MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building * P.O. Box 201711 * Helena, MT 59620-1711 * (406) 444-2986 * FAX (406) 444-3036

Director
AMY CARLSON

DATE: January 1st, 2014

TO: Economic Affairs Interim Committee

FROM: Scot Conrady, Fiscal Analyst

RE: Budget Options for Old Fund Payout – Workers' Compensation Loss Costs

INTRODUCTION

This document will present several options for addressing the Montana State Fund (MSF) Old Fund liability. The MSF Old Fund liability represents future costs that are related to medical and indemnity benefits for accident claims occurring prior to July 1st, 1990. This report will serve to identify some of the issues with financing the Old Fund and list options for the Economic Affairs Interim Committee to consider. The financial and legislative history of the Old Fund will not be reviewed as this perspective has already been well documented[1].

The current actuarial estimate for how much cash will be required to satisfy Old Fund claims from FY 2014 forward is $51 million. The key word in the preceding sentence is estimate. During the Economic Affairs Interim Committee (EAIC) meeting on October 22nd, 2013, other actuarial estimations were provided indicating that the MSF board accepted estimate of $51 million was low. In other words, the final coast could be much higher. This is an important concept for the EAIC to understand in that the final actual number may not be as projected. It may be higher or it may be lower. The committee should consider this fact in the funding options and choose the best option for this uncertainty long term.

FUNDING OPTIONS

Option 1 – "Continue as is" This option uses the current methodology of contributing general fund dollars to pay for annual Old Fund liability costs. The projected schedule of payments, as determined by Towers Watson, can be referenced in Appendix A. The major benefit of this option is that no additional money is spent in transferring the claim costs to a third party and the fact that the claim costs decrease significantly over the next ten years. However, this option yields attrition to the general fund and year-to-year variability on actual costs may be experienced. In this case the structural balance of the general fund is compromised due to a lack of revenue stream.

---

[1] Murdo, Pat, *Montana State Fund History*. Economic Affairs Committee Report, Legislative Services Division, http://leg.mt.gov/content/Committees/Interim/2013-2014/Economic-Affairs/Meetings/October-2013/MSF-history-draft.pdf

Option 2 – "Loss Portfolio Transfer" This option uses a third party to assume the liability of the old fund claim costs and removes the Old Fund from the state's balance sheet. There will be a premium charge related to this transfer. The amount of premium charged to take this debt off the books may be significant. How significant will be dependent on the reinsurer's analysis of the claims and how much final liability is ultimately agreed upon. There is a high probability that the final claim costs in the eyes of the reinsurer will be higher than that of the current MSF board accepted figure of $51 million. Once the final liability is set, the reinsurance provider will assume the liability. It should be noted, however, that in most cases, any increases in costs over the final set liability will be returned to the state. In other words, if the reinsurance policy is set to $60 million, any fees above and beyond $60 million will be returned to the state for payment.

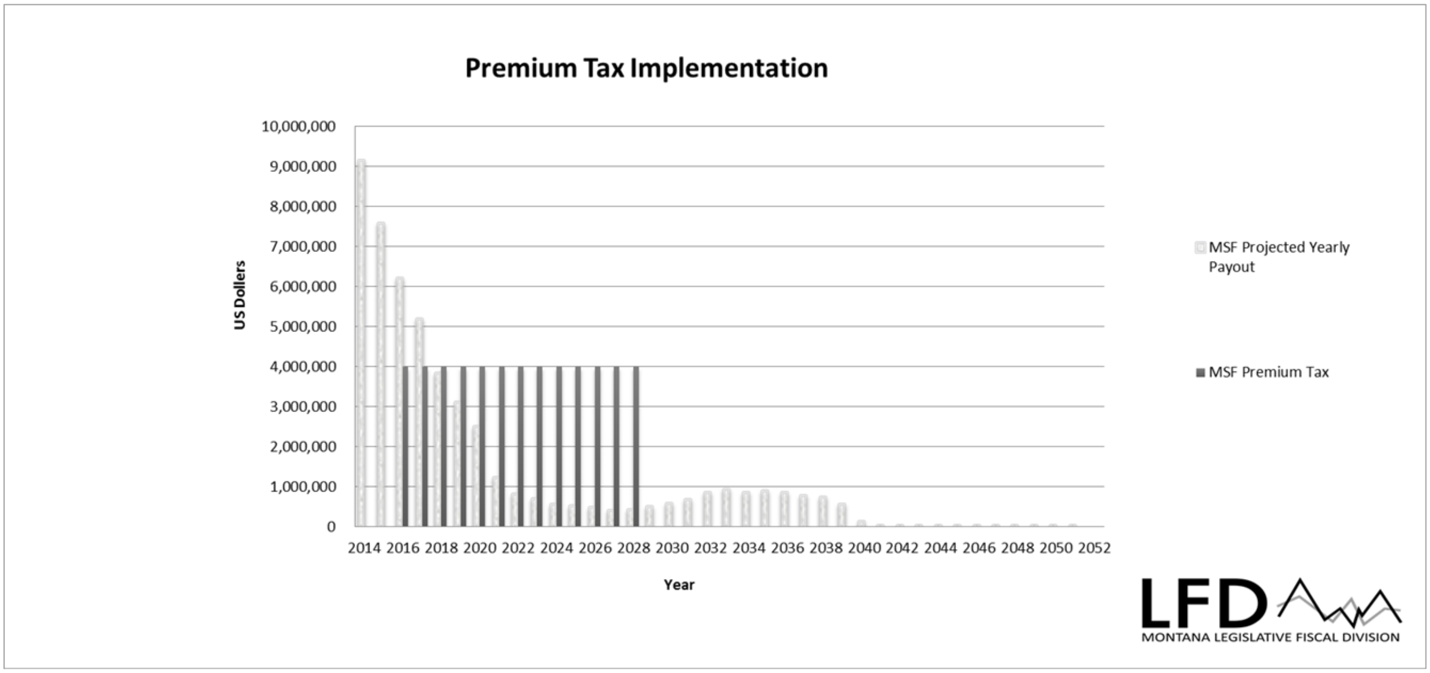
The legislature may consider working an agreement with the MSF to pursue option 2. An agreement could possibly be made to use one time only funds (OTO) to secure and transfer the Old Fund liability back to the MSF. If this were to occur in FY 2016 for example, the legislature would need to transfer approximately $27 million (present value) to the MSF based on current Towers Watson Old Fund cash flow mid estimate.

Option 3 – "Adverse Development Cover" This option uses a third party to cover expenses beyond an expected amount. In the Old Fund case, MSF expects to pay $51 million to settle all Old Fund debt. The state could attempt to purchase insurance that would in essence cover any charges in excess of the $51 million. However, the issue of actual final liability comes into play once again. The reinsurance provider may likely conclude that the state MSF losses are underestimated. This being the case, the provider may not be interested in this situation. In the event that the provider accepts the stated Old Fund liability, a premium would be assessed for this cover.

Option 4 – "Premium Tax and bridge as needed" – This option uses a 2.75 % premium tax based on MSF annual premiums and uses bonds, OTO, or general fund cash to pay the remaining yearly balance if the tax is not sufficient. Currently MSF is exempted from the requirement that insurers pay an annual premium tax of 2.75%. This option assumes that the legislature will eliminate this exemption in the statute to generate additional premium tax revenues.

For FY 2013, MSF premiums brought in $156 million. Imposing the 2.75 % tax on this amount would be approximately $4 million. Figure 1 shows what this would possibly look like assuming a $4 million dollar premium was generated yearly from this tax.

Figure 1



In FY 2014 and FY 2015, the general fund will be required to pay approximately $16.7 million if current projections for yearly loss cost hold true. For FY 2016 and FY 2017, additional bond, general fund, or OTO money would be required to satisfy the projected payout in the amount of $2.2 million and $1.2 million respectively. In FY 2018 forward, the premium tax is sufficient to pay the projected yearly Old Fund payout liability and excess diverted back to GF or bond payments as needed. Option 4 is attractive from a structural balance perspective as this option has a revenue stream.

In considering the premium tax, MSF would be required to assess the impact of this change and provide necessary comment and structure. An understanding of how long the premium tax would be in place would also need to be determined.

There are no simple solutions for removing the Old Fund off the state's balance sheet. The uncertainty of the Old Fund ultimate cost is still prevalent and relevant in assessing which option is best suited.

Appendix A

Towers Watson Old Fund Cash Flow-Mid Estimate

Fiscal Year	Estimated Yearly Payout - TW
2014	9,151,185
2015	7,585,617
2016	6,205,555
2017	5,194,118
2018	3,830,540
2019	3,112,828
2020	2,496,369
2021	1,231,128
2022	812,429
2023	689,824
2024	550,954
2025	509,232
2026	483,191
2027	394,821
2028	424,907
2029	498,875
2030	568,434
2031	668,657
2032	844,668
2033	925,515
2034	861,529
2035	882,327
2036	850,205
2037	780,961
2038	736,977
2039	558,923
2040	119,594
2041	31,867
2042	9,405

2043	**3,151**
2044	**1,238**
2045	**1,105**
2046	**989**
2047	**885**
2048	**795**
2049	**714**
2050	**642**
2051	**578**
2052	**0**