MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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DATE: June 15, 2004

TO: Legislative Finance Committee

FROM: Harry Freebourn

RE: Montana State Fund: Old Fund Projected Deficit and New Fund Rate Increase

PURPOSE

The purpose of this paper is to inform the Legislative Finance Committee (LFC) about two fiscal impacts to the State of Montana that relate to the funds managed by the Montana State Fund (MSF). These fiscal impacts are discussed in the sections that follow this paragraph. MSF is a self-supporting, competitive insurer that offers workers' compensation insurance coverage to state agencies as well as to non-state entities. MSF is the component unit of the state that administers the receipt of premiums and payments from both the Old Fund and the New Fund. As per 39-71-2352, MCA, the Old Fund relates to the settlement of workers' compensation claims for injuries resulting from accidents that occurred before July 1, 1990. The New Fund is for injuries incurred on or after July 1, 1990.

THE OLD FUND FISCAL 2004 PROJECTED DEFICIT

The Old Fund is projected to experience an ending fund deficit of approximately $0.6 million by the end of fiscal 2004, which creates a potential general fund liability for the State of Montana. The state is required to cover deficits in the fund per 39-71-2352 (6), MCA, which states, "If in any fiscal year after the old fund liability tax is terminated claims for injuries resulting from accidents that occurred before July 1, 1990, are not adequately funded, any amount necessary to pay claims for injuries resulting from accidents that occurred before July 1, 1990, must be transferred from the general fund to the account provided for in 39-71-2321." The Legislative Fiscal Division (LFD), MSF, and the SB 304 Study Committee are considering when a deficit in the Old Fund is to be funded by the general fund because the current statute is vague on the timing of any funding. The SB 304 Study Committee was created during the 2003 Montana legislative session and is charged to look at the role of the MSF, the feasibility of selling all or part of the fund, and also study the creation of an assigned risk pool mechanism.

MSF believes that this deficit is due to the following: 1) investment earning rates are lower than planned (4.5% vs. 5.25%); 2) medical expenses are increasing due to changes in technology and the development of new prescription drugs; and 3) the aging of plan participants. Although not

currently reflected in the numbers, there are pending court cases that could have a material impact on the Old Fund's balance if the outcome is adverse.

The Old Fund has created fund surpluses in the past. In accordance with SB 19 (August 2002 Special Session) and HB 363 (2003 regular session), MSF transferred $23.1 million in surpluses to the state's general fund during fiscal 2003 and 2004. MSF originally predicted that the Old Fund would create surpluses in fiscal 2004 and 2005 of at least $4.3 million and $3.8 million, respectively. These surpluses were to be transferred to the general fund.

Future fiscal impacts are difficult to forecast due to the number of variables that cause changes in the fund's balance. However, if the conditions mentioned above continue or become more pronounced, the remaining invested assets held by the Old Fund could be exhausted before all claims have been settled and closed.

THE NEW FUND RATE INCREASE

The New Fund provides workers compensation coverage to the agencies of the State of Montana as well as to non-state entities. This fund experienced a net loss of $17.6 million during fiscal 2003. Fiscal results for fiscal 2004 are not yet available. This loss is the result of adverse developments from prior year claims. To mitigate this loss, MSF's Board of Directors recently approved an overall rate increase of 9.5 percent to be effective at the beginning of fiscal 2005. However, this is an average increase and the actual rate increase that each customer will be levied depends on the past claim experience of that customer.

The estimated fiscal 2005 premium for Montana's state government is $13.3 million, which is a 21 percent increase over the prior fiscal year. The following table illustrates the actual or estimated premiums for the state by fiscal year with corresponding dollar and percentage increases. The dollar amounts are in millions.

Fiscal Year	2002 (Actual)	2003 (Actual)	2004 (Est.)	2005 (Est.)
Premium	$6.6	$8.2	$11.1	$13.3
Dollar Increase	$0.4	$1.6	$2.9	$2.3
Percent Increase	6%	24%	35%	21%
Adjusted % Inc.	3%	19%	30%	18%

The dollar and percent increases noted in the table above include adjustments due to increases or decreases in the payroll of the state. The row titled "Adjusted % Inc" reflects the percentage increase based solely on changes in rates.

MSF believes that this rate increase is necessary to cover plan losses and the erosion of the fund's surplus. These conditions occurred because: 1) earning rates on investments are lower than planned (4.5% vs. 6%); 2) medical expenses are increasing due to changes in technology and the development of new prescription drugs; and 3) an increase is necessary in the "assumed contribution to the plan surplus."

Future fiscal impacts are difficult to forecast due to the number of variables that cause changes in the fund's balance. However, if the conditions mentioned above become more pronounced, future fiscal years will experience net losses, which may trigger additional rate increases.

CONCLUSION

The LFD will update the LFC as additional information becomes available.

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