WORKERS' COMPENSATION: OLD FUND ANALYSIS

A Report Prepared for the

Legislative Finance Committee

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INTRODUCTION

The Legislative Finance Committee (LFC) has formed a workgroup to examine legislative options in relation to the oversight of the State Compensation Insurance Fund, commonly called Montana State Fund (MSF), and workers' compensation insurance. The purpose of this report is to provide both the workgroup and the LFC with background information on the Old Fund and the projected unfunded liability of $32.6 million.

As a matter of public policy, the objective of the Montana workers' compensation system is to provide, without regard to fault, wage-loss and medical benefits to workers suffering from work-related injuries or diseases through employer provided workers' compensation insurance. It is a further matter of public policy that Montana provides employers an option to insure their liability for workers' compensation and occupational disease coverage with the state workers' compensation insurance fund. The requirement that the state fund provide coverage for all employers is sometimes referred to as the state fund being the insurer of last resort.

HISTORY OF OLD FUND LIABILITY

Workers' Compensation Unfunded Liability

During the 1980s, workers' compensation insurance was provided by the State Compensation Insurance Fund as a bureau under the Workers' Compensation Division of the Department of Labor and Industry. During this period an unfunded liability for workers' claims existed and grew substantially each year, due in part to premium rates set at artificially low levels resulting in losses substantially exceeding premiums. The issue was of significant concern to the legislature and it examined various solutions to correct the problem. As outlined in the findings and purpose of 39-71-2502, MCA, the legislature determined that legislative action would not provide sufficient revenue sources to offset the unfunded liability. The legislature also determined that the burden of the unfunded liability should be shared by all employers who had workers' compensation insurance because the availability of insurance to all employers through the state fund benefited all employers who had workers' compensation coverage. Commencing with the payroll quarter ending September 30, 1987, a 0.3 percent workers' compensation payroll tax was imposed on all Montana employers, with the revenues to be used to provide a supplemental source of financing the unfunded liability in the workers' compensation insurance fund.

When the unfunded liability continued to increase, the 1989 Legislature decided to separate the workers' compensation function from the Department of Labor and Industry and created the State Compensation Mutual Insurance Fund as a nonprofit, independent public corporation. The statement of intent attached to the legislation outlined the chief purposes for creating the state fund as a mutual insurer and placing it in a department other than the Department of Labor and Industry:

- *1) To remove the inherent conflict between the interests of the workers' compensation division in regulating all workers' compensation insurers in this state, including the state compensation insurance funds, and the interest of the state fund as a workers' compensation insurer; and*
- *2) To ensure the solvency of the new state fund*

The 1989 Legislature also recognized that the fund actuary had determined that at June 30, 1988, a funding deficiency of $157.3 million existed for the state compensation insurance fund.

The June 1989 Special Legislative Session provided the state compensation insurance fund with a $20 million general fund appropriation to partially address the unfunded liability and eliminate a planned 22 percent rate increase to policyholders.

However, even with these changes the unfunded liability mushroomed. In order to restructure and develop a plan to reduce the debt, the May 1990 Montana Special Legislative Session separated funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990 (Old Fund) and claims occurring on or after July 1, 1990 (New Fund). In order to provide operating cash for the New Fund, $12 million of funding from the Old Fund was transferred to the New Fund.

Old Fund Liability Taxes and Payroll Bonds

The payroll tax assessed to employers was reduced to 0.28 percent from 0.30 percent during the 1990 Special Legislative Session. The payroll tax revenue was dedicated to repayment for loans from the New Fund used to pay claims of the Old Fund or to pay for Old Fund claims directly. This payroll tax became known as the Old Fund Liability Tax (OFLT).

The 1991 Legislature passed legislation authorizing the Board of Investments to issue up to $220 million in payroll bonds to provide additional funding for the Old Fund. OFLT was used as the revenue source to redeem the bonds. Payroll tax bonds of $142,095,000 were issued July 15, 1991 to provide operating cash for claims payment and administration costs associated with the Old Fund.

The cash provided through the payroll bonds was exhausted in February 1993. During the following period the New Fund loaned the Old Fund $13 million to provide necessary cash flow. The 1993 Legislature increased the payroll tax on employers to 0.50 percent and required a 0.20 percent payroll tax on employees. In addition, a 0.10 percent payroll tax implemented on self insured persons was added after December 31, 1992 and increased to 0.2 percent beginning January 1, 1994. The New Fund loaned the Old Fund an additional $8 million between July and October of 1993.

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On October 27, 1993 the Board of Investments issued $32.5 million of variable rate payroll tax bonds. Bond proceeds were used to repay $21.3 million in loan principal and interest due to the New Fund and to pay Old Fund claim costs.

Figure 1
Old Fund
Payroll Tax Bonds

Date	Amount	Revenue Source
7/24/1995	$20,880,000	OFLT collections
3/26/1996	$13,075,000	OFLT collections
9/24/1996	$97,885,000	New Fund dividend, debt service reserves, OFTL collections
1/2/1997	$32,500,000	New Fund dividend, debt service reserves, OFTL collections
Total	$164,340,000	

Beginning July 24, 1995, OFLT collections and other revenue sources were used to pre-pay the Old Fund payroll tax bonds. The last pre-payment was made October 3, 1996 and, as a result, the payroll bonds were removed as a liability from the Old Fund financial statements. Figure 1 shows the dates, revenue sources, and amounts used to pre-pay the outstanding bond principal.

One of the revenue sources noted above is a dividend from the New Fund. Under state law in effect until 1997, the MSF board of directors could declare dividends for the New Fund when there was an excess of assets over liabilities and adequate reserves were set aside. This excess is commonly referred to as surplus. Dividends were required to be transferred to the account designated to offset the unfunded liability of the Old Fund.

On September 24, 1996 the MSF board of directors declared a dividend to the Old Fund of approximately $102.3 million. $12 million of the dividend was designated as a return of the New Funds' contributed capital transferred by the May 1990 Montana Special Legislative Session.

Elimination of the Unfunded Liability

The 1997 Legislature passed Senate Bill 67, which required the transfer of a $63.8 million dividend from New Fund surplus funds to establish adequate funding for the Old Fund. Senate Bill 67 specified that the OFLT terminated on January 1 or July 1 of the year in which Old Fund claims were projected to be adequately funded. The budget director certified the Old Fund was adequately funded as of January 1, 1999 and terminated the OFLT. Senate Bill 67 also required MSF to pay from the New Fund to the general fund $10 million in FY 1998 and $10 million in FY 1999. This was done to reimburse the general fund for a transfer of $20 million made in FY 1989.

The 1999 Legislature passed House Bill 167, eliminating the OFLT from statute. House Bill 167 also defined the term “adequately funded” as the present value of the total cost of future benefits remaining to be paid, the cost of administering the claims, and an additional amount equal to 10 percent of the total of the cost of benefits and the cost of administering claims. The bill required that each year after the OFLT was terminated any funds above the amount needed to adequately fund the Old Fund claims would be returned to the MSF to pay off the $63.8 million transfer from the New Fund included in Senate Bill 67.

In years when the Old Fund was determined to have inadequate funding, House Bill 167 required MSF to transfer from the New Fund necessary funds back into the Old Fund. MSF transferred $6,765,027 and $7,407,512 in FY 2001 and FY 2002, respectively, from the Old Fund to the New Fund to partially repay the Senate Bill 67 transfer.

Transfers of the Old Fund Surplus to the General Fund

Surplus is defined by statute as an excess of assets over liabilities. The August 2002 Special Legislative Session passed Senate Bill 19, which required MSF to transfer a total of $4 million from Old Fund excess surplus funds to the general fund. The bill also required that in any year the Old Fund was not adequately funded, general fund must be transferred to the Old Fund to pay the claims.

The 2003 Legislature passed House Bill 363, which eliminated the reserve requirement of 10 percent of the total of the cost of benefits and the cost of administering claims fund from the definition of adequately funded. The bill transferred the reserve of $9,090,000 and surplus funds of $9,178,000 to the general fund prior to June 30, 2003. It also required that up to $4.3 million and $3.78 million of available surplus funds be transferred to the general fund in FY 2004 and FY 2005, respectively. In FY 2004 $815,605 of surplus funds were transferred from the Old Fund to the general fund. Total transfers from the Old Fund to the general fund during this period were $23,083,605.

Old Fund Unfunded Liability

Increases in medical loss costs and adverse court rulings have resulted in increases to the Old Fund liabilities. As of June 30, 2004, the Old Fund had an unfunded liability of $7,442,792. The unfunded liability has continued to increase each year. As of June 30, 2007 it is estimated to be $32.6 million. Current statute requires that general fund be transferred to pay claims when all available assets are depleted. It is currently estimated that the Old Fund will require general fund transfers to pay claims beginning in FY 2012.

The 2005 Legislature considered Senate Bill 315, which would have transferred $6.2 million from the general fund to the Old Fund to offset a portion of the unfunded liability. The bill did not make the transmittal deadline for general bills.

OLD FUND CLAIMANTS

When the Old Fund and New Fund were separated there were at least 8,100 claims outstanding in the Old Fund. As of October 23, 2007 there were 953 open or active claims in the Old Fund. According to MSF, an open or active claim reflects benefits, either indemnity or medical, which are currently being paid, or are expected to be paid. Claimants can be either injured employees or beneficiaries receiving fatality benefits. Actuarial estimates project Old Fund claim payments until 2045. The estimates include consideration of the age of claimants and the type of claims.

Figure 2 presents the number of Old Fund Claims by age group as of September 7, 2007.

As shown, a number of the claimants are in their 30s, 40s and 50s, which will result in claims payments potentially over the next several decades. Increases to the amount of the unfunded liability in the Old Fund can be anticipated if medical loss costs continue to increase or there are additional adverse court rulings which are applied retroactively to the Old Fund claims.

Figure 2
Old Fund
Claims By Age Group

Age	Injured Workers	Beneficiaries for Fatalities
90 and above	1	4
80 and above	26	15
70 and above	117	24
60 and above	287	32
50 and above	301	17
40 and above	119	7
30 and above	9	1
Total	860	100

Source: Montana State Fund

OLD FUND ADMINISTRATIVE COSTS

When the workers' compensation insurance claims were separated into the Old Fund and the New Fund, statute limited the amount of administrative expenses for the Old Fund to $3 million per year. This amount was reduced to $1.25 million in House Bill 167.

The actual cost of administering the Old Fund was higher than the allowed $3 million expenditure limit in FY 1991 and FY 1992 and higher than the allowed $1.25 million in FY 1999, FY 2000, FY 2001, FY 2002, and FY 2003. MSF tracked the total amount of the underpayments and has recovered the majority of the additional costs when the administrative costs were lower than the allowed amount. As of June 30, 2007 the outstanding obligation for the unrecovered administrative costs was $321,262.

Figure 3
Transfers Between Funds

Fiscal Year	General Fund	Old Fund	New Fund
Jun-89	($20,000,000)	$20,000,000	
May-90		(12,000,000)	12,000,000
Feb-93		13,000,000	(13,000,000)
Jul-93		5,000,000	(5,000,000)
Aug-93		1,000,000	(1,000,000)
Sep-93		1,000,000	(1,000,000)
Oct-93		1,000,000	(1,000,000)
Oct-93		(21,321,007)	21,321,007
Sep-96		102,300,000	(102,300,000)
Jul-97		63,800,000	(63,800,000)
Jun-97	10,000,000		(10,000,000)
Jun-98	10,000,000		(10,000,000)
Jul-01		(6,765,000)	6,765,000
Jul-02		(7,407,512)	7,407,512
Aug-02	4,000,000	(4,000,000)	
Jun-03	18,268,000	(18,268,000)	
Jun-04	815,605	(815,605)	
Total	$23,083,605	$136,522,876	($159,606,481)

SUMMARY

A summary of the transfers between the general fund, the Old Fund, and the New Fund are presented in Figure 3.

As shown, the New Fund transferred significant amounts of revenue to the Old Fund to eliminate the unfunded liability and the OFLT. The general fund, at this time, has received more funding from the Old Fund than it has transferred into the account. However, given the current unfunded liability in the Old Fund and the lack of an additional revenue source such as the OFLT, the general fund will be required to pay claims for the Old Fund as soon as FY 2012.