Fund (the funds) to the Legislative Finance Committee (LFC) no later than October 1 for their review. While the LFC reviews the MSF 2011 budget, it has no authority to require MSF to change its budget unless it amends statute. The only entity charged with overseeing and approving budgets, operations, and expenditures of MSF is the Board of Directors.

This report discusses the analysis of the MSF board approved 2011 budgets for both the New and Old Funds, which are attached It also discusses the FY 2010 budget and actual costs, and general fund transfers required in the 2013 biennium. In summary, the report outlines the following:

- Budgetary risks associated with the funds
- Factors resulting in need for additional reserves
- Increased loss reserves in the New Fund
- Achievement of reserve to equity targets
- Decreases in loss costs average 6.4 percent
- Manual rates decrease an average 4.0 percent
- Merit rate adjustments and employee incentive payments
- Increased general fund transfers of $4 million needed for Old Fund in the 2013 biennium
- The reasonableness of discounting Old Fund liabilities
- Economic Affairs Interim Committee (EAIC) bill drafts

BUDGETARY RISKS ASSOCIATED WITH THE FUNDS

A significant difference between MSF and other state agencies reviewed by the Legislative Finance Committee is that revenues, in this case net earned premiums, are collected in the current fiscal year and are used to pay benefits for injuries to workers in the current year and the benefits and claims relating to those injuries in subsequent years, in some cases for 50 to 60 years in the future. The net earned premiums that are collected above what is needed to pay current year benefits and operational costs are set aside in reserves to pay future claims. The major budgetary risk associated with the funds of MSF is that the net earned premiums collected in a year may not be sufficient to pay all benefits, claims, and operational costs associated with injuries over the long period the benefits and claims are paid out.

The legislature need only look at the unfunded liability recorded in the Old Fund to find an example of the significance of this risk. In 1999 the Old Fund was determined to be adequately funded, meaning that the MSF determined and the budget director certified that the loss reserves of $130.1 million set aside for the claims and benefits were sufficient to pay the costs over the life of the claims. In addition, at that time MSF estimated that the Old Fund had equity or surplus of $14.4 million. From FY 2002 to FY 2003 there was about $23 million of reserves transferred from the Old Fund to the state's general fund. In FY 2011, only 12 years later, the Old Fund has an unfunded liability of $60.8 million. The funding for this unfunded liability becomes the responsibility of the state's general fund at the end of this fiscal year. Components of the changes in the financial stability of the Old Fund are discussed further in later sections of this report.

The legislature has the same budgetary risks in the New Fund. Due to the significance of the risk that future benefit costs may exceed the reserves set aside for payment, the legislature requires the Legislative Audit Division to evaluate the amounts reserved and the current report of the MSF's contracted actuary. In addition to having the LFC review the approved budget, statute also requires that MSF include the entire expense of administering the state fund in the estimated budget. It should be noted that MSF does not include future benefit

costs in the budget approved by the board, the single largest cost to the MSF each year. Instead the board approves a budget prepared on a cash basis, showing the amount of funding it will need to pay for benefits and claims to injured workers for the current year and previous years. The funding for the previous years has already been collected and set aside in loss reserves. Future benefit costs are recognized in the financial statements on an accrual basis.

Figure 1 provides estimates of net earned premiums, investment income, reinsurance receipts, future benefit costs, operational costs, bad debt, and contribution to equity for FY 2011 and FY 2010 as well as actual costs for FY 2010 for the New Fund. The numbers presented in this figure assess the budgetary risk in FY 2011 that the earned net premiums may not be sufficient to pay for future benefits and claims in future years by including an estimate of the future benefit costs for workers injured in FY 2011. FY 2010 estimates and actuals are presented for comparison.

Figure 1
Montana State Fund
New Fund

	FY 2011 Estimated	FY 2010 Estimated	FY 2010 Actual	FY 2010 Variances
Revenues				
Net Premiums	$153,940,603	$186,519,814	$166,265,384	($20,254,430)
Investment Income	46,300,000	46,731,000	44,943,082	(1,787,918)
Reinsurance Program	13,524,000	10,379,135	13,829,193	3,450,058
Total Revenues	213,764,603	243,629,949	225,037,659	(18,592,290)
Expenditures				
Operating Expenditures				
Personal Services	22,304,891	22,770,780	21,915,413	(855,367)
Operating Expenses	20,911,412	24,076,998	21,449,205	(2,627,793)
Equipment & Intangible Assets	141,000	4,673,639	4,352,911	(320,728)
Allocated Loss Adjustment Expense	4,361,386	4,233,879	4,332,506	98,627
Bad debt expense	1,200,000	1,305,639	1,682,547	376,908
Adjustments for accruals				
Reduction for Capital Expenditures	(141,000)	(4,673,639)	(4,352,911)	320,728
Depreciation	1,767,120	1,139,579	369,213	(770,366)
Amortization	2,287,200	2,360,636	2,093,322	(267,314)
Compensated Absences	150,000	265,000	30,466	(234,534)
Other Post Employment Benefits	946,000	860,000	770,426	(89,574)
LAE Reserve Changes	4,577,089	3,160,817	5,459,203	2,298,386
Subtotal Operational Expenditures	58,505,098	60,173,328	58,102,301	2,071,027
Current and Future Benefit Costs				
Accident Year Incurred Loss	118,600,000	147,776,000	129,500,000	(18,276,000)
Other State Incurred Loss	1,053,000	1,470,000	1,700,000	230,000
Working Rx settlement	0	0	($958,000)	(958,000)
Development on Prior Accident Years	9,000,000	8,039,000	13,800,000	5,761,000
Subtotal Current and Future Benefit Costs	128,653,000	157,285,000	144,042,000	(13,243,000)
Net	26,606,505	26,171,621	22,893,358	(3,278,263)
Management merit and incentive plan changes	9,128	0	0	$0
Employee incentive program (goal sharing)	*	*	0	
Contribution to Equity Charged to Rate Payers	11,237,664	10,072,000	8,978,311	(1,093,689)
Dividends to Policyholders	0	0	2,001,000	2,001,000
Subtotal	11,246,792	10,072,000	10,979,311	907,311
Net After Employee Incentives, Contribution to Equity and Dividends	$15,359,713	$16,099,621	$11,914,047	($4,185,574)

* MSF declined to provide estimates of employee incentive program costs as the payments were not paid and are dependent on numerous variables and board approval

As shown, in FY 2011 $26.6 million of estimated revenues would be available for non budgeted items such as executive merit increases or incentives, employee incentives, dividends, increases in estimates of the costs of

providing claims and benefits for workers' injuries, or to increase equity to the level recommended by MSF contracted actuary.

Figure 1 also shows that estimates in FY 2010 varied significantly from actuals in a number of instances including:

- Net earned premiums were $20.2 million or 10.8 percent below budget. MSF estimates the lower premiums were due to lower business payrolls and increased competition
- Personal services were $855,367 or 3.8 percent below budget and operating expenses were $2.6 million lower or 10.9 percent below budget
- Equipment and intangible assets budgeted for the new building were $320,728 lower than estimated or 6.9 percent below budget. MSF replaced employee computers and other equipment when it moved into the new building and actual costs were lower than anticipated
- Loss adjustment expenses (LAE) reserve changes were $2.3 million or 82.6 percent higher than estimated. This is discussed further in the report
- Accident year losses for 2010 were $18.3 million or 12.4 percent lower than estimated. This is related to the lower net premiums
- Development on prior accident years was $5.8 million or 71.7 percent higher than estimated. This is discussed later in the report

Economic Factors Impacting MSF

The impacts of the recession are evident in the insurance business of MSF. As shown in Figure 1, the FY 2010 premium revenues were significantly lower than anticipated. A major contributing factor to the reduction in premiums was lower payrolls reported by Montana employers insuring with MSF. As the premiums are based on the rate paid per $100 of payroll, the impacts of higher unemployment and reduced hours in some businesses notably construction is impacting MSF operations. The lower payrolls also affected the accident year losses as fewer employees were working and as a result accidents were less. For FY 2011, MSF budgeted lower premium revenues and related accident year losses as MSF does not anticipate business payrolls will recover in FY 2011.

Factors Resulting In Need for Additional Reserves

Of the $118.6 million in costs for accident year incurred losses, $23.0 million is estimated to be needed to provide benefits and claims for workers injured in FY 2011. The remaining net earned premium collected above that necessary for FY 2011 costs and not required for operational costs is set aside in MSF loss reserves to be paid out to injured workers over the next several decades depending, for the most part, on the severity of the injury and the success of the medical treatment. If the cost of providing future benefits increases beyond what was collected and set aside in the loss reserves the amount of the loss reserves must be increased.

Figure 2
Montana State Fund
New Fund
Increases in Loss Reserves
(in millions)

Fiscal Year	Additional Loss Reserves
2010	$13.8
2009	19.4
2008	19.9
2007	21.9
2006	30.9
2005	15.2
Total	$121.1

As shown in Figure 1 on pg 4, in FY 2010 development on prior accident years was estimated to be $8.0 million while MSF needed to set aside an additional $13.8 million in loss reserves or $5.8 million higher than anticipated. According to MSF, the changes to prior years were primarily driven by medical losses. Funding for the additional reserves comes from investment income or equity.

Increased Loss Reserves in the New Fund

In FY 2011 MSF estimates that an additional $9.0 million will be needed for increased benefit costs for prior accident years. Figure 2 shows the additional loss reserves needed for the New Fund over the last 5 years.

As shown in Figure 2, changes in estimates have resulted in the need for an additional $121.1 million in funding for prior year benefits and claims in the last 5 years in the New Fund. Changes in the Old Fund are discussed later in the report under the section discussing the need for an additional $1.6 million in general fund transfers in the 2013 biennium.

Another reserve is for loss adjustment expenses (LAE), or reserves for the future costs of administering the claims and benefits. As shown in Figure 1, in FY 2010 MSF estimated that LAE reserves would need to increase by $3.2 million. MSF needed to add an additional $5.5 million or $2.3 million above the estimate to these reserves in FY 2010. In FY 2011, MSF estimates that LAE reserves will need to be increased by $4.6 million. According to MSF, the funding set aside in previous years for administration will need to increase due to changes determined by the consulting actuary. The changes would include increases to personal service costs due to employee merit adjustments or incentive payments that are discussed later in the report. Ensuring that funding for loss reserve increases is available is discussed in the next section.

ACHIEVEMENT OF RESERVE TO EQUITY TARGETS

The adequacy of the equity used to offset increases to loss reserves is measured using reserve to equity ratios as this ratio reflects the multi-year nature of MSF's obligations. The lower the reserve to equity ratio (2.0 to 1.0 compared to 4.0 to 1.0) the greater the financial strength of the insurer and, in MSF's case, the lower the potential risk that the state's general fund will be needed for unfunded liabilities. Due to the significance of the budgetary risks associated with the need for additional loss reserves in the New Fund, the budget analysis has focused on reserve to equity ratios of MSF for the last several years.

The 2010 budget analysis found that MSF had not achieved various equity targets set by the board at least since FY 2003 and that actual loss reserve to equity ratios had increased significantly between FY 2003 and FY 2009. One of the effects of not attaining these projections is that a substantial percentage for contribution to equity continues to be included in ratepayer premiums. Figure 3 presents equity to target ratios contained in MSF board approved strategic business plans for FY 2010 and FY 2011.

Figure 3
Montana State Fund
Reserve to Equity Targets

	Projected	Revised	Actual
FY 2010	4.24		3.30
FY 2011	3.88	3.05	
FY 2012	3.55	2.77	
FY 2013	2.48		

As shown, in FY 2010 the board set the reserve to equity ratio target at 4.24 to 1.00. The actual reserve to equity ratio achieved in FY 2010 was 3.3 to 1.0, a significant improvement and the first time since at least FY 2003 that the target was achieved. The FY 2011 reserve to equity ratio target set by the board in FY 2010 was 3.88 to 1.00. This has been revised downward in the FY 2011 strategic business plan to 3.05 to 1.00 indicating a potential reversal in the previous trend. If the targets are achieved as proposed through FY 2013 MSF should achieve the reserve to equity targets of 2.0 to 2.5 to 1.0 recommended by MSF's contracted actuary. According to the 2007 equity analysis conducted by the MSF contracted actuary, this would put MSF's equity in the range of A- state funds or median private carriers.

MSF includes contribution to equity as a component of insurance premiums charged Montana employers. If MSF achieves the reserve to equity targets of 2.0 to 2.5 to1.0, then MSF could reduce the amount of premiums attributable to contribution to equity benefiting all ratepayers or pay more dividends to ratepayers that demonstrate lower accident rates.

In FY 2011, the board increased the percentage of the contribution to equity component of the premiums from 5.4 percent included in FY 2010 to 7.5 percent. The actual net earned premiums attributable to the contribution to equity component in FY 2010 were $9.0 million. In FY 2011 it is estimated that this component of net earned premiums will be $11.2 million. The effect of the increase in contribution to equity on rates is discussed further under manual rates.

DECREASES IN LOSS COSTS AVERAGE 6.4 PERCENT

The first component of the premium rate is the loss cost or the cost of providing indemnity and medical benefits to the injured worker. The National Council on Compensation Insurance (NCCI) develops advisory loss costs for workers' compensation insurance in Montana that are the basis for the costs of workers compensation. During its May 2010 meeting, the board approved using NCCI loss costs as a basis for MSF premium rates for the majority of Montana businesses. For FY 2011, NCCI filed loss costs that are an average of 6.4 percent lower than in FY 2010. The 6.4 percent decrease is an average for all Montana industries. Actual amounts vary by industry and job classification or class code.

MANUAL RATES DECREASES AVERAGE 4.0 PERCENT

The next component of premium rates is loss cost multipliers. The loss cost multiplier includes the costs to operate MSF in FY 2011, reductions or increases in investment income, and the amount of funding needed for equity. Loss costs multiplied by the loss cost multiplier result in the manual rate for businesses insuring with MSF. In FY 2011 manual rates decrease by 4.0 percent, the result of changes to the loss cost multipliers adopted by the board.

Figure 4
Montana State Fund
Loss Cost Multipliers
FY 2011 Compared to FY 2010

Experience Modifier From	Experience Modifier To	Tier	FY 2010 Loss Cost Multiplier	FY 2011 Loss Cost Multiplier	Percentage Change
0.01	0.79	Tier 1	0.911	0.925	1.54%
0.80	0.94	Tier 2	0.973	0.989	1.64%
0.95	1.24	Tier 3	1.041	1.057	1.54%
1.25	1.74	Tier 4	1.249	1.269	1.60%
1.75	& above	Tier 5	1.665	1.692	1.62%

MSF uses rating tiers to assess premiums to businesses. The board has approved the use of 5 rating tiers, with tier 1 assessed the lowest premiums and tier 5 assessed the highest. A business with no or few workers' compensation claims over a period of years receives a low experience rating with NCCI. As the experience relating to workers' compensation costs increases or if a business has less than $5,000 in annual premiums the businesses are placed in higher rating tiers.

The FY 2011 MSF rating tiers for MSF as well as the associated loss cost multipliers and the percentage changes between FY 2010 and FY 2011 are presented in Figure 4. As shown, the loss cost multiplier increases between 1.54 and 1.62 percent depending on the tier. The effect on premium rates of the loss costs multipliers adopted by the board for FY 2011 is that manual rates will decrease an average of 4.0 percent in FY 2011. The means that the reduction in average loss costs of 6.4 percent will be offset by an increase included in the loss cost multiplier of 2.4 percent. As discussed previously, one of the components of the loss cost multiplier that significantly increased in FY 2011 was the contribution to equity, from 5.4 percent to 7.5 percent.

Merit Adjustments

As shown in Figure 1, the funding available for equity is reduced by management merit and incentive payments and incentives for employees. In FY 2011 employee merit adjustments are budgeted within personal services at 2.5 percent. The budget does not include merit adjustments for the executive staff. However, during its September 2010 board meeting the board voted to provide its CEO with a 4 percent merit adjustment in salary, raising the base salary for the CEO from $242,000 to $252,000. As the increased personal service costs were not included in the adopted budget of MSF, the board approved a budget amendment of $9,128. According to MSF, the CEO has not determined if remaining executive staff positions will also receive merit adjustments for FY 2011. Legislative audit recommendations on executive pay disclosures are included in Appendix A.

Employee Incentive Program

The Montana State Fund board approved an executive incentive plan in FY 1995. This was changed to an employee incentive plan in FY 2002. The amount of the incentives is determined through a weighted formula

depending on MSF achievement of incentive targets. Enterprise-wide initiatives, performance indicators, and success measures for these initiatives are found in Appendix A.

Figure 5 shows the measurement factors used in the calculations of incentive payments for the CEO. Figure 5 shows the level of achievement and payout opportunities for the various targets adopted by the board for FY 2011. As shown in Figure 5, the CEO has the possibility, if MSF attains all targets at the outstanding level, of receiving an additional payment of $75,600 above his base salary. At its September 2010 meeting the board changed the payout opportunities associated with the CEO incentive program beginning in FY 2012

Figure 5				
Montana State Fund				
CEO Incentive Plan				
Measurement Factor - 1				
Probability of Achieving Varying Results				
and the Opportunity Payout				
Level of Acheivement	Probability	Payout		
		Opportunity		
Threshold	80%	10.0%		
Target	50%	20.0%		
Outstanding	20%	30.0%		
Measurement Factor - 2				
Measurements Included in the Strategic Business Plan				
	FY 2011	Threshold	Target	Outstanding
Measure	Weight Factor			
Achieve Net Earned Premiu	0%	153.9 M	158.7 M	165.2 M
Achieve targeted FY net operating income	30%	23.9 M	32.2 M	42.7 M
Achieve fiscal year loss ratio	30%	83.6%	79.6%	75.0%
Maintain expense ratio	10%	27.8%	26.7%	25.5%
Achieve investment income	5%	46.3 M	47.2 M	48.5 M
Achieve enterprise-wide inititatives	25%	80%	90%	100%
Payment Amount		$25,200	$50,400	$75,600

The effect of the change is to increase the payout at the various levels of achievement. The changes were:

- Threshold level increased from 10% to 12.5%
- Target level increased from 20% to 25%
- Outstanding level increased from 30% to 37.5%

Under the newly adopted CEO employee incentive program, the outstanding level payment would be $94,380 if the CEO's base salary remains the same in FY 2012. Incentive payments are not included as part of the personal services budget.

The remaining employee incentives are based on the measurements provided above but include achieve total net earned premium. Figure 6 provides the threshold, target, and outstanding percentages for the executive team comprised of the various vice presidents and the general counsel, and the remaining employees. As shown the executive team has the possibility of receiving an additional 15 percent above their base salaries if MSF meets the target levels while employees have a possibility of receiving an additional 10 percent above their base salaries. Before any employee incentive payments are made MSF must achieve the target net operating income, this is called the gatekeeper for the program. In FY 2010 employee incentive payments were not made as MSF failed to achieve the required net operating income

Figure 6			
Montana State Fund			
Employee Incentive Plan			
Payout Opportunity			
	Threshold	Target	Outstanding
Payment Amount Executive Team	7.50%	15.00%	22.50%
Payment Amount Employees	5.00%	10.00%	15.00%

INCREASED GENERAL FUND TRANSFERS OF $1.6 MILLION NEEDED FOR OLD FUND IN THE 2013 BIENNIUM

The state's general fund is responsible for the payment of claims and related administrative costs of the funds at the time they are due once the current resources of the funds are exhausted. For the Old Fund this is estimated to occur at the end of the current year. Figure 7 presents the MSF contracted actuary estimates for the costs to the general fund for the Old Fund over the next 38 years. As shown the MSF actuarial central estimate for the

Figure 7
Montana State Fund
Old Fund
General Fund Transfers

Fiscal Year	Beginning Balance	Total Loss & Expense	Investment Income	General Fund Transfer	2013 Biennial General Fund
2011	$10,229,136	$12,424,782	$140,586	($2,055,060)	
2012		11,157,605		(11,157,605)	
2013		6,909,883		(6,909,883)	(18,067,488)
2014		5,959,212		(5,959,212)	
2015		5,180,633		(5,180,633)	
2016		4,223,272		(4,223,272)	
2017		3,339,841		(3,339,841)	
2018		2,568,249		(2,568,249)	
2019		2,010,461		(2,010,461)	
2020		1,544,477		(1,544,477)	
2021		1,157,184		(1,157,184)	
2022		909,561		(909,561)	
2023		843,905		(843,905)	
2024		714,318		(714,318)	
2025		657,872		(657,872)	
2026		671,541		(671,541)	
2027		669,417		(669,417)	
2028		710,160		(710,160)	
2029		825,120		(825,120)	
2030		916,366		(916,366)	
2031		977,866		(977,866)	
2032		1,043,348		(1,043,348)	
2033		1,045,313		(1,045,313)	
2034		1,023,024		(1,023,024)	
2035		977,335		(977,335)	
2036		964,640		(964,640)	
2037		726,441		(726,441)	
2038		499,601		(499,601)	
2039		302,008		(302,008)	
2040		89,320		(89,320)	
2041		30,106		(30,106)	
2042		11,975		(11,975)	
2043		10,705		(10,705)	
2044		9,582		(9,582)	
2045		8,592		(8,592)	
2046		7,716		(7,716)	
2047		6,938		(6,938)	
2048		6,250		(6,250)	
2049		5,637		(5,637)	
Totals	$10,229,136	$71,140,256	$140,586	($60,770,534)	

general fund costs of benefits in the 2013 biennium is $18.1 million. This is an increase of $1.6 million in increases to loss reserves for the 2013 biennium since FY 2010.

Overall the actuarial estimate for general fund transfers needed over the life of the claims has increased by $3.0 million since FY 2010. Changes related to these increases include:

- Estimates for indemnity payments for the Old Fund declined by approximately $0.6 million
- Estimates for medical benefits increased by about $3.0 million

Correlating increases to loss adjustment expenses and Department of Labor and Industry assessments and an extension of one year in payout of benefits make up the majority of the remaining changes.

THE REASONABLENESS OF DISCOUNTING OLD FUND LIABILITIES

In its September 2010 meeting the MSF board approved the Old Fund loss reserves which are a major component of the unfunded liability included in the financial statements. For its financial statements as of June 30, 2010, MSF calculates the unfunded liability for the Old Fund to be $48.1 million. As part of the calculation the board approved loss and LAE reserves discounted at 3.5 percent. The discount is based on the Old Fund earning investment income.

According to MSF's management, discounting using present value of the Old Fund loss reserves is included as part of the calculation as it is statutorily required in 39-71-2352, MCA. For an accurate discounting of loss reserves, the present value calculation should be based on a realizable annual investment income. MSF asserts that the calculation of present value is made as if the MSF received the $48.1 million at time the Old Fund assets are fully depleted or the end of FY 2011 and received 3.5 percent interest on the investment. The 2009 Legislature considered SB 224, an act authorizing a fund transfer of up to $30 million from the state general fund to the state compensation insurance fund to be used to pay claims for injuries resulting from accidents that occurred before July 1, 1990. The bill was not moved from the House Appropriations Committee and did not pass. Given the current financial condition of the state it is highly unlikely that MSF will receive any additional general fund beyond that required to pay benefits and claims in the 2013 biennium.

ECONOMIC AFFAIRS INTERIM COMMITTEE BILL DRAFTS

SJR 30, a resolution to examine the premium cost drivers in Montana's workers' compensation system and laws related to MSF, was the number one study priority for the legislature in the 2011 biennium. The EAIC has requested 3 bill drafts related to its work on workers compensation. These include:

- LC 310 – a bill revising the composition of the board of directors of the MSF
- LC311 – a bill allowing state agencies the option to choose between self insurance, using private insurers, or using MSF for workers' compensation insurance
- LC255 – a bill to revise workers' compensation laws

Some of the changes to statute included in LC255 are:

- Indemnity benefit changes effective in FY 2012
- Stay at work/return to work changes relating to vocational rehabilitation payments
- A refinement on how attorney fees are paid for disputed medical claims
- Changes in fee schedules for medical providers and medical facilities
- Implementation of utilization and treatment guidelines approved by the 2007 Legislature
- Changes to worker's compensation medical settlements and claim closures

The EAIC considered but did not approve a committee bill draft to require market conduct and financial examinations on MSF. This draft was similar to SB 60, a LFC committee bill that was unanimously approved by the LFC for the 2009 session but that was as not passed by the 2009 Legislature. Copies of the bill drafts and additional information on the work of the EAIC can be found at:
http://leg.mt.gov/css/Committees/interim/2009_2010/Economic_Affairs/default.asp

APPENDIX A

KEY PERFORMANCE INDICATORS AND SUCCESS MEASURES FOR MSF ENTERPRISE-WIDE INITIATIVES – MSF 2011 STRATEGIC BUSINESS PLAN

WORKFORCE MANAGEMENT AND DEVELOPMENT FOCUSED ON EMPLOYEE TALENT DEVELOPMENT, RETENTION AND SUCCESSION PLANNING

Key Performance Indicators

Talent Retention/Knowledge Transfer

Create generationally focused pilot programs to improve/enhance employee engagement and retention. These programs will develop and implement creative learning opportunities for high performance employees, coupled with a mentoring program to bolster personal and professional development. Besides enhancing employee satisfaction,, growth, and recognition, these tactics are intended to mitigate the loss of critical Montana State Fund institutional, situational, and proprietary business operations knowledge by pairing 'subject matter experts' with potential back-ups/replacements to enhance knowledge transfer. In addition we will continue the succession planning/succession management and development program that was established in FY 2010.

Success Measures

1. Complete focus group activities and implement Mentor/Mentee pilot of three members by February 2011 and Job Reassignment by March 2011. Gain feedback and evaluations in fourth quarter.
2. Proceed with development plans identified in CEO succession planning in first quarter and ongoing.
3. Move VP/Leadership phase of succession planning evaluations during first quarter of FY 11 and initiate development plans in second quarter.

Customer Service Improved By Implementing A Single Source Document Package

Key Performance Indicators

Document Management System

As the first step in unbundling the architecture of our legacy policy application, implement a single source document generation package that will serve the needs of both our policy and claims applications. This initial step is part of an overall strategy to modernize our policy application.

External First Notice of Loss

Develop and implement a tool that makes it easier for Montana employers to report claims more promptly and thoroughly, thereby accelerating the resolution process.

Utilization and Treatment Guidelines

Effectively implement the Utilization and Treatment Guidelines adopted by the Department of Labor and Industry.

Reserve Rewrite

Improve ClaimCenter functionality through the development and implementation of a system enhancement that allows greater flexibility in the entering and subsequent adjusting of individual claim reserve levels.

Claim QA Review and Improvement

Conduct an independent review of current Montana State Fund Claims Best Practices Guides and our management of claim files relative to industry best practices.

WorkSafe Champions

Fully communicate, develop, and nurture a culture of safety among Montana State Fund policyholders. Strengthen our partnerships with our policyholders and enlist their support to make Montana a safer work environment for all its citizens.

Success Measures

1. Achieve fiscal year loss ratio at or below FY 2011 plan Key Success Measure.
2. Manage prior period development to less than $5 M (currently estimated at $9.8 million for FY 2011).
3. Quarterly evaluation by Communications to develop a baseline of customer service perception.
4. Deliver projects on time and within approved budget.

Infrastructure Development

Key Performance Indicators

Enterprise Risk Management

Research and establish a comprehensive enterprise-wide process for defining, recognizing, prioritizing, anticipating, and communicating the risk environment in which Montana State Fund operates. This cultural re-focusing throughout the organization will ensure consistency relative to risk and the measures employed to control or mitigate overall risk.

Business Team Alignment

Review potential changes to our current organizational structure to ensure the most efficient and effective means of providing a differential level of customer service to our stakeholders. Particular attention will be focused on the claim handling process to enhance efficiency and improve claim outcomes.

Success Measures

1. Provide a report with recommendations on financial and customer service improvements as a result of the review of business team alignment.
2. Decrease internal claim file transfers.
3. Train and educate MSF leadership by October 2010 on the concepts, processes, and procedures involved in establishing the Enterprise Risk Management (ERM) program.
4. Establish the ERM Framework by May 2011 with the following steps
    a. Review current risk management environment.
    b. Conduct gap analysis and develop recommendations.
    c. Establish specific ERM framework that includes the goals and objectives of the program, the organization and governance methodology, and the measurements and reporting processes to monitor and track progress in meeting MSF risk objectives.
    d. Develop ERM Road Map of Priorities for Implementation of the program in FY 2012

AUDIT RECOMMENDATIONS ON EXECUTIVE COMPENSATION

The Legislative Audit Division (LAD) conducted a performance audit on the governance of the MSF. One recommendation included in the report was that MSF prepare and publically distribute executive compensation disclosures as part of the process for releasing its annual financial report. The FY 2010 annual financial report has not yet been released. The FY 2009 annual financial report, released after the audit report, did not include the recommended disclosures.