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Economic Affairs Interim Committee
Pat Murdo, Committee Staff

MONTANA STATE FUND: BOARD MEMBER STATUS AND FEDERAL TAX ISSUE

Current Factors

As a state-authorized provider of Montana's guaranteed market for workers' compensation, Montana State Fund benefits by meeting criteria for exemption of federal income taxes under 26 U.S.C. 501(c)(27)(B). In short, the criteria include:

- Creation by state law to provide workers' compensation;
- Serving as the guaranteed market;
- State backing, either through the state providing its full faith and credit behind the organization or having provided the initial operating capital of the organization, which includes either that the assets of the organization revert to the state upon dissolution or state law does not allow dissolution; and
- Appointment of a majority of the board of directors by the governor or other executive branch official or by the Legislature or both.

Board member composition is described in statute. One of the suggestions made at the February 2018 Economic Affairs Interim Committee meeting by State Auditor Matthew Rosendale was for a board member to include a financial expert. Current law provides the following requirements for the seven-member board under 2-15-1019(5):

- At least four of the seven members shall represent state fund policyholders and may be employees of state fund policyholders.
- At least four members of the board shall represent private enterprises.
- One of the seven members may be a licensed insurance producer.
- One of the seven members must be a person with executive management experience in an insurance company or executive level experience in insurance financial accounting.
 - A member of the board may not, except for the licensed insurance producer member, represent or be an employee of an insurance company that is licensed to transact workers' compensation insurance under compensation plan No. 2 and may not be an employee of a self-insured employer under compensation plan No. 1.

Recommendation

The State Auditor's Office provided a recommendation for financial expertise on the board as part of the first financial examination performed after Montana State Fund was put under the regulatory authority of that Office as of January 2016. That financial examination also recommended that board members sign conflict of interest statements. Presumably the board of directors already is subject to the code of

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ethics spelled out in Title 2, chapter 2, part 1, which includes under the definition of “state agency” all executive boards.

Implications for Future Actions

The financial examination highlights board member appointments/status as a potential for future discussion. Under the Senate Joint Resolution 27 study of State Fund, the options listed in the table below are possible for different scenarios.

Board/ Other Factors	Moderate Change Retaining Short-Term State Status	Mutualization	Dissolution
Board appointments	Provide for 4 appointments by governor, 3 by policyholders as a way of moving toward mutualization. This would allow retention of the tax exemption, if other factors stayed the same.	Date-certain transition, allowing current board to operate until after elections by policyholders. Upon formation as a mutual, a policyholder-elected board mean no federal tax exemption.	Not applicable except for the question of whether the federal government could reach back for past income tax based on the state law not applying to dissolution.
Inclusion of one board member with financial expertise	The appointment might be considered. One concern is the difficulty of finding appropriate “volunteers” for the role.	This provision increases in importance once the Board of Investments no longer handles investments; at that point the board would not be appointed by the governor. Montana State Fund notes this recommendation relates to membership on the audit committee, which currently is the full board. An independent corporation could design its structure with this best practice.	If Montana State Fund were to be dissolved, this recommendation would be moot.
Serving as a Guaranteed Market	The income tax exemption criteria could be met by changing how appointments are made by the governor or other elected executive or legislative officials and retaining the guaranteed market requirement.	The requirement for a federal income tax exemption extends to a mutual insurer that provides the guaranteed market. A question is whether the state’s financial commitment or dissolution protection would be required per 26 U.S.C. 501(c)(27)(B)(iii).*	This issue would be addressed by legislation determining how to deal with the residual market (those policyholders not able to buy on an open market at a reasonable price.)

*An organization is exempt under 26 U.S.C. 501(c)(27)(B)(iii) if it is a guaranteed market for workers’ compensation and: (I) the State makes a financial commitment with respect to such organization either by extending the full faith and credit of the State to the initial debt of such organization or by providing the initial operating capital of such organization, and (II) in the case of periods after the date of enactment of this subparagraph, the assets of such organization revert to the State upon dissolution or State law does not permit the dissolution of such organization, and ...