



SJR 27 OPTIONS: WHICH PATH FORWARD FOR MONTANA STATE FUND?

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Economic Affairs Interim Committee
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SUMMARY

The Economic Affairs Interim Committee (EAIC or Committee) has three choices of study on SJR 27, a study of workers' compensation that the Committee has decided will be a study of the future of Montana State Fund. Doing nothing is, of course, an option, but that path does not involve analysis and will not be addressed in this report. However "doing nothing" will be an option after the Committee hears information on the other options. In broad terms those options include:

- Privatization/Mutualization
- Dissolution
- Incremental Changes

This report will outline different study components for each option. The committee may decide to explore several approaches at the same time, with the goal of further narrowing its focus at the February 8, 2018, subcommittee meeting so that future subcommittee meetings will work on analyses and bill drafts related to the selected option.

Privatization/Mutualization

The term privatization encompasses mutualization, but there are differences between the two. Privatization could mean that Montana State Fund as an entity of government is sold to a for-profit or a nonprofit organization. Mutualization means that Montana State Fund retains roughly its current operations but is reformatted as a mutual insurance company owned by its policyholders, rather than being a state entity designated as a nonprofit independent public corporation (whose "ownership" is closely linked to the state). See 39-71-2313 and 39-71-2315, MCA. For the purposes of this paper, a decision to explore privatization and mutualization will entail similar analyses. If the EAIC decides to follow one approach or the other, the distinctions between the two approaches will be made at that point.

Key Decisions

In following the Privatization/Mutualization path, the key decision is to determine who owns Montana State Fund's assets. The ultimate decision may be made by the courts, but the question is critical because the answer points to how the Legislature determines Montana State Fund's future. For example, would the Legislature separate Montana State Fund from state government with all its assets (except possibly requiring contributions to pension and other state-related services that would be disrupted by the severance)? Or would the Legislature be able to "sell" Montana State Fund to an in-state or out-of-state bidder? Alternatively, if the Legislature decided to dissolve the Montana State Fund pursuant to 39-71-2322, MCA, what are the implications?

The question of who owns Montana State Fund's assets is not simple, however, and there are a number of laws that impact the discussion. As an entity formed by state government with general fund money for a public purpose of providing workers' compensation coverage to those employers who cannot get insurance at a reasonable price on the voluntary market, Montana State Fund has operated somewhat under state government's umbrella. Having the imprimatur of state government authority (and a history of money flowing from state government to Montana State Fund and to state government from Montana State Fund) suggests that state government may ultimately "be on the hook" if Montana State Fund is unable to pay claims for injured employees. Additionally, the statutes that created Montana State Fund and that exist today exempted Montana State Fund from being part of the Montana Insurance Guaranty Association created under 33-10-103, MCA. The exemption is tied, in part, to Montana State Fund serving as the guaranteed market, as indicated in 33-1-115, MCA, and part of the trade-off was for Montana State Fund to have higher solvency level requirements than are imposed on private insurers. But,

in essence, not participating in the guaranty association means that there is no backup for paying claims if Montana State Fund could not pay them.

As a creation of statute, Montana State Fund also can be dissolved by statute, which does not resolve the question of “to whom do Montana State Fund’s assets belong”. Another question that dissolution would raise relates to the state determining how to make sure that all employers have access to workers’ compensation insurance, which is required of all employers not exempt under 39-71-401, MCA. For the money question, the Legislature may answer the question one way; the courts another. For the market question, there are options ranging between a guaranteed market and a residual risk market.

Privatization/Mutualization Considerations

The boxes below indicate issues associated with privatization or mutualization. Information on these issues is necessary before bill drafting could occur for either type of change.

Whose Money is it? Issues to Explore

- What have other states (with other constitutions) done as part of a privatization or mutualization of state funds?
- Implications of tax exemption under federal law for serving as a guaranteed market. Would an analysis be possible or helpful of annual federal tax savings and the implications for premiums?
- Review of previous financial data showing Montana State Fund transfers to state’s general fund.
- Review of current statutes and contract concerns related to policyholder contracts that reference 39-71-2316(2) regarding restrictions on the use and transfer of State Fund money in accordance with 39-71-2320 “All premiums and other money paid to the State Fund... are the sole property of the State Fund...”
- Is a constitutional amendment needed to remove references to the state workers’ compensation trust?
- Other?

If Mutualization is Explored, What are the Options?

- Could the state seek to continue a guaranteed market if Montana State Fund were to become a mutual? Have other states done that? A guaranteed market is tied somewhat to a federal tax exemption but the exemption also requires appointment of a majority of the board by the governor, which may not be possible with mutualization (in which policyholders elect the board.) What have other states’ mutual funds done?
- What are the financial implications to Montana State Fund and to the state of mutualization? Who pays whom? Is the company valued similarly as under privatization?
- Other?

If Privatization is Explored, What are the Options?

- If the state transacted a deal for Montana State Fund to become private, how would the company be valued? Who pays whom?
- Would all the past New Fund accounts (for which claims could be reopened) accrue to the new entity or would these accounts become the responsibility of the state (much like the Old Fund) and, if so, who would handle them?
- Other?

Considerations with either Privatization or Mutualization?

- What is the actuarial cost of Montana State Fund pulling its 300+ employees from the Public Employees Retirement System?
- What is the short-term impact on the Board of Investments if the Montana State Fund assets are pulled out? Is there a glide path or transition period needed to mitigate impact?
- What is the expected increase in state revenues if Montana State Fund (and ultimately by its policyholders) started to pay the 2.75% premium tax?
- How would the cost of managing Old Fund claims be calculated and would this task be put out for bid? How long would a contract last and what would be the requirement for continuity of coverage/file management? What are the costs/benefits of loss portfolio transfer as compared with adverse development cover?
- Other?

Dissolution

Senate Bill No. 371 in the 2017 session proposed dissolution of Montana State Fund, with the Department of Labor and Industry (DLI) assigned to handle various duties. Comments prepared for the fiscal note (not officially submitted) by DLI indicated no additional cost because DLI was going to be able to tap the Montana State Fund trust. Maintenance of that state workers' compensation trust fund within the state also meant that no constitutional amendment to Article VIII, section 13, would be necessary to remove references to the "state compensation insurance fund assets."

What was not clear from the proposed fiscal note descriptions was how much a residual market would cost the state or whether the trust fund could be used to pay for anything other than compensation and benefits for injured workers covered by premiums paid by policyholders to Montana State Fund. Those premiums were paid with the expectation, according to policy language, that the money belonged to the "state fund." Could the money in the trust fund be used to pay for the cost of running a residual market, if the state had to contract for a residual market?

Among other considerations that privatization or mutualization pose but that dissolution avoids or ignores were:

- Impacts on PERS of dealing with 300+ employees, most of whom are vested in PERS. An actuarial assessment for PERS by Cavanaugh Macdonald of Kennesaw, Georgia, apparently requested in January 2017 said, "The impact of the Montana State Fund leaving PERS is de minimis as the liability of the Fund is roughly 1% of the total liability of PERS." The rationale was not clearly delineated. A January 2014 estimate by different actuaries of the loss of new Montana State Fund employees in the system showed \$4 million less in expected contributions without future Montana State Fund participants and an unfunded actuarial liability of an additional \$102 million without future Montana State Fund employees being in the system. (See <http://leg.mt.gov/content/Committees/Interim/2013-2014/Economic-Affairs/Meetings/January-2014/MSF-PERS2014.pdf>.)
- Impacts on the Board of Investments. The Board of Investments manages the investment assets of Montana State Fund and, because the trust fund would stay as part of the unified investment program, there would be no large exodus of funds from the Board of Investments under a dissolution scenario.

Among unresolved concerns related to SB 371 was a provision in part of the bill that allowed the Legislature to redirect some money from the trust for other purposes; some SB 371 opponents saw this as contrary to the language in Montana State Fund policies that referenced 39-71-2320, MCA. That statute says the money is to be used “exclusively for the operations and obligations of the state fund.” The 39-71-2320, MCA, statute further states: “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. However, state fund money must be invested by the board of investments provided for in 2-15-1808, and subject to the investment agreement with the board of investments, the earnings on investments are the sole property of the state fund as provided in this section.”

What Legislative Dissolution of Montana State Fund Entails (as in SB 371)

“Dissolution” means:

- Montana State Fund ceases to exist.
- Current claims and claims that may be reopened that were settled by Montana State Fund must be:
 - handled by a third-party administrator overseen by a state agency; or
 - handled by a state agency directly through a setup similar to MSF; and
 - paid for by the reserves and surplus set aside for the claims by MSF (with the state on the hook for any shortfalls, particularly if the state diverts any surplus to its own purposes rather than retaining funds/assets in trust – similar to how the state now is responsible for Old Fund claims.
- Possibility that any diversion of funds may trigger constitutional challenges based on trust language and contract clauses that said the premiums paid and interest on assets belongs to Montana State Fund.
- Setting up an assigned risk pool or an entity contracted to administer accounts that the private market does not voluntarily service (that is, the residual market) and determining how to pay for that plus the TPA if the trust fund is tapped once too often or is otherwise drained.
- Figuring out how to address the shortfall/unfunded liability in the state’s PERS.

Incremental Changes

Across the many studies carried out regarding Montana State Fund, private insurers have contended that several provisions in Montana law tilt the playing field toward Montana State Fund’s best interests. These include:

- Nonpayment of premium taxes
- Not being subject to punitive damages
- Being able to use the Attorney General’s Office to fight fraud complaints (although currently Montana State Fund spends nearly \$400,000 a year to fund the fraud prosecution services in the Attorney General’s Office).

Montana State Fund would argue that the conditions listed above are trade-offs for the following:

- Montana State Fund must insure any business requesting coverage and cannot deny coverage unless the business has not paid its work comp premiums.
- Montana State Fund cannot leave the state if the system becomes unstable as a result of court decisions or legislation.
- Montana State Fund deals with only workers’ compensation and employer liability insurance, which may be written only for Montana. This means Montana State Fund cannot diversify as private insurers can.
- Montana State Fund is not allowed to access financial markets, for example, by issuing debt, if the need arises.
- Montana State Fund is subject to open meetings and public disclosure.
- Montana State Fund is held to higher standards than private insurers for the amount of capital and policyholder equity that must be held.

Dealing with these issues would build on other changes that have taken place over the nearly 30 years that Montana State Fund has operated as a nonprofit, independent public corporation, as provided in 39-71-2313, MCA. While Montana State Fund operated for 6 months as a mutual, the complications at the time related to having emerged from a situation in which liabilities overwhelmed assets by almost \$500 million. The State Auditor's Office normally would shut down an insurer with that kind of (im)balance sheet. But the State Auditor's Office could not shut down a creation of the legislature, approved by the governor. The May 1990 special session ended up separating the Old and the New Fund, starting life for the New Fund with more assets courtesy, in part, of the general fund. Montana State Fund repaid this startup funding for the New Fund in 1996. The latest change that moved Montana State Fund incrementally toward the same requirements as private insurers came in the 2015 session, when SB 123 put the now-solvent Montana State Fund under the State Auditor's regulatory eye, albeit with some carveouts, which included the inability of the State Auditor to revoke Montana State Fund's certificate of authority.

Options for (Some) Incremental Changes

- Allow Plan 2 (private insurers) to compete to provide state agencies with workers' compensation coverage
- Require MSF to pay premium tax either on a graduated timeline or fully at a point certain
- Revise PERS pension participation for new employees.
- Remove MSF from state agency payroll, mail, insurance, and other related aspects of an agency.
- Require MSF to have insurance for punitive damages and specify that MSF is not a state agency for tort purposes.
- Allow mix of stakeholders and governor appointments to Board of Directors.