

Evolving, Revolving, and Reassessing:

WHAT TO LEARN FROM PAST MONTANA STATE FUND STUDIES?

Prepared by Pat Murdo
Staff for the Economic Affairs Interim Committee
September 2017

Legislative Services Division



PO Box 201706
Helena, MT 59620-1706
PHONE: (406) 444-3064
FAX: (406) 444-3036
<http://leg.mt.gov/>

"Once more unto the breach, dear friends, once more..." Henry V, Act III, Scene 1.

The following report reviews a history of workers' compensation and past major workers' compensation studies tied to Montana State Fund, including references to related, ensuing changes.

Table 1: History of Montana State Fund (State Fund/State Compensation Insurance Fund)

Year	Status
Pre-1987	Prior to 1987, Montana's workers' compensation system operated as a three-tiered system in which operated self-insured employers (plan 1), private insurers (plan 2), and a unit for workers' compensation in the Department of Labor and Industry (plan 3).
1987	A liability crisis prompted the Legislature to take action and resulted in enactment of a payroll tax on employers to help pay claim liabilities that had grown, in part, because premiums had been held artificially low while claims rose.
1989	<p>The crisis did not abate. In an effort to operate plan 3 as a business, the Legislature created the State Compensation Mutual Insurance Fund, which was to operate as a domestic mutual insurance company regulated by the Insurance Commissioner. This took the state fund out of the Department of Labor and Industry. See 39-71-2313 (1989).</p> <p>A June 1989 special session appropriated \$20 million from the general fund to help address the liabilities. That wasn't enough to avoid a steep rate increase.</p>
May 1990	<p>The Legislature met in special session on three topics, one of which was to deal with the mounting liabilities of the State Fund. The decision was to:</p> <ul style="list-style-type: none"> • change the structure of the State Compensation Mutual Insurance Fund so that it no longer would operate as a mutual insurer under the authority of the Insurance Commissioner; and • separate the existing liabilities into an Old Fund with all claims filed on or after July 1, 1990, getting a fresh start in the New Fund. <p>That special session reduced the payroll tax on employers from 0.3% to 0.28%. But 3 years later the 1993 Legislature imposed a 0.5% employer payroll tax and a 0.2% payroll tax on employees and others receiving compensation. Bonds were sold to help reduce the Old Fund liability, with the payroll tax paying off the debt.</p>
July 1990	Legislation separated liabilities based on the date of injury. Claims for injuries from accidents or occupational disease that occurred on or after July 1, 1990, are the responsibility of the New Fund. Claims that were filed or were from accidents or occupational disease before July 1, 1990, are the responsibility of the Old Fund. The State Fund operated both Old and New Fund. Money was put into trust for the Old Fund claims and over time the Legislature drained that trust until in 2003 the Legislature claimed all money from the trust and said the state would pay claims on an ongoing basis until no more claims exist, projected for about the year 2050 or 2052.
1993-1997	Legislatures made statutory changes to provide the State Fund Board of Directors with more business-oriented authority over MSF. In 1997, MSF paid back to the General Fund the \$20 million the Old Fund received from the General Fund when the New Fund and Old Fund were split in 1990. MSF also paid \$63.8 million to the Old Fund Trust, which allowed MSF to pay dividends to its policyholders.

2000	Montana voters were asked through SB 23 to amend the state constitution under C-34 to specifically allow up to 25% of the state compensation insurance fund's assets to be invested in private equity. The amendment passed 197,399 to 180,850, or by 52% of the vote.
2002 Special Session and 2003 Session	SB 19 required MSF to transfer \$4 million from Old Fund Trust to the General Fund and the Legislature set the stage for the General Fund to make future payments for Old Fund claims. In 2003 HB 363 removed reserve requirements from the Old Fund and transferred \$18.2 million to the General Fund from the Old Fund. Additional changes to 39-71-2352 made the General Fund responsible for payments of Old Fund claims and expenses as part of a transfer of funds to the General Fund that year. The trust was depleted in 2011, and General Fund payments began that year.
January 2015	The 2013 Legislature requested the HJR 25 study of Montana State Fund, which resulted in legislation (SB 123) that gave the State Auditor's Office regulatory oversight of Montana State Fund. The State Fund would operate more fully as a domestic insurer.

Studies

Starting in 1999, the interim committee structure took shape, which meant in general that studies became the duty of an interim committee. Prior to that (and even after that date for some studies), special commissions undertook studies requested by the Legislature. Multiple studies since 1999 have related to workers' compensation; their outcomes are listed in Table 2.

With the exception of the study in 2009-2010 that focused on all aspects of workers' compensation and the 2007-2008 study, the other studies resulted in a trajectory toward greater independence for State Fund yet retained its status as a nonprofit, "independent" public corporation as described in 39-71-2313, MCA. The lack of full independence stems from State Fund being under the state umbrella and subject, in particular, to legislative oversight, which has made the entity less independent than a private insurer.

As indicated in the history in Table 1, the "state fund" was a part of the Department of Labor and Industry in the early 1980s, after starting life in 1915 as the Industrial Accident Board. From that status, the "state fund" moved briefly to a mutual insurance company in January 1990 but remained part of state government. After a special session in May 1990, the "state fund" became the "nonprofit, independent public corporation" described in 39-71-2313, MCA, whose independence is somewhat constrained by the Legislature and by its status as a state entity. Intermittent changes since 2000 have retained the state entity affiliation but as of passage of SB 123 in 2015 put the organization under regulatory authority of the State Auditor's Office. The Legislative Audit Division continues, as it did in the past, to audit MSF's governmental financial statements as a component unit of the State of Montana.

Summary of Major Changes, 2001 - 2015

Studies have, in general, resulted in legislation that gradually has moved Montana State Fund (MSF) toward being more like an insurance company than a state agency. Examples are:

- *legislation exempting MSF from certain references as a state agency (2001)*
- *transfer of Old Fund funding responsibility to the general fund from the Old Fund Trust within MSF (2002) with final transfers set out in 2003 (HB 363).*
- *legislation (SB 360) that stated contracts with policyholders must say that the premium and interest are MSF assets (2003) (39-71-2316)*
- *regulation under the State Auditor's Office (but with the requirement to remain the guaranteed market and exemption from premium tax/income tax, and retention of state portfolio of customers, among other benefits tied to being a state entity. (2015).*

Actions that may have complicated the "independence" of MSF:

- passage in 2000 of an amendment to the state constitution to allow investment of the state compensation insurance fund's assets in private corporate stock.

Table 2: Studies of Workers' Compensation, including Montana State Fund, and Results

<p>2002 Study SB 19</p>	<p>The study resulted from SB 19 (2002 special session) and was conducted by State Fund, meeting 3 times in September, October, and November 2002. The committee included 6 legislators, 3 stakeholders, and a representative of the State Auditor's Office. The recommendations included:</p> <ul style="list-style-type: none"> • revising reference to MSF as a public, independent, nonprofit corporation; • stating that MSF was not a state agency except for certain provisions; • recommending legislation to protect MSF assets.
<p>2003-2004 SB 304</p>	<p>The study required State Fund to pay for and provide support functions under the direction of a committee comprised of 3 members each of the House and the Senate, and 1 representative each from the governor's office, the State Auditor's Office, plan 1, and plan. 2. Information on the study is at http://www.sb304.com. The recommendations included: that State Fund</p> <ul style="list-style-type: none"> • not be sold; • receive permission to bid on public entities as a third party administrator. • phase-in premium tax payments, starting in FY 2006; • have 4 legislative liaisons (2 House, 2 Senate) as nonvoting MSF board members. (Only this became SB 61, amended to 2 liaisons, and enacted in 2005.)
<p>2007-2008 Legislative Finance subcommittee, bipartisan</p>	<p>A Legislative Finance Committee subcommittee study included fiscally oriented topics, including accounting methodologies as well as ways to assess fiscal soundness. Bills drafted after that study did not pass. They included SB 60 to provide for market conduct examinations and other financial solvency tests.</p>
<p>2009-2010 SJR 30 - A broad study that reviewed regional work comp systems and state funds as well as benefits.</p>	<p>A study under SJR 30 covered a broad range of subjects, including State Fund. A consultant hired by the Department of Labor and Industry, Ann Clayton, did a regional comparison of work comp systems. The Economic Affairs Interim Committee's SJR 30 study paralleled the research being done by Ms. Clayton, who briefed the EAIC as well as the Labor-Management Advisory Council. The work done on this study led to a bill draft that did not move forward but that had several elements that became part of HB 334 in the 2011 Session. Enacted, that bill resulted in a rate filing recommendation from NCCI of a 22%-plus reduction in workers' compensation loss cost rates on which premiums are based.</p>
<p>2009-2010 - Conning Research and Consulting</p>	<p>This 2009 proprietary study (not done as part of a legislatively requested study) had a focus on state funds in the workers' compensation market, which gets coverage from self-insureds/captives, traditional insurers, and state fund public entities. The private report is not included in Table 3.</p>
<p>2013-2014 HJR 25</p>	<p>This study of Montana State Fund resulted in legislation, SB 123, that put Montana State Fund under the oversight of the State Auditor's Office, with some carveouts. State Fund was to remain a provider of the guaranteed market, was exempt from participating in the insolvency fund that other workers' compensation insurers must be in, did not have to pay a tax on net premiums, and retained its sole insurer position for state agencies' workers' compensation. The study also considered but did not pursue an option to privatize State Fund.</p>

<p>2017-2018 SJR 27 - The study resolution allows for a broad look at work comp, but the EAIC is looking primarily at State Fund.</p>	<p>This study will look at the future of Montana State Fund and include</p> <ul style="list-style-type: none"> • Overview of how current system works (rates set, 3-tier system, benefits paid), distribution of insurers in market including captive insurers and premium paid, size of market, premium distribution for existing work comp insurers (high-low) and client sizes (high-low and distribution) • Examinations of other states that have similar conditions to see how each state assures coverage availability at an affordable price for all businesses. This would include looking at guaranteed markets and residual or risk-sharing pools. • Potential impacts to employers, injured workers, and the state pension system and investment board if Montana State Fund were dissolved or privatized. • Complications for various options: dissolution or privatization. • Expected costs and benefits.
---	---

Components of past studies

As the "state fund" became financially stronger, studies since 2002 have sought to determine how independently the organization ought to operate. These studies generally have focused on similar issues. Discussions included whether to:

- turn the state fund into a private insurer (which raises questions as to whether it would have to buy itself "free" of the state and, if so, with what money);
- sell the state fund and its liabilities (claims), which raises questions about how to make sure that hard-to-insure companies or small-premium paying companies are able to buy coverage through either a risk-assignment option or other type of residual pool; or
- keep the status quo but revise competitiveness concerns and interconnections with the state.

Examples of the components of the various studies, along with descriptions, are listed in Table 3.

Table 3 - Similar Legislative Study Components

Study Components	2002 SB 19	2003-2004 SB 304	2008-2009 Legislative Finance Subcommittee	2009-2010 EAIC SJR 30	2013-2014 EAIC HJR 25
Preliminary information	State Fund provided priority list used for discussion. Membership was 4 Republicans, 2 Democrats, 3 lobbyists, and SAO representative.	State Fund was required to pay study costs but no more than \$100,000. Committee had 9 members: 4 legislators, SAO and governor representatives, and 3 insurer representatives.	This subcommittee of the Legislative Finance Committee explored State Fund's operations as an insurer. Bipartisan, 4 members of Legislative Finance.	This EAIC study, broadly aimed at all aspects of workers' compensation, included a look at the competition factors in state funds.	The EAIC study had many topics: subrogation, work comp court, MSF structure, work safety, benefits

<p>Agenda outlines</p> <p>abbreviations: CSI = Commissioner of Securities and Insurance (State Auditor)</p> <p>GF = General Fund</p> <p>MSF = Montana State Fund</p> <p>NCCI = National Council on Compensation Insurance</p>	<p>1st Agenda MSF - overview & review of proposal -National state fund overview</p> <p>2nd Agenda -Guaranty Fund -Legal issues -Privatization, surplus, Old Fund, competition issues</p> <p>3rd Agenda -Organizational -Regulation (CSI) -State sole server -Premium tax -Old fund to GF</p>	<p>1st Meeting Expectations: -Review whether to sell all/part of MSF, switch to assigned risk pool, value MSF -Review whether to sell Old Fund responsibility -Review agency, small business/contractor rates -Review other states' experiences -Clarification of agency status -MSF operations</p> <p>2nd Meeting -MSF overview -Competition- -Ratemaking -NCCI rates -Valuing of MSF (handout, no mention in minutes)</p> <p>3rd Meeting -Residual market -Nevada experience -Other insurers, other states and assigned risk pools/plans</p> <p>4th Meeting Discussions of Received Information, New Requests</p> <p>5th Meeting -Old Fund Sale? -MSF Status</p>	<p>1st Meeting -Reviewed study proposal</p> <p>2nd Meeting -Reviewed ratemaking and oversight by State Auditor of private carriers -Reviewed work comp cost-savings in state agencies -Reviewed budget issues</p> <p>3rd Meeting -Reviewed budget issues -Reviewed safety program -Reviewed legislative oversight as compared to private carriers' oversight -Reviewed rate-setting/mod factors and premium assessments</p> <p>4th Meeting -Reviewed different budget options (cash/accrual bases) -Reviewed MSF oversight by the Legislature -Explanations of premium-setting/effect on customers -Review of state agency premiums</p> <p>5th Meeting -Performance audit reviewed -Discussion of market conduct and finance exams -Reviewed MSF budget, business plan, financial plan -Reviewed MSF as state agency</p>	<p>1st Agenda --Review of national, state work comp</p> <p>2nd Agenda -Reviewed cost drivers for premiums, safety, return to work concerns</p> <p>3rd Agenda -Studied return to work, fraud, and medical provider and employer views</p> <p>4th Agenda -Compared MSF, private carrier rate-setting and regulation -Reviewed state funds in other states and other MSF, private carrier differences -Reviewed independent insurance agents' role with MSF, private carriers -Reviewed claims data, incidents</p> <p>5th Agenda -Reviewed MT work comp benefits and various other system issues -Competition for MT state work comp business -Heard reviews by actuaries -Bill discussion</p> <p>6th Agenda -Review of LMAC proposal and EAIC member drafts</p> <p>7th Agenda -Votes on drafts for state choice, change in MSF board, LMAC bill (~ HB 334)</p>	<p>1st Agenda - MT and region premium overview:NCCI</p> <p>2nd Agenda -State Fund structure + options -Old Fund funding options -MSF actuarial reviews</p> <p>3rd Agenda -MSF key points -Decision matrix</p> <p>4th Agenda -MSF view on restructuring -SAO view -PERS view -State agency changes -Nevada case -Old Fund issue</p> <p>5th Agenda -Bill contents</p> <p>6th Agenda -Reviews and public comment - Competition, guaranteed markets, risk pools, cost comparisons (continued)</p> <p>7th Agenda -Legislative oversight -Class codes -Fraud cases -Bill review</p> <p>Final agenda -Bill review</p>
---	---	---	---	---	--

<p>Structure</p> <ul style="list-style-type: none"> state entity/ agency hybrid* private firm guaranteed market <p>*Hybrid means part state agency, part private</p>	<p>MSF prefers:</p> <ul style="list-style-type: none"> being nonstate agency being the guaranteed market (insurer of last resort), having its employees be state employees. <p>There was a question as to whether MSF could build own office w/o OK from legislature</p> <p>*** <i>Proposal retained MSF preferences</i></p>	<p>-Reviewed residual markets, assigned risk plans, and state funds: NCCI info</p> <p>-Two of 9 state funds/ employer mutuals had more market share than MSF, (Rhode Island at 74%. Maine had 54%. Rest were below 33%. MSF in 2002 was 52.5%, according to MSF report. (p 8)</p>	<p>Study focused on different treatments of private carriers and MSF in terms of budget accounting and oversight.</p> <p>*** <i>No proposed change in structure</i></p> <p>*** <i>Introduced SB 60 to require market conduct and financial exams. The bill did not pass.</i></p>	<p>Reviewed what other states do in terms of regulating their state funds. MSF was only state fund regulated strictly by legislature and own Board of Directors. See chart.</p> <p>*** <i>No proposed change in structure except to add insurance management expertise to board, HB 118</i></p>	<p>Considered options from status quo to privatization. See flow chart and matrix. MSF comments</p> <p>*** <i>Proposed moving MSF under regulation of State Auditor with carveouts to keep guaranteed market role. Would remain hybrid agency, not paying premium or income taxes.</i></p> <p>*** <i>Introduced SB 123, which passed, to put MSF under State Auditor oversight</i></p>
<p>Competition</p> <p>Premium Tax, Other Exemptions (punitive damages, class code variations)</p> <p>State book of business listed below as "built-in market"</p>	<p>Would stay exempt from premium and federal/state income taxes and punitive damages.</p> <p>Has coverage by state Torts/Claims Division of D of A for liabilities.</p> <p>Exempt from using certain rate classes, allowed own classes for state, ag, etc.</p>	<p>Information from MSF pointed out that Montana's share of work comp premiums in national market ran at less than 1/2 of 1%. Notes for slides said private insurers wrote more premium in some years prior to 2000, but then the market "hardened" and MSF wrote more premium.</p>	<p>This study included a look at accounting changes that would allow comparisons of private insurers with State Fund, which had to do accounting as a public entity.</p> <p>Studied adding market conduct and financial exams required of other insurers.</p>	<p>Reviewed differences in rate-setting by MSF, private carriers. Heard from Victory Insurance CEO, Liberty representative and MSF CEO.</p> <p>Report on competition and history/addition, HH Index 2010, list of statutes and enacting dates</p>	<p>Retained exemption from premium taxes, income taxes, and punitive damages in part as exchange for being the guaranteed market..</p> <p>*** <i>Proposed change to let all MT insurers use MSF special class codes, thus unifying codes.</i></p>

<p>Regulatory Costs</p>	<p>SAO presented as to exam cost (about \$50,000 every 5 years)</p>	<p>MSF proposed being regulated by State Auditor's Office with exceptions. Proposal was not part of bill that passed.</p>	<p>Addressed indirectly in that MSF did not have regulatory cost of private insurers that the State Auditor requires</p>	<p>Costs for MSF actuarial, audit review (prior to being regulated by State Auditor) MSF response to review costs</p>	<p>2nd fiscal note lists market conduct exam cost every 3-5 yrs of \$768,012 and financial exams over 3 yrs at \$205,400</p> <p>Regulatory costs included in staff briefing paper (pp. 9-10)</p> <p>State interaction</p>
<p>Built-in Market of State Agencies</p>	<p><i>Proposed retaining state agencies in MSF book of business.</i></p>	<p>Proposed that MSF remain sole provider of state agencies' work comp coverage.</p> <p>State agency pricing showed losses for years 1999-2002 and a 34% rate hike in 2003.</p>	<p>Looked at cost of state agency premiums.</p> <p>*** <i>Introduced SJ 10 on state use of MSF. Did not pass.</i></p>	<p>Looked at whether to let state seek bids from other carriers for state agency work comp.</p> <p>Reviewed bill draft on options for state coverage (EAIC OK'd but bill not introduced)</p>	<p>Included in decision matrix, but not made part of eventual SB 123.</p>
<p>Old Fund</p>	<p>Bill (SB 19) to require state to assume liability came in 2002 special session</p>	<p>MSF Financial Report for New Fund / Old Fund</p> <p>Old Fund financials</p> <p>Report on financial transfers - revenue from tax surcharge</p> <p>MSF comments on Old Fund risk financing</p>	<p>Didn't study</p>	<p>-Heard report from Legislative Fiscal on Old Fund costs</p>	<p>Options: Legislative Fiscal report and presentation; Towers-Watson overview</p> <p>Legal review of Old Fund liability (not state debt)</p> <p>Old Fund transfer report</p>
<p>Surplus - Who "Owns" Assets?</p> <p>and does state have any claim?</p>	<p>MSF priority is to protect surplus -Legal opinions of Greg Petesch and Joe Mazurek assets = "public" money</p>	<p>MSF Financial Report indicated in notes a goal of 1.5 to 2 for reserve to surplus (equity) ratio.</p> <p>Consultant report on role of surplus</p>	<p>Report on oversight says MSF is a component unit of the state (for which the state is financially accountable).</p>	<p>Asset ownership not reviewed, but consultant report showed which entity bore cost of insolvency of state fund equivalents.</p>	<p>MSF comments on matrix states assets are owned by MSF.</p>

Pension	MSF employees would stay in state PERS.	Lists pension expenses among other "state" expenses	Didn't study	Didn't study	Letter from PERS actuary on unfunded liability if MSF future hires not in PERS Regulatory change impacts (includes PERS) p. 9 of briefing paper
----------------	---	---	--------------	--------------	--

A look at 2017 bill proposing dissolution of Montana State Fund

[SB 371](#), which did not pass in 2017, provided a novel approach that would have ended State Fund's existence and transferred its book of business to a residual plan called "Plan No. 4". The bill required the Commissioner of Labor and Industry to contract with NCCI to implement and administer Plan No. 4. This approach avoided some of the transfer concerns addressed in previous studies, including how to deal with a constitutional amendment removing reference to the state compensation fund's asset investment; that was because the assets were to be transferred in trust to a mechanism handled by the Department of Labor and Industry to make sure that existing claims were addressed. The bill also would have allowed the legislature to "tap" the asset surplus for some of its own budgetary needs, although one question was whether a lawsuit might result, based on policy language that says the "assets" are those of Montana State Fund. (Table 4 addresses some of the key points of SB 371)

Table 4: Key Points of SB 371 Requiring Montana State Fund's Dissolution and Related Actions

Dissolution	Transfer	Funding
<ul style="list-style-type: none"> Requires Commissioner of Labor and Industry to either choose a new insurer to handle MSF existing claims or pick another contractor. 	<ul style="list-style-type: none"> Plan 2 operators must participate through policy or risk-sharing pool in handling those accounts not picked up by voluntary market, although insurance commissioner "may" decide not to remove a certificate of authority. 	<ul style="list-style-type: none"> Use of residual market to handle MSF claims "runoff" allows Plan 2 or Plan 4 operators to charge expenses as well as claim benefits to the Trust. Not clear if there is oversight.
<ul style="list-style-type: none"> Freezes in place the retirement benefits of existing MSF employees. 	<ul style="list-style-type: none"> Three Plan 2 providers must deny coverage before an employer can be assigned to a Plan 4 in a residual market. Given that MSF as of 2016 had 61.6% of the Montana market, the remaining "likely" insurers were Victory, Liberty, and AmTrust all with less than 10% combined. Of the 219 active insurers that wrote direct premiums in 2016, the remainder were each under 1.5% 	<ul style="list-style-type: none"> The trust would continue to be invested by the Board of Investments. But Legislature can tap into the principal of the trust with a 3/4 vote of each house and can get up to 50% of the income of the trust (less anticipated claim costs + 20%). Current MSF income goes toward surplus or dividends.

<ul style="list-style-type: none"> • Puts reserves and surplus into a 3/4 majority of each house. The trust is to be used for runoff of claims, with incursions allowed on income as well as principal. 	<ul style="list-style-type: none"> • Asset transfers may not be as simple as saying the Dept. of Administration assesses a value and decides if the asset is needed for the trust. • Similarly, if reserves and surplus are MSF money, per contract, can a trust be used, after dissolution, for measures other than claims? 	
--	--	--

Factors behind efforts to change Montana State Fund

Competition -- One of the main reasons given for introducing SB 371 was to encourage competition in Montana's workers' compensation market. Although roughly 272 insurers have certificates of authority from the State Auditor's Office in 2017 to provide workers' compensation in this state, only 79 had direct written premium that was at least one-tenth of 1% of the market. Even fewer companies (29) are involved if the count reflects as one company all those insurers with the same corporate management -- for example, counting all Liberty-affiliated companies as one entity. Further complicating the count of companies is the role played by captive insurers who provide for the parent company a form of self-insurance by setting up a separate company to handle the parent company's affiliates' workers' compensation insurance. These captive insurers may be counted as work comp insurers, but they operate under mostly separate rules In title 33, chapter 28, and unless they operate as association captives, they are limited to writing insurance only for affiliates.

One way of looking at whether Montana's market is attractive is to determine if the top-ranked insurers nationally also are operating in this state and whether their market share here compares with their national ranking. Only Liberty Mutual's share is similar nationally and in Montana. (See Table 5)

Table 5: Market Share of National Workers' Compensation Insurers in Nation and in Montana
(National market data for 2013 from JLT Towers Re; Montana data for 2017)

Companies	Market Share Nationally	Combined firm Montana share
Travelers Group	8.07%	3.24% (3.67% in 2013)
Hartford Insurance Group	6.54%	3.01% (2.11% in 2013)
Liberty Mutual Insurance Cos.	5.95%	5.62% (9.58% in 2013)
American International Group	5.05%	2.02% (2.25% in 2013)
Zurich Financial Services NA Group	4.79%	2.88% (3.03% in 2013)

What this implies is that the market is open enough for 272 companies to participate, which then implies that a noncompetitive market, if one exists, may arise out of separate issues. Usual anticompetitive suspects have included:

- Montana State Fund not having to pay a premium tax, which theoretically should allow MSF to have lower rates than other insurers who have to pay the premium tax; and
- a multi-million dollar built-in book of business achieved through the statutory requirement for the state to obtain its employees' workers' compensation insurance from MSF (see 39-71-403, MCA). In 2006 the state's portfolio amounted to about 8% of MSF's total premium count. As indicated by dividend returns to most, but not all state agencies, the state's portfolio provides mixed opportunities.

- other workers' compensation insurers being able to spread their business risk by having multiple lines of insurance in multiple states, which is a benefit when one particular line faces a hard market.

If the competition is in the pricing, the first component is the need for Plan 2 insurers, the private insurers, to incorporate the loss cost filing done by the National Council on Compensation Insurance (NCCI), the rating organization for Montana. NCCI files the loss costs on which insurers base their rates for various classes of business, determining if their rates will be above or below the NCCI loss cost. Until MSF was placed by SB 123 under the regulation of the State Auditor's Office, MSF did not have to follow NCCI's loss cost filing in its own pricing determinations. For the years 2005 through 2011, NCCI's proposed loss costs that were much higher than MSF's. These loss costs have begun to converge, closer to what MSF has forecast. Dan Gengler of Montana State Fund notes that NCCI develops its loss cost to cover the statewide cost of benefits and claims administration for about 600 different industries or class codes. Montana State Fund develops the same estimate for its own book of business. The loss costs are used as a base and then other expenses and factors are added to develop the rate.

For other impacts or nonimpacts from competition, see Table 6 below.

Table 6: Factors affected by and not affected by competition in Montana's work comp market

Factors in Montana's premium development:	
A: that will not change based on competition	B: that could change based on competition
<ul style="list-style-type: none"> • Low wages 	<ul style="list-style-type: none"> • Claim closure rates. Testimony for SB 371 indicated claim closure rates were higher for non-Montana State Fund insurers in Montana¹ (See handout in testimony for SB 371)
<ul style="list-style-type: none"> • High accident rate 	<ul style="list-style-type: none"> • Increased denial of benefits
<ul style="list-style-type: none"> • Greater than average number of business startups for which there is no experience rating 	<ul style="list-style-type: none"> • Montana State Fund's use of dividends to reward good employer and potentially lower premiums
	<ul style="list-style-type: none"> • Greater selectivity or cherry-picking of good accounts, resulting in higher premiums for less experience-rated, high-risk, or small accounts

Noninterference from Legislature -- From Montana State Fund's perspective, independence from the biennial potential for negative impacts to its operations, policyholders, and injured workers by the

¹Higher claim closure rates are not automatically a good thing. Nor is a lower cost per claim automatically an indication of good practices. Some possibilities for higher claim closure rates are:

- lower cost indicates selectivity in who is signed as a client.
- the potential for a closed claim to be reopened, more than once.
- lack of reserves because of expectations to close claims; if claims then are reopened, an insurer will be using surplus (not reserves) to handle the reopened claims. Claim closure means either that an injured employee:
 - no longer needed care and care was minor enough not to require MMI assessment (maximum medical improvement);
 - was pronounced at maximum medical improvement and no longer in need of care; or
 - had agreed to a settlement.

Legislature has been one appealing aspect of privatization. However, that "plum" has the potential to be a "prune," depending on how changes are made. During the 2013-2014 study, which resulted in Montana State Fund being put under regulation by the State Auditor's Office, MSF sought to retain the guaranteed market role and did not overtly push for more autonomy. Rather, MSF supported SB 123 as a way of demonstrating to the Legislature that oversight of the State Auditor's Office would show that MSF was operating as a financially sound, competitive, and stable insurance company.

Capturing "surplus" funds -- From the executive branch (and perhaps legislative branch) perspective, any time there is a budgetary squeeze finance-oriented personnel look for already-in-the-bank funding. State fund's "surplus," which is the amount of "banked" money intended to make up for unexpected medical inflation, retroactive court decisions, or other unanticipated costs for existing claims, often has been a temptation for legislators and the governor's budget office. MSF can say the money "may be needed" but--as with the money set aside to pay Old Fund claims--the Legislature may see the money as ripe for use in the near term rather than someday. An apparent rationale for "confiscation" is the argument that the state will be, if necessary, on the hook tomorrow but needs the money today. Or, put another way, that, if MSF were to become financially insolvent at some point in the future, the state would be obligated to provide "full faith and credit" for those obligations. However, a complication arises because of language inserted in statute by SB 360 in 2003, in an apparent effort to diminish the temptation of MSF's surplus funds. Passage of SB 360 was in the year that the Legislature removed all of the Old Fund reserves and surplus by requesting legislation that became subsection (2) of 39-71-2316, MCA:

(2) The state fund shall include a provision in every policy of insurance issued pursuant to this part that incorporates the restriction on the use and transfer of money collected by the state fund as provided for in 39-71-2320.

The policy language relies on constitutional support for contracts to strengthen the case for saying all the premiums and other money paid to State Fund belongs to MSF. The policy language references 39-71-2320, MCA, which reads in part:

All premiums and other money paid to the state fund, all property and securities acquired through the use of money belonging to the state fund, and all interest and dividends earned upon money belonging to the state fund are the sole property of the state fund and must be used exclusively for the operations and obligations of the state fund. The money collected by the state fund for claims for injuries occurring on or after July 1, 1990, may not be used for any other purpose and may not be transferred by the legislature to other funds or used for other programs.

Proposals for "modernizing" the system

- Privatization or dissolution of Montana State Fund, meaning in terms of privatization becoming a mutual insurer (owned by member insureds) or a for-profit insurer. Dissolution is self-explanatory.
- Removing MSF from the "guaranteed market" responsibility in favor of using risk pools or assigned risk plans (residual market mechanisms) with or without a "state fund." This also would mean all insurers would pay premium taxes and there would be competition for workers' compensation accounts for state agencies.

Complications for Dissolution or Privatization

- **Constitutional Reference**

Montana State Fund requested through Sen. Fred Thomas's [SB 23](#) in 1999 a constitutional amendment, No. 35, that would specifically reference that state compensation insurance fund assets could be invested in private corporate capital stock. The private corporate capital stock investment could not exceed 25% of the book value of the state compensation insurance fund's total invested assets. (Article VIII, section 13 --

approved in November 2000 by 52% of voters) The question is: if the state constitution holds sway over state compensation insurance fund assets, does that mean these are public/state funds or are they the funds of a "nonprofit public corporation" that can become privatized if the corporation is privatized?

- **Determination of who owns the assets and whether MSF can be sold or be converted to a private mutual insurance company**

MSF's definition is as a "nonprofit, independent public corporation" (see 39-71-2313, MCA). The term "public corporation" is not defined in statute, nor is the term the same as a "nonprofit public benefit corporation", for which Title 50, chapter 4, part 7, describes a dissolution process to recognize the benefits given to nonprofit corporations (e.g. tax benefits), which for-profit corporations do not receive. The dissolution of Blue Cross Blue Shield of Montana as a nonprofit public benefit corporation is a prime example of this section of law being carried out. See also, 50-4-720(5). MCA. regarding distribution of proceeds. However, as a public corporation, Montana State Fund has received income tax and premium tax benefits as well as start-up costs from the state (although MSF has paid back the startup costs) and continues to serve as the insurer of last resort or the "guaranteed" market.

A related question as to who owns Montana State Fund's assets is whether the building that MSF built (using its surplus) would be sold if MSF is sold or whether the state as the ultimate creator of MSF would be entitled to take over those assets to make sure that all claims from existing contracts are paid in full. (Some policyholders might say that the assets ought to revert through dividends to the policyholders, although the distribution would be complicated by current policyholders not necessarily being the same as past policyholders, some policyholders going out of business or being insured with another insurer, or conceivably a policyholder having more claims than they paid in premiums (and investments of the premiums) and, in that sense, not eligible for dividends.

- **Hard market and Montana's position in the national market**

For the past 20 years in general the workers' compensation market has trended downward for premium rates. It is unclear what might happen if less competition is available, insurers go out of business, and the hard market drives premiums upward nationally.

Summary

Numerous studies over the years have moved Montana State Fund toward more independence than when the late 1980s crisis occurred and resulted in splitting of the New Fund and Old Fund as well as a payroll tax to help address the liabilities for claims stemming from injuries due to accidents or occupational disease occurring before July 1, 1990. The current state fund is a state entity with state entity benefits and constraints in some arenas and independence from other agency constraints. Providing a guaranteed market for a system that requires most employers to provide workers' compensation coverage for their employees has been accompanied by various benefits, including nonpayment of the state's premium tax and exemption from state and federal income taxes. The federal income tax exemption also has required that a majority of the board be appointed by the governor and that state law either prohibit dissolution or the assets revert to the state upon dissolution. Adding to the complications of dissolution in Montana is a constitutional provision that requires investment of the state compensation insurance fund assets by a unified investment program.

CI0425 7241pmxa.