



November 23, 2015

Sent Via Email

Monica J. Lindeen
Commissioner of Securities and Insurance
State Auditor's Office
840 Helena Avenue
Helena, Montana 59601

**Re: Montana State Fund Actuarial Report for Montana CSI
Initial Review of Towers Watson 2015 Analysis of Policyholder Equity and Dividends**

Dear Commissioner Lindeen,

In our report dated November 19, 2015 regarding Montana State Fund (“MSF”) Reserves and Rates, we discussed the then latest available analysis of MSF policyholder equity and the policyholder dividend program from Towers Watson (“TW”), which was dated November 14, 2014. We also mentioned that an update of this study was expected from TW in mid-to-late November of 2015 and that we would provide comments to CSI on this update in advance of the December 2015 EAIC meeting. This letter is intended to provide our initial thoughts on the updated TW study and last week’s related dividend declaration by the MSF Board of Directors.

To assist MSF management and the Board, TW examined historical financial performance and current policyholder equity of MSF. TW updated its assessment of key financial risks and provided a series of benchmarks for reasonable levels of equity, applying measures similar to those in its November 2014 presentation. TW further assessed whether the financial status of MSF supported a policyholder dividend, and if so, how much.

In their November 2015 updated analysis, TW observed that MSF’s June 30, 2015 policyholder equity significantly exceeded regulatory solvency perspective benchmarks and that MSF’s policyholder equity was in the middle of the range indicated by “A” and “A-” rated state funds in other states and by the workers compensation industry. TW concluded that MSF’s equity has performed well, absorbing adverse loss development, retroactive benefit level changes, and investment volatility while allowing relatively stable rates, especially since 2005. TW discussed the threat of terrorism for MSF and concluded that required equity for terrorism risk is generally negligible. TW concluded that MSF’s financial position was strong and opined that an important priority is to maintain equity levels relative to loss reserves and operational risks.

In a separate but related presentation dated November 4, 2015, TW reported on its policyholder equity modeling analysis as of June 30, 2015. The model provides quantification of expected change in reserve and premium to equity ratios and reserve to risk-based capital levels under a variety of “stress” scenarios over the next 10 years. The results of this analysis were incorporated into the November 2015 presentation to the Board.

TW modeled four main scenarios, including: 1) “expected” business conditions, 2) hard market, 3) financial crisis, and 4) repeal or substantial impairment of HB334. TW also modeled two combination stress scenarios: 1) combination of hard market and financial crisis, and 2) combination of hard market and impairment of HB334. In each case, TW provided probabilities of “financial trouble,” which they defined as any one of insolvency, falling below certain risk-based capital levels, or the need to suspend dividends. TW concluded that current MSF policyholder equity was sufficient at the 99.5% (one-in-200 year) level under expected business conditions but was not sufficient at this same level under several of the stressed scenarios. TW determined that that possible impairment of expected benefit reductions from HB334 appears to be a very material risk facing MSF at this time, and we concur with this assessment.

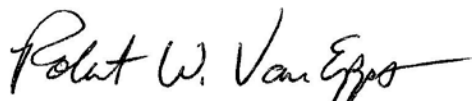
TW identified various strategic considerations supporting declaration of dividends, including incentives and rewards for best policyholders with focus on safety and attracting and retaining good business. Finally, TW concluded that MSF had the financial performance and strength to declare a large dividend at this time. Based on the TW report (and presumably other considerations), the Board of MSF declared a dividend of \$35 million.

The question of the appropriate level of policyholder equity at any point in time is a function of many factors, including financial performance, financial strength, and risk assessment and tolerance. Recognizing that the determination of appropriate levels of equity is dynamic considering these factors, decisions regarding the proper level of equity should be made with due regard to input from all stakeholders, including MSF’s management, Board, regulators, and the legislature.


Based on our review of the TW analysis, we believe that MSF policyholder equity was in the upper end of the range for well capitalized workers compensation specialists as of June 30, 2015. Until court challenges to HB 334 are resolved, we believe it makes sense for MSF policyholder equity to be in the upper end of the range for well-capitalized companies. We believe that MSF is well positioned to absorb the financial impact of any adverse decisions, should such occur. We believe that the level of dividend declared by MSF’s Board appears to be reasonable.

We appreciate the opportunity to provide service to the Montana CSI. We will be pleased to discuss our work and findings and are available to answer any questions you may have.

Sincerely,



Robert W. Van Epps, FCAS, MAAA
Managing Principal



Daniel A. Reppert, FCAS, MAAA
Principal

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