

Agency Proposed Budget								
Budget Item	Base Budget Fiscal 2002	PL Base Adjustment Fiscal 2004	New Proposals Fiscal 2004	Total Exec. Budget Fiscal 2004	PL Base Adjustment Fiscal 2005	New Proposals Fiscal 2005	Total Exec. Budget Fiscal 2005	Total Exec. Budget Fiscal 04-05
FTE	69.50	4.00	0.00	73.50	4.00	0.00	73.50	73.50
Personal Services	2,715,801	521,007	0	3,236,808	517,029	0	3,232,830	6,469,638
Operating Expenses	790,438	243,268	(43,397)	990,309	305,139	(43,397)	1,052,180	2,042,489
Equipment	0	0	0	0	0	0	0	0
Transfers	0	0	0	0	0	0	0	0
Total Costs	\$3,506,239	\$764,275	(\$43,397)	\$4,227,117	\$822,168	(\$43,397)	\$4,285,010	\$8,512,127
General Fund	334,795	45,719	(380,514)	0	43,490	(378,285)	0	0
State/Other Special	3,171,444	718,556	337,117	4,227,117	778,678	334,888	4,285,010	8,512,127
Total Funds	\$3,506,239	\$764,275	(\$43,397)	\$4,227,117	\$822,168	(\$43,397)	\$4,285,010	\$8,512,127

Agency Description

The Office of the State Auditor is authorized under Article VI of the Montana Constitution. The State Auditor is the ex-officio Commissioner of Insurance and Securities and is responsible for licensing and regulating insurance companies and agents, and registering and regulating securities dealers in the state. The auditor also adopts rules and administers reform for the insurance and securities industries operating in the state.

Agency Discussion

Office of the State Auditor Major Budget Highlights	
<ul style="list-style-type: none"> ○ Total funding increases about \$1.2 million over the 2003 biennium appropriation ○ Office is requesting an additional 4.00 FTE, along with increased funding for contract examinations of insurance and investment companies ○ A funding switch would eliminate general fund, although with no net general fund impact ○ Budget balancing items provide a \$119,400 biennium savings, reducing personal services by \$30,300 and operating expenses by \$89,100 	
Major LFD Issues	
<ul style="list-style-type: none"> ○ Additional FTE ○ Securities Program funding 	

Funding

The following table summarizes funding for the agency, by program and source, as recommended by the Governor. Funding for each program is discussed in detail in the individual program narratives that follow.

Total Agency Funding 2005 Biennium Executive Budget			
<u>Agency Program</u>	<u>State Spec.</u>	<u>Grand Total</u>	<u>Total %</u>
Central Management	\$ 1,069,974	\$ 1,069,974	12.6%
Insurance	6,129,359	6,129,359	72.0%
Securities	1,312,794	1,312,794	15.4%
Grand Total	\$ 8,512,127	\$ 8,512,127	100.0%

Biennium Budget Comparison								
Budget Item	Present Law Fiscal 2004	New Proposals Fiscal 2004	Total Exec. Budget Fiscal 2004	Present Law Fiscal 2005	New Proposals Fiscal 2005	Total Exec. Budget Fiscal 2005	Total Biennium Fiscal 02-03	Total Exec. Budget Fiscal 04-05
FTE	73.50	0.00	73.50	73.50	0.00	73.50	69.50	73.50
Personal Services	3,236,808	0	3,236,808	3,232,830	0	3,232,830	5,668,253	6,469,638
Operating Expenses	1,033,706	(43,397)	990,309	1,095,577	(43,397)	1,052,180	1,633,822	2,042,489
Equipment	0	0	0	0	0	0	15,655	0
Transfers	0	0	0	0	0	0	0	0
Total Costs	\$4,270,514	(\$43,397)	\$4,227,117	\$4,328,407	(\$43,397)	\$4,285,010	\$7,317,730	\$8,512,127
General Fund	380,514	(380,514)	0	378,285	(378,285)	0	658,140	0
State/Other Special	3,890,000	337,117	4,227,117	3,950,122	334,888	4,285,010	6,659,590	8,512,127
Total Funds	\$4,270,514	(\$43,397)	\$4,227,117	\$4,328,407	(\$43,397)	\$4,285,010	\$7,317,730	\$8,512,127

New Proposals

The "New Proposals" table summarizes all new proposals requested by the executive. Descriptions and LFD discussion of each new proposal are included in the individual program narratives.

Program	Fiscal 2004					Fiscal 2005				
	FTE	General Fund	State Special	Federal Special	Total Funds	FTE	General Fund	State Special	Federal Special	Total Funds
DP 1 - Securities Program Funding Switch										
04	0.00	(380,514)	380,514	0	0	0.00	(378,285)	378,285	0	0
DP 2 - Additional Reductions										
04	0.00	0	(43,397)	0	(43,397)	0.00	0	(43,397)	0	(43,397)
Total	0.00	(\$380,514)	\$337,117	\$0	(\$43,397)	0.00	(\$378,285)	\$334,888	\$0	(\$43,397)

Agency Issues

LFD
ISSUE

Additional FTE

The Auditors Office is requesting additional state special revenue to fund 4.00 new FTE, including three insurance examiners and one security analyst. Although these are non-general fund requests, unspent revenue in the insurance fee account and securities fee account is transferred to the general fund. Therefore, the addition of these positions will reduce revenue to the general fund.

Examination costs, including travel and per diem, are recoverable through examination fees charged to the insurance companies for exams conducted by these new employees. However, associated operating costs such as computer, supplies and equipment, and long distance charges are additional state expenses. The office conducts exams through a mix of in-house staff and contracted examiners. Contract examiners are used for statutorily required routine exams conducted every five years to ensure companies financial soundness and compliance with statute. In-house examiners provide targeted exams, review applications, investigate complaints, and conduct some routine exams.

The issue for legislative consideration is whether new demands and workload increases warrant the need for additional FTE or if existing resources combined with the contract examiner funding requests (Program 03-DP 6 and Program 04-DP 7) could meet the additional demands. New FTE in the Insurance Program would allow the office to implement new activities not previously undertaken by the office, including market conduct examinations and captive insurance program. An additional FTE in the Securities Program is based on additional demands in the securities industry. Refer to individual decision packages for information and options regarding these requests.

Program Proposed Budget								
Budget Item	Base Budget Fiscal 2002	PL Base Adjustment Fiscal 2004	New Proposals Fiscal 2004	Total Exec. Budget Fiscal 2004	PL Base Adjustment Fiscal 2005	New Proposals Fiscal 2005	Total Exec. Budget Fiscal 2005	Total Exec. Budget Fiscal 04-05
FTE	10.00	0.00	0.00	10.00	0.00	0.00	10.00	10.00
Personal Services	342,208	92,567	0	434,775	91,911	0	434,119	868,894
Operating Expenses	109,346	(6,582)	0	102,764	(11,030)	0	98,316	201,080
Total Costs	\$451,554	\$85,985	\$0	\$537,539	\$80,881	\$0	\$532,435	\$1,069,974
State/Other Special	451,554	85,985	0	537,539	80,881	0	532,435	1,069,974
Total Funds	\$451,554	\$85,985	\$0	\$537,539	\$80,881	\$0	\$532,435	\$1,069,974

Program Description

The Central Management Division is responsible for the administrative, personnel, budgeting, and accounting functions for the State Auditor's Office. The division also supports activities related to the Auditor's membership on the state land and hail insurance boards.

Central Management Division Major Budget Highlights
<ul style="list-style-type: none"> ○ Statewide present law adjustments increase funding by \$86,000 and \$80,900 in each year. ○ Operating expenses decrease due to lower fixed costs in some categories and reallocating some to the insurance program. ○ Personal services increase 27 percent over base year expenditures primarily due to annualization of the pay plan and full funding of FTE that were vacant during the base year

Funding

The following table shows program funding, by source, for the base year and for the 2005 biennium as recommended by the Governor

Program Funding Table Central Management						
Program Funding	Base Fiscal 2002	% of Base Fiscal 2002	Budget Fiscal 2004	% of Budget Fiscal 2004	Budget Fiscal 2005	% of Budget Fiscal 2005
02235 Insurance Fee Account	\$ 434,490	96.2%	\$ 505,294	94.0%	\$ 500,457	94.0%
02283 Securities Fee Account	<u>17,064</u>	<u>3.8%</u>	<u>32,245</u>	<u>6.0%</u>	<u>31,978</u>	<u>6.0%</u>
Grand Total	<u>\$ 451,554</u>	<u>100.0%</u>	<u>\$ 537,539</u>	<u>100.0%</u>	<u>\$ 532,435</u>	<u>100.0%</u>

This program is funded from the insurance fee and securities fee accounts, which draw their revenue from percentages charged to the industry on the sale of insurance and securities in Montana.

Present Law Adjustments	-----Fiscal 2004-----					-----Fiscal 2005-----				
	FTE	General	State Special	Federal Special	Total Funds	FTE	General	State Special	Federal Special	Total Funds
Personal Services					107,211					106,538
Vacancy Savings					(14,644)					(14,627)
Inflation/Deflation					529					590
Fixed Costs					(7,111)					(11,620)
Total Statewide Present Law Adjustments					\$85,985					\$80,881
Grand Total All Present Law Adjustments					\$85,985					\$80,881

Executive Present Law Adjustments

The "Present Law Adjustments" table shows the primary changes to the adjusted base budget made by the legislature. "Statewide Present Law" adjustments are standard categories of adjustments made to all agencies. Legislative decisions on these items were applied globally to all agencies. The other numbered adjustments in the table correspond to the narrative descriptions.

Program Proposed Budget								
Budget Item	Base Budget Fiscal 2002	PL Base Adjustment Fiscal 2004	New Proposals Fiscal 2004	Total Exec. Budget Fiscal 2004	PL Base Adjustment Fiscal 2005	New Proposals Fiscal 2005	Total Exec. Budget Fiscal 2005	Total Exec. Budget Fiscal 04-05
FTE	47.50	3.00	0.00	50.50	3.00	0.00	50.50	50.50
Personal Services	1,967,501	321,944	0	2,289,445	319,646	0	2,287,147	4,576,592
Operating Expenses	566,962	172,921	0	739,883	245,922	0	812,884	1,552,767
Equipment	0	0	0	0	0	0	0	0
Transfers	0	0	0	0	0	0	0	0
Total Costs	\$2,534,463	\$494,865	\$0	\$3,029,328	\$565,568	\$0	\$3,100,031	\$6,129,359
State/Other Special	2,534,463	494,865	0	3,029,328	565,568	0	3,100,031	6,129,359
Total Funds	\$2,534,463	\$494,865	\$0	\$3,029,328	\$565,568	\$0	\$3,100,031	\$6,129,359

Program Description

The Insurance Division regulates the insurance industry in Montana. The Policyholder Services Bureau resolves insurance consumer inquiries and complaints involving agents, coverage, and companies. The Examinations Bureau monitors the financial solvency of insurance companies, collects premium taxes and company fees, and audits insurance company annual statements. The Rates and Forms Bureau reviews form filings and rate filings to ensure compliance with the applicable insurance code. The Licensing Bureau licenses and provides continuing education to insurance agents, agencies, and adjustors. The Investigations Bureau investigates insurance code and rule violations, including possible criminal violations, and refers cases to county attorneys for prosecution.

Program Narrative

Insurance Division Major Budget Highlights	
<ul style="list-style-type: none"> ○ Funding increases about \$500,000 in fiscal 2004 and \$565,000 in fiscal 2005 over base year expenditures ○ Statewide present law adjustments add about \$200,000 each year due to annualization of the pay plan and a higher proportion of fixed costs charged to this program ○ Other increases are attributed to an additional 3.00 FTE and funding for contract insurance examinations 	

Funding

The following table shows program funding, by source, for the base year and for the 2005 biennium as recommended by the Governor

Program Funding Table Insurance							
	Base Fiscal 2002	% of Base Fiscal 2002	Budget Fiscal 2004	% of Budget Fiscal 2004	Budget Fiscal 2005	% of Budget Fiscal 2005	
Program Funding							
02235 Insurance Fee Account	<u>\$ 2,534,463</u>	<u>100.0%</u>	<u>\$ 3,029,328</u>	<u>100.0%</u>	<u>\$ 3,100,031</u>	<u>100.0%</u>	
Grand Total	<u>\$ 2,534,463</u>	<u>100.0%</u>	<u>\$ 3,029,328</u>	<u>100.0%</u>	<u>\$ 3,100,031</u>	<u>100.0%</u>	

This program is funded from the insurance fee account, which draws its revenue from a percentage charge against every insurance policy sold in the state, as well as from charges for insurance company examinations and fees paid by individual agents.

	-----Fiscal 2004-----					-----Fiscal 2005-----				
	FTE	General	State Special	Federal Special	Total Funds	FTE	General	State Special	Federal Special	Total Funds
Present Law Adjustments										
Personal Services					258,506					256,610
Vacancy Savings					(89,038)					(88,968)
Inflation/Deflation					3,819					4,309
Fixed Costs					36,440					17,776
Total Statewide Present Law Adjustments					\$209,727					\$189,727
DP 3 - Market Conduct Examiners	2.00	0	119,372	0	119,372	2.00	0	110,493	0	110,493
DP 4 - Captive Insurance FTE	1.00	0	58,479	0	58,479	1.00	0	54,061	0	54,061
DP 6 - Contract Insurance Examinations	0.00	0	107,287	0	107,287	0.00	0	211,287	0	211,287
Total Other Present Law Adjustments	3.00	\$0	\$285,138	\$0	\$285,138	3.00	\$0	\$375,841	\$0	\$375,841
Grand Total All Present Law Adjustments					\$494,865					\$565,568

Executive Present Law Adjustments

The "Present Law Adjustments" table shows the primary changes to the adjusted base budget made by the legislature. "Statewide Present Law" adjustments are standard categories of adjustments made to all agencies. Legislative decisions on these items were applied globally to all agencies. The other numbered adjustments in the table correspond to the narrative descriptions.

DP 3 - Market Conduct Examiners - This request is for 200 FTE, grade 16 and grade 17, market conduct examiners to review insurer's market place practices to determine what they are and what they should be. Most of the costs associated with these positions will be recovered from the companies. Examination costs can be charged to the company and the company will reimburse the auditor for these costs.

LFD COMMENT	Examination costs are recovered through the insurance companies, but some costs such as, equipment and supplies, training, and long distance charges would remain a state expense.
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LFD ISSUE	A Market Conduct Examination is conducted to ensure equitable treatment of policyholders, determine compliance with statutes and regulations regarding writing insurance policies, advertising products, setting rates and handling claims, and actively monitor the insurance marketplace. Examinations are performed through a review of an insurer's market place practices, conducted by qualified full-time examiners while on site at the company. The process of market conduct exams allows early identification of potential problem areas resulting in long-term protection of the consumer and ensures equal treatment of insurers.
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The National Association of Insurance Commissioners (NAIC) recommends that every state establish a separate market conduct division to regulate these activities and ensure the fair treatment of policyholders. A fall "2001 NAIC Journal of Insurance Regulation" report indicates that in 1998, there were 32 states with separate market conduct units, 12 of which used a combination of in-house and contract examiners. Three additional states conducted exams only through contracted services. Montana intended to regulate these activities with existing staff in the Policy Holder Services bureau. A budget amendment has recently been submitted to conduct the office's first market conduct exam as a result of numerous policy holder complaints regarding one of the largest insurance companies doing business in Montana. The anticipated cost is \$12,000 and will be conducted through contracted services. If additional FTE are not authorized through this decision package, market conduct exams could be conducted through the office's contracted insurance examination process and funding for such is requested through DP 6.

**LFD
ISSUE
(continued)**

The NAIC also recommends that each state initially should thoroughly assess and analyze its market and then attempt to dedicate adequate resources to the market conduct examination process.

"...the focus of any program needs to be on the proper application of market conduct examinations and not just upon obtaining a specified number of staff members. In general, adequate time should be spent to develop a Market Conduct Analysis and Examination Program." (NAIC Market Conduct Examination Resources, May 22,2002)

Such an analysis would consider the number of companies conducting business within the state and involve reviewing complaint indices and information from other states, determining the role of market conduct examinations, use of routine versus targeted exams, use of contracted versus in-house examiners, and drafting an examination scheduling plan. The legislature may want to direct the auditor's office to conduct a market analysis prior to funding additional FTE for this activity.

Options:

- Provide funding to the office to develop a market analysis and examination program without additional FTE
- Authorize one FTE to develop a market conduct analysis and examination program and perform examinations during the next biennium. If the analysis identifies the need for additional resources they could be requested during the next biennium
- Approve this decision package as submitted and reduce DP 6 by \$120,000 per year
- Fund either option two or three at the entry level for each position for a general fund savings of \$7,800 per year under option two and \$16,500 per year under option three
- Fund options two, three, or four and designate funding for computers (\$2,702) and supplies and minor equipment (\$3,340) as one-time-only
- Take no action on this decision package, but fully fund DP 6 authorizing funding for market conduct exams as part of the contracted insurance examination process

DP 4 - Captive Insurance FTE - The 2001 legislature passed SB 373, which allows captive insurance companies to operate in Montana. The State Auditor's Office was appropriated \$20,000 each year of the 2003 biennium for operating expenses only. Currently, the auditor has licensed three companies and anticipates an additional two by the end of the year. This proposal would provide 1.00 FTE, Grade 15, insurance examiner to approve the applications of prospective captives and conduct the examinations of captive insurance companies licensed in Montana.

**LFD
ISSUE**

Captive insurance refers to a subsidiary corporation established to provide insurance to the parent company. These companies are owned by its policyholders and are able to underwrite their own insurance rather than pay premiums to third-party insurers. Advantages include; 1) the ability to establish premiums based on the company's risk rather than industry loss averages; 2) savings on overhead costs associated with marketing, claims and regulatory compliance; 3) ability to control costs; greater control over claims; 4) funding and underwriting flexibility; 5) ability to tailor coverage to meet needs; and 6) less regulation. Captive insurance companies in Montana pay a minimum of \$5,000 per year in premium taxes. At least one new business has started in Montana related to the captive insurance industry, Big Sky Captive Managers in Missoula.

**LFD
ISSUE
(continued)**

The auditor's office has received six applications, to date, of which three companies were licensed, one application was denied, and two reviews are still underway. Application reviews and licensing approvals were conducted through existing staff during the 2003 biennium. Of the annual \$20,000 provided, \$109 was expended in fiscal 2002 and \$6,800 in the first five months of fiscal 2003. The auditor's office anticipates an increase in the number of applications based on trends in other states. For example, Vermont, the U.S. leader in captive insurance operations, began its program in 1981 licensing 3 captives by 1982, 10 per year from 1983 to 1985, and 17 to 51 per year thereafter. The request is based on an anticipated increase in applications and requirements of SB 373 to conduct examinations of captive insurers every three years to ascertain each company's financial condition, its ability to fulfill its obligations and whether it has complied with statute. In addition, organizational reviews are conducted within the first year of licensing. If approved, the legislature may want to designate the computer (\$1,351) and supplies and minor equipment costs (\$1,670) as one-time-only. In addition, the legislature may want to fund the position at entry level for a grade 15 providing a general fund savings of about \$7,000 per year.

DP 6 - Contract Insurance Examinations - This request adjusts the line item for insurance contract exams for the new biennium. The expenses will be offset by examination cost reimbursements from insurance companies. The requested funding is based upon the examination schedule for the 2005 biennium.

**LFD
COMMENT**

This proposal continues the restricted appropriation for contract examinations and adjusts the funding to meet projected costs for the 2005 biennium. State statute (33-1-401, MCA) requires the auditor's office to examine domestic insurers once every five years. Base year expenditures for this activity were about \$92,000. This request combined with the base amount increases funding for contract insurance examinations to almost \$199,000 in fiscal 2004 and \$302,000 in fiscal 2005. Approximately six to eight companies are examined each year and funding required per year fluctuates depending on the schedule and size of the companies being examined.

**LFD
ISSUE**

The 2005 biennium schedule includes \$120,000 each year for market conduct examinations. If the prior decision package (DP 3), adding FTE for market conduct exams, is approved this decision package can be reduced by \$120,000 each year.

Program Proposed Budget								
Budget Item	Base Budget Fiscal 2002	PL Base Adjustment Fiscal 2004	New Proposals Fiscal 2004	Total Exec. Budget Fiscal 2004	PL Base Adjustment Fiscal 2005	New Proposals Fiscal 2005	Total Exec. Budget Fiscal 2005	Total Exec. Budget Fiscal 04-05
FTE	12.00	1.00	0.00	13.00	1.00	0.00	13.00	13.00
Personal Services	406,092	106,496	0	512,588	105,472	0	511,564	1,024,152
Operating Expenses	114,130	76,929	(43,397)	147,662	70,247	(43,397)	140,980	288,642
Transfers	0	0	0	0	0	0	0	0
Total Costs	\$520,222	\$183,425	(\$43,397)	\$660,250	\$175,719	(\$43,397)	\$652,544	\$1,312,794
General Fund	334,795	45,719	(380,514)	0	43,490	(378,285)	0	0
State/Other Special	185,427	137,706	337,117	660,250	132,229	334,888	652,544	1,312,794
Total Funds	\$520,222	\$183,425	(\$43,397)	\$660,250	\$175,719	(\$43,397)	\$652,544	\$1,312,794

Program Description

The Securities Division administers and enforces the Securities Act of Montana, which includes registering securities issuers, salespeople, broker-dealers, investment advisers, and investment adviser representatives. The division is also responsible for investigating unregistered and fraudulent securities transactions, and has sole jurisdiction for investment advisor firms with assets of under \$25 million. The division investigates securities code and rule violations, including possible criminal violations, and refers cases to county attorneys for prosecution.

Program Narrative

Securities Division Major Budget Highlights	
o	Total funding increases about \$140,000 in fiscal 2004 and \$130,000 in fiscal 2005 over base year expenditures
o	Increases are due to statewide present law adjustments, the addition of 1.00 FTE securities analyst, and increases in security contract examinations
o	Budget balancing reductions offset increases by approximately \$59,700 each year
o	A funding switch eliminates general fund within the program and agency, although there is no net impact to the general fund

Funding

The following table shows program funding, by source, for the base year and for the 2005 biennium as recommended by the Governor

Program Funding Table Securities							
Program Funding	Base Fiscal 2002	% of Base Fiscal 2002	Budget Fiscal 2004	% of Budget Fiscal 2004	Budget Fiscal 2005	% of Budget Fiscal 2005	
01100 General Fund	\$ 334,795	64.4%	\$ -	-	\$ -	-	
02283 Securities Fee Account	<u>185,427</u>	<u>35.6%</u>	<u>660,250</u>	<u>100.0%</u>	<u>652,544</u>	<u>100.0%</u>	
Grand Total	<u>\$ 520,222</u>	<u>100.0%</u>	<u>\$ 660,250</u>	<u>100.0%</u>	<u>\$ 652,544</u>	<u>100.0%</u>	

This program is funded with state special revenue from the securities fee account, which draws its revenue from securities portfolio registration fees charged to investment advisors and investment companies. Unspent collections are deposited to the general fund and were approximately \$2.2 million in fiscal 2002.

Present Law Adjustments	-----Fiscal 2004-----					-----Fiscal 2005-----				
	FTE	General	State Special	Federal Special	Total Funds	FTE	General	State Special	Federal Special	Total Funds
Personal Services					99,163					98,232
Vacancy Savings					(20,210)					(20,175)
Inflation/Deflation					384					567
Fixed Costs					(8,453)					(11,043)
Total Statewide Present Law Adjustments					\$70,884					\$67,581
DP 2 - Securities Examiner/Analyst	1.00	0	50,229	0	50,229	1.00	0	45,826	0	45,826
DP 7 - Securities Contract Examinations	0.00	0	78,626	0	78,626	0.00	0	78,626	0	78,626
DP 8 - Special Session Reductions	0.00	0	(16,314)	0	(16,314)	0.00	0	(16,314)	0	(16,314)
Total Other Present Law Adjustments	1.00	\$0	\$112,541	\$0	\$112,541	1.00	\$0	\$108,138	\$0	\$108,138
Grand Total All Present Law Adjustments					\$183,425					\$175,719

Executive Present Law Adjustments

The "Present Law Adjustments" table shows the primary changes to the adjusted base budget made by the legislature. "Statewide Present Law" adjustments are standard categories of adjustments made to all agencies. Legislative decisions on these items were applied globally to all agencies. The other numbered adjustments in the table correspond to the narrative descriptions.

DP 2 - Securities Examiner/Analyst - This proposal requests funding for an additional 1.00 FTE, grade 14, securities analyst to address the increase in both the number of issuers filing with the department and the number of individuals registered to sell as broker dealer agents. The new position would provide support and consultation for those efforts. In addition, the federal government recently passed legislation (Gramm-Leach-Bliley) that permits banks and insurance companies to expand their activities in the securities markets. The State Auditor's Office anticipates that this will further increase demands.



This request is based on anticipated demands in the securities industry. Over the past ten years, there have been 2.50 FTE security analysts in the division. During that same timeframe, firms filing with the auditor's office have increased from less than 1,000 to near 2,000, and the number of issuers registering to sell their securities has increased from under 1,000 to over 9,000 filers annually. The broker-dealer examination function could be conducted through routine contracted securities exams. However, additional duties of the position include application and consumer complaint reviews of broker dealers, multi-level marketing companies, and living trust companies. Figure 1 provides information on security regulation in Montana.

Options:

- Fund the FTE as submitted, allowing more aggressive oversight of security broker dealers, multi-level marketers, and living trust companies
- Fund the FTE at the entry salary for a grade 14, for an approximate \$6,100 savings per year
- Fund the FTE through option one or two and designate \$1,351 for computer equipment as one-time-only
- Take no action on this decision package

Figure 1
Securities Program Indicators

Regulated Entity	Estimated						
	FY1997	FY1998	FY1999	FY2000	FY2001	FY2002	FY2003
Broker-Dealer & Investment Advisory firms (1)	\$ 1,100	\$ 1,150	\$ 1,200	\$ 1,250	\$ 1,350	\$ 1,476	\$ 1,525
Investment Advisory firms (2)	300	325	350	375	400	450	500
Broker-Dealer branches (Montana only) (3)	0	0	0	0	0	0	350
Salespeople (4)	38,000	42,000	45,000	48,000	52,000	53,800	55,000
Issuers (5)	7,819	8,529	8,880	10,101	10,231	9,886	13,000
Multi-Level Marketing Company (6)	0	0	0	50	100	150	200
Total Firms/People regulated	\$47,219	\$52,004	\$55,430	\$59,776	\$64,081	\$65,762	\$ 70,575

(1) \$200/year fee collected annually per firm
 (2) \$200/year fee collected annually per firm
 (3) Proposed legislation in FY2003 session would require all brokerage firms with Montana branches to register with Department and pay fee
 (4) \$50/year fee collected annual per salesperson
 (5) Average annual fee paid per issuer calculated at \$250
 (6) Proposed legislation in FY2003 session would require all Multi-Level Marketing Companies to pay an annual fee of \$200

DP 7 - Securities Contract Examinations - This request adjusts the line item for Securities Contract Exams for the new biennium. The expenses will be offset by examination cost reimbursements from investment companies. The requested funding is based upon the examination schedule for the 2005 biennium.

LFD COMMENT This request continues funding for examinations of investment advisors at the current year appropriation level of \$12,000. In addition, \$77,615 is added for proposed broker-dealer examinations. Although statute implies that examinations be conducted, there is no mandatory requirement to do so on a routine basis. This proposal would increase funding to move the office toward routine examinations of at least 200 broker dealer branch offices in Montana. Exams would be conducted on a three-year cycle at a cost of \$25 per hour. The office estimates about 2,360 hours of exams per year at a cost of \$59,000 plus an additional \$18,600 for travel, lodging, and per diem.

DP 8 - Special Session Reductions - The total amount of on-going reductions, as a result of the special session for the biennium, is \$32,628 of general fund. Of this amount, \$30,322 is taken from personal services and \$2,306 is taken from operating.

LFD COMMENT Impacts of this reduction are not specified by the auditor's office.

Program	FTE	Fiscal 2004				Fiscal 2005				
		General	State Special	Federal Special	Total Funds	FTE	General	State Special	Federal Special	Total Funds
DP 1 - Securities Program Funding Switch										
04	0.00	(380,514)	380,514	0	0	0.00	(378,285)	378,285	0	0
DP 2 - Additional Reductions										
04	0.00	0	(43,397)	0	(43,397)	0.00	0	(43,397)	0	(43,397)
Total	0.00	(\$380,514)	\$337,117	\$0	(\$43,397)	0.00	(\$378,285)	\$334,888	\$0	(\$43,397)

New Proposals

The "New Proposals" table summarizes all new proposals requested by the executive. Descriptions and LFD discussion of each new proposal are included in the individual program narratives.

DP 1 - Securities Program Funding Switch - This decision package proposes to eliminate the general fund appropriation for the securities program and fund the entire program with state special revenue collected from portfolio revenue. Currently, the program is funded with approximately \$335,000 of general fund and \$205,000 of state special revenue per year. The fund switch will have a net impact of zero on the general fund because the amount that would have been deposited into the general fund will not be appropriated from the general fund.

LFD ISSUE Program Funding
The securities program collects a variety of fees and taxes from security dealers. 30-10-115, MCA requires that the majority of these fees be deposited to the general fund, except for examination costs and portfolio notice filing fees.

Historically, this program has been primarily a general fund program. The 1993 legislature created the portfolio registration program to conduct merit review of each securities portfolio registered and established a new registration fee on portfolios to be deposited into a state special revenue account. Funding of the program has shifted from 100 percent general fund prior to fiscal 1994 to a combination of general fund and state special revenue since. Total agency funding has moved from 80 percent general fund during the 1997 biennium to about nine percent during the 2003 biennium due to replacing general fund within the insurance and central management programs, with state special revenue from the insurance fee account.

**LFD
ISSUE
(continued)**

Because all un-appropriated fees are deposited to the general fund, this request has no overall impact on general fund. Revenues to the general fund will be reduced by a like amount. Therefore, funding of the program is a policy consideration for the legislature. Use of the state special revenue account can insure that particular functions of government are not subsidized inappropriately by other funding sources and can make it easy to track changes in costs and revenues. Funding from the general fund provides more legislative control over the budget and allows the legislature to collectively consider the importance of general fund programs from all agencies when setting funding priorities.

Options:

- Continue funding the program with a combination of general fund and state special revenue
- Fund the program as proposed, entirely with state special revenue
- Fund the program entirely with general fund

DP 2 - Additional Reductions - In order to meet the biennial target consistent with other agencies, additional reductions of \$86,794 were taken from operating for the biennium. When the state special revenue is not spent, it is deposited to the general fund as revenue.

**LFD
COMMENT**

August 2002 Special Session reductions reduced funding by \$16,314 in fiscal 2003, which is continued into the 2005 biennium through DP 8. This proposal further decreases funding annually by \$43,397, for a total general fund savings of \$59,711 per year. The reduction is 1.7 percent of the office's total base year expenditures. Impacts of this reduction are not specified.