

# COMMISSIONER OF SECURITIES & INSURANCE

MATTHEW M. ROSENDALE, SR.  
COMMISSIONER



OFFICE OF THE MONTANA  
STATE AUDITOR

February 21<sup>st</sup>, 2018

Dear Members of the Economic Affairs Interim Committee,

Below you will find a summary of the recommendations that I presented on SJ 27 at your February 8<sup>th</sup> meeting:

Since 2016, Montana State Fund (MSF) has been under the regulation of the Insurance Commissioner. The Insurance Code requires protection of consumers, which are the insured employers and ultimately the employees who are covered by the workers' compensation policy.

Any change in law that impacts or impairs access to workers' compensation coverage, or the cost of that coverage, or the financial stability of an insurer, is not a step that benefits Montana businesses.

Montana employers are required to have Workers' Compensation coverage for their employees. MSF, serving as the "Guaranteed Market", is required to insure any employer who requests coverage. MSF insures approximately 26,000 employers. Approximately 75% are considered small employers. (*\$5,000 or less in annual premium*) MSF is unlike other private institutions who may refuse policies to higher risk firms or those with little or no history.

SAO Financial Examination- Completed in December 2017 - Comments recommending additional risk mitigation: Please keep in mind these recommendations were made prior to the recent special session and are summarized as follows:

First: Recommendation that Board membership include a "financial expert"; this is a best practice in the insurance community for performance of the Board's corporate governance role. (Member with an accounting certification, CPA, CFE, etc., and have previously been employed in a financial oversight role.)

Second: Recommendation to reduce the risk that MSF's surplus level or financial solvency could be impacted by action of the Montana State Legislature. Existing statutes address the risk in regards to prohibiting transfers by the legislature for other purposes. However, the legislature may pass laws, especially in times of economic stress, and when some may consider the surplus, without any actuarial consideration, to be excessive.

The Board and legislative liaisons need to ensure the Montana Legislature is provided information clearly explaining the following:

- 1) MSF's capital is shown as "surplus" on MSF's balance sheet
- 2) "Surplus" cannot be interpreted using common definitions as it may lead to the erroneous conclusion that surplus is excess or unneeded funds
- 3) MSF's capital must remain at a level satisfactory to the Risk Based Capital (RBC) system and other tools used by the Insurance Commissioner to assess financial solvency.

Third: Recommendation that conflicts of interest by the Board may not be fully disclosed. The practice of annually signing conflict of interest statements by MSF management and employees should be required by Board members.

The exam also went into detail to describe the events which led to the creation of the 'Old Fund', which primarily was a result of influence by the legislature on premium rates. There was also legislative diversion of funds with no regard to the actuarial impact of those decisions.

The recent special session that resulted in a transfer of MSF funds to the fire suppression account, clearly reflects a need - not to dissolve MSF - but to consider what structure for MSF assures or provides the following business conditions:

- Protection of MSF assets, (approx. \$1.5 Billion-reserves and surplus)
- Ongoing access to workers' compensation coverage for any employer

**Recommendation:**

1. Retain MSF as a competitive insurer that serves as the Guaranteed Market
2. Move MSF from a state government structure to that like a private insurance company, which process was begun during the 2015 legislature.

Doing so provides the following benefits:

- Available coverage (no declinations required)-from a Montana domiciled insurer- particularly for small or higher risk businesses.
- Purchase of coverage without the potential of higher premium in an assigned risk mechanism
- No threat of future premium/asset transfers for purposes other than MSF business obligations and payment of benefits to covered workers. Employers expect the premiums they pay to be used for benefits.



Primary components of a law change:

1. Establish MSF as a Domestic Mutual Insurer
  - o MSF to have the Guaranteed Market responsibility and is required by law to provide insurance to any employer needing workers' compensation coverage (unless a debt is owed)
  - o The Board members are to be elected by policyholders as provided in the Insurance Code for a Mutual Insurer. Federal law currently exempts MSF from payment of Federal Taxes, however an elected board would subject MSF to payment of federal taxes.
2. MSF is to be exempted from membership in the Guaranty Association. MSF, as the Guaranteed Market, cannot be dissolved. The Insurance Commissioner would need to provide aggressive regulation and Risk Based Capital (RBC) (and other tools to evaluate solvency) would need to be continuously monitored.
3. Include express statutory language that MSF is not considered a state agency or instrumentality of the state
4. Express affirmation that the state is not to borrow or otherwise appropriate funds from MSF
5. Payment of premium taxes by MSF

Items that may require additional review/research and/or exploration of options for transition, several of which have been identified by this committee:

- Membership of employees in the state retirement plan
- MSF ownership of assets

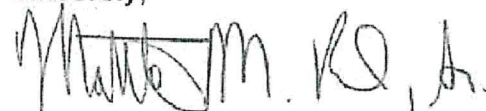
The courts may decide this question in a recently filed lawsuit: *Moodys Market, Inc.; Liquid Engineering Corp.; Stieg Ranch, LLC; Z Inc.; Story Distributing Co.; Vinton Construction; Montana Roofing Contractors Association, Inc.; Ace Roofing, LLC; Cory Simons Construction, Inc.; and National Federation of Independent Business; Plaintiffs, v. Montana State Fund, Montana Board of Investments and State of Montana, Defendants.*

- Investment of assets by the Board of Investments
- Replacement of services from the state- i.e., IT services, accounting/payroll services, employee benefits

- Fraud Prosecution and Investigation by the Attorney General's Office: 2018 budgeted amount is \$276,711. Should the office of the Insurance Commissioner be required to assume fraud investigation and prosecution for MSF, it cannot be absorbed without fiscal impact.
- Old Fund administration by MSF – funded through General Fund. Responsibility for administering the Old Fund would need to be reviewed if MSF established as a non-state entity.
- Timeline for implementation and transition

The Office of the Commissioner of Insurance will continue to support legislation that maintains the trajectory of the cost of workers compensation insurance in the state of Montana, which has been downward, including the most recent submittal to my office by NCCI for Loss Costs for 2018, which continues to provide protection for our workers.

Sincerely,

A handwritten signature in black ink, appearing to read "Matthew M. Rosendale". The signature is stylized and somewhat cursive.

Matthew M. Rosendale  
Commissioner of Securities and Insurance