

**INTERIM ECONOMIC AFFAIRS COMMITTEE
FEBRUARY 10, 2006
TESTIMONY OF LAURENCE HUBBARD, PRESIDENT/CEO
MONTANA STATE FUND**

Good afternoon Mr. Chairman and members of the Committee. I am privileged to appear before you today and report the state of Montana State Fund is in excellent overall health.

I would also like to thank and recognize the Committee for appointment of Rep Keane and Rep Milburn as liasons to our Board of Directors, and I am confident they will provide additional insight and perspective on the matters I will be addressing today.

Montana State Fund insures approximately 31,000 employers and serves as a competitive workers' compensation market as well as the guaranteed market for employers in our state.

Our 'vision' as an organization is:

*Montana State Fund is committed to the **health and economic prosperity** of Montana through **superior service, leadership, and caring individuals** working in an environment of **teamwork, creativity and trust.**"*

We know that our stakeholders rely on us to be able to maximize our resources to fulfill that vision and our mandate as a competitive state fund.

It is a challenge we willingly accept.

The Fund manages an average of 8,000 open medical and wage loss claims.

Generally, claims fall under the following disability types:

	Percent by Injury Type					
	TTD	PPD	PTD	FT	MO	NO DIS
AY06	9.71%	6.95%	0.03%	0.14%	75.81%	7.36%
AY05	10.56%	8.21%	0.01%	0.10%	76.23%	4.88%
AY91-AY06	9.85%	7.95%	0.36%	0.11%	79.76%	1.97%
AY01-AY06	9.36%	8.69%	0.14%	0.11%	76.36%	5.35%
	TTD	PPD	PTD/FT	MO		
MSF	10.05%	8.10%	0.48%	81.37%		
MT*	13.50%	7.00%	0.30%	79.20%		
REGION*	14.70%	5.30%	0.10%	79.90%		
US*	14.60%	7.70%	0.20%	77.50%		

*from NCCI report of April 2005, page 37 "Montana Distribution of Claims by Injury Type"

During the past several years we have been challenged with rapidly rising claims costs resulting in net operating losses (before dividends) in 2003 and 2004 of \$41 million. However, beginning in FY05 we achieved a net operating income (before dividends) of \$24 million and are currently projecting FY06 net operating income (before dividends) of approximately \$18 million. Our current financial projections suggest we will achieve approximately \$170 million of equity by the end of FY06. Our written premium is projected to be approximately \$220 million, with total ultimate liabilities and loss adjustment expense as of December 31, 2005 of \$557 million.

During the last several years our independent actuaries continue to observe adverse development in our losses of approximately \$15 million per year. That means we are currently able to absorb negative loss development trends and produce a solid, yet modest, net operating income. As MSF's claims liability grows, so must our equity that insures against catastrophic events, adverse cost trends, and other unexpected events, including legislative and judicial changes impacting liabilities.

While achieving strong financial and operational performance we continue to face challenging claim cost trends, particularly in medical cost inflation, which I will detail further in my testimony.

Old Fund

The Old Fund's financial performance is measured on an annual basis and as of June 30, 2005 net assts were (\$15.6) million. Again, the performance of the Old Fund closely follows trends in new fund claim development; primarily adverse medical cost trends.

There are currently 1,049 open claims compared to 1,123 as of June 30, 2005, representing a claim reduction of -7% in the first 6 months of the fiscal year.

Although there remains an unfunded liability in the Old Fund, our most recent actuarial information suggests the invested assets and payment

patterns will provide enough cash to pay claims through FY 2013 (CY 2012).

As of June 30, 2005 the present value new money needed to fully fund the current obligations of the Old Fund were \$14.2 million, assuming a statutory loss discount of 5%.

Operational Challenges and Our Response

Looking at recent results, we observe that accident frequency has remained relatively stable while the severity of injuries reported has continued its upward trend. As the working population ages, the nature and severity of injuries change as well as the time it takes to heal from an accident.

General Health Care Costs

As I stated above, medical inflation has become one of the major issues facing all workers' compensation insurers. Advancements in treatments, new technologies, and cost increases in physical medicine and pharmaceutical utilization have combined to increase medical costs beyond previously anticipated levels, and will continue to challenge us into the foreseeable future.

The Centers for Medicare & Medicaid Services reports nationally the cost of health care in 2004 was \$1.9 trillion, or \$6,280 per person. Health care spending as a share of GDP for 2004 is 16% and the rate of spending

(inflation) is 8% per year. Prescription drug spending accounts for 14% of personal health care spending between 2002 and 2004. In addition, hospital care expenses account for 38% for the same period. Blue Cross/Blue Shield of Montana has produced a very concise brochure explaining health cost drivers. BC/BS relates that approximately 19% of Montanan's have no health care insurance. While this may not be surprising for Montana, this particular demographic may contribute to system cost shifting to workers' compensation.

Workers' Compensation Medical Costs

Workers compensation trends largely mirror what is happening with general healthcare spending.

- Medical expenses are a primary driver of the increase in workers' compensation costs.
- 60% of workers' compensation costs are medical expenses.
- For Montana State Fund, the average annual increase in cost per claim over the past five complete fiscal years is currently 7.1%.
- About half of this increase is caused by increases in utilization of medical services while about half is caused by increases in the cost of medical services.

Challenges for Montana: Rates and Costs

If you have attended the Montana Economic Outlook Seminar you have no doubt heard workers' compensation is on the mind of Montana business according to an informal survey. Authors Jack Morton and Michael

Harrington of the UM Law School cite a number of Montana Laws described as barriers to business development. Second on their list is workers' compensation costs.

As recently as today, news coverage of the *Satterlee v. Montana State Fund* court case demonstrate not only public concern for the health of the workers' compensation system, but underscores the potential impact of retrospective application of court decisions. In my view, these uncertainties and potentially dramatic financial impacts to the system only add to overall system costs and disincentives for insurers to write workers' compensation insurance in Montana.

What Are We Doing

By maintaining our excellence in safety management to prevent injuries, and by achieving positive outcomes for injured employees through effective disability management, we deliver the best possible bottom-line results for our customers.

For example, In FY05 we implemented a Pharmacy Benefit Manager (PBM) to assist in effective and appropriate prescription medication management. This program has saved MSF approximately \$1.5 million in the first year. In addition, we have initiated a medical and hospital bill review process to ensure appropriate and timely payment for services are made. Importantly,

we made substantial progress in development of our new claim management system that will enhance claims examiner productivity and improve claim outcomes.

Case Management

MSF case loads are targeted to 150 claims per examiner in accordance with industry best practices. Despite an increase of 500 new claims over prior YTD, closure rates have maintained a relatively stable open case load. Through improvement in our Managed Care Organization (MCO) we have been effective at reducing average temporary total disability durations on active claims from 49 weeks in FY01 to 32 weeks.

MSF maintains a proactive claim quality assurance program with at least quarterly forensic file reviews. Our most recent results reflect greater than 85% meets or exceeds published best practice guidelines.

In closing, our organization continues to turn-over every stone we find to reduce the frequency of work place injuries and positively impact the outcomes and costs of claims when they do occur.

I would like to thank the Committee for their time and attention and would be glad to answer any questions you may have.