DRAFT 2018

Economic Affairs Interim Committee
Pat Murdo, Staff Researcher

**FINAL REPORT TO THE 66TH MONTANA LEGISLATURE**

# THE FUTURE OF MONTANA STATE FUND: AS REFERENCED BY THE SJR 27 STUDY

# ECONOMIC AFFAIRS INTERIM COMMITTEE MEMBERS

Before the close of each legislative session, the House and Senate leadership appoint lawmakers to interim committees. The members of the Economic Affairs Interim Committee, like most other interim committees, serve one 20-month term. Members who are reelected to the Legislature, subject to overall term limits and if appointed, may serve again on an interim committee. This information is included in order to comply with 2-15-155, MCA.

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*Rep. Nate McConnell of Missoula started the interim as a member of the Economic Affairs Interim Committee but was named as a senator early in 2018 and his "representative" spot was then assigned to Rep. Lynch.

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# SUMMARY

This report is a summary of the work of the Economic Affairs Interim Committee's 2017-2018 study under Senate Joint Resolution 27, as outlined in the Economic Affairs Interim Committee's 2017-2018 work plan and Senate Joint Resolution 27 (2017). Members received additional information and public testimony on the subject, and this report is an effort to highlight key information and the processes followed by the Economic Affairs Interim Committee in reaching its conclusions. To review additional information, including audio minutes, and exhibits, visit the Economic Affairs Interim Committee website: www.leg.mt.gov/eaic.

# RECOMMENDATIONS

The Economic Affairs Interim Committee chose to devote most of its time to the SJR 27 study of Montana State Fund and workers' compensation in Montana. After spending three meeting days and portions of at least two other meetings on the subject, the Economic Affairs Interim Committee determined the following:

- Montana State Fund serves an important role as the guaranteed market in a state where the majority of workers' compensation policyholders pay less than $5,000 in premiums a year.
- Montana State Fund, as a quasi-governmental nonprofit corporation that competes with private insurers, ought to be free of certain state controls, such as the requirement to procure supplies and information technology using state-controlled tools.
- Removing a requirement for the state to obtain workers' compensation insurance only through Montana State Fund may benefit the state by allowing competitive bids for its book of business and may help level the playing field by letting private insurers compete for state business. The committee specified that the state book of business could not be separated among insurers.
- The many small or high-risk employers that are unable to get competitively priced workers' compensation insurance in the private market and that rely on Montana State Fund as a provider of guaranteed workers' compensation coverage in this state benefit from the federal income tax and state premium tax advantages that Montana State Fund receives because of its role as a guaranteed provider of workers' compensation.
- Allowing Montana State Fund policyholders to vote for three members of the seven-member board of directors moves Montana State Fund toward a business model that is more like that of a mutual insurer but still maintains the structure of a majority of its board being appointed politically, which allows Montana State Fund to benefit from a federal income tax exemption.
- Making major changes in the way that Montana State Fund operates would result in various impacts that a majority of the Economic Affairs Interim Committee is not ready to propose, although the members recognize that individual legislators may find that desirable.
- The best way to lower workers' compensation costs is by preventing accidents, which means that employers and employees ultimately hold the key to achieving a safe work environment; legislation alone cannot force businesses to have a safe workplace or employees to act safely.

- The following concepts should be adopted as committee bills:
  - Allowing Montana State Fund additional independence as related to procurement and oversight of the state information technology requirements (LCMSF1)
  - Allowing the state of Montana a choice in insuring agencies for workers' compensation (LCMSF2)
  - Allowing policyholders to elect some of Montana State Fund's directors (LCMSF3).

# Table of Contents

# SJR 27: THE FUTURE OF MONTANA STATE FUND

## OVERVIEW

Early in the interim, the 2017-2018 Economic Affairs Interim Committee decided that the whole committee would meet separately as a subcommittee when studying Senate Joint Resolution 27. That allowed all members of the committee to hear the information that was being presented. Additionally, the Economic Affairs Interim Committee decided to devote the major time in its work plan to the SJR 27 study and to focus on Montana State Fund and learning what options were available for making sure that workers' compensation insurance was available in the state.

Recognizing that the Senate Joint Resolution 27 study of Montana State Fund was the most recent of numerous studies, the Economic Affairs Interim Committee first asked for information on those other studies. Common elements from past studies formed the basis for SJR 27 topics. Among these was a focus on how—if State Fund no longer is the guaranteed market—coverage would be provided to employers whose small size or accident history made them unattractive to private workers' compensation insurers. Competition also was a focus as was the question of whether changes in State Fund's structure would increase or decrease premium rates. Finally, the review included possible impacts of dissolution or privatization of State Fund not only on State Fund but on the state and on employers in Montana who had relied on State Fund either as a first choice or as an insurer of last resort.

### Reports and Presentations

The three themes around which reports and presentations evolved were: (1) whether to retain State Fund's current status or modify how State Fund operates within state government, (2) privatize State Fund or allow State Fund to become a mutual insurer operated by its policyholders, or (3) dissolve State Fund.

Background briefing papers and other information incorporated some of the information provided in past studies, updated some of that information, and offered new analysis of related topics. Presentations generally followed the same approach, using a wide exploration of how the structure of workers' compensation operates in Montana followed by the specific role played by State Fund.

Committee members reviewed these options:
**(1) Continue as is (or maybe modify);**
**(2) Privatize;**
**(3) Dissolve.**

#### Briefing Papers and Background Information

Staff provided briefing papers either at meetings or in a three-ring binder that provided background information related to workers' compensation and State Fund. The briefing papers also were posted on the Economic Affairs Interim Committee website under SJR 27 Committee Topics. The topics were grouped loosely into general background, issues related to dissolution of State Fund, and issues related to incremental changes.

# SJR 27: THE FUTURE OF MONTANA STATE FUND

## General Background

- Statutes related to State Fund's Ownership of Assets. This included a copy of language added to Montana State Fund policies regarding State Fund's ownership of "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… ."
- The reference in Montana's Constitution, Article VIII, section 13, to investment of state compensation insurance fund assets and compiler's notes of the history of the reference.
- An overview of past studies related to State Fund (see more under "Presentations").
- A legal analysis of the State Fund building at 855 Front Street in Helena as an asset investment not subject to the state's long-range building program criteria.
- A legal review by State Fund's then chief legal counsel of the ability of State Fund to purchase a parking garage owned by the City of Helena and adjacent to the State Fund building. The summary said: "Montana State Fund may own property that is acquired through its own funds." The Economic Affairs Interim Committee's staff attorney provided legal analysis as did an outside firm contacted by State Fund.
- A briefing paper on State Fund's historic cash flows, including the flow of money to and from the state related to the Old Fund, which included reserves bolstered by an employer and employee payroll tax to help stabilize an Old Fund that at one point had nearly a $500 million shortfall in assets to handle its outstanding claims.
- Information related to whether Montana's workers' compensation situation is unique. This included information from the 2016 Oregon Study of Workers' Compensation, presented by Department of Labor and Industry researchers at the Feb. 28, 2018, meeting of the subcommittee on SJR 27 (see more under "Presentations").
- A review of legal challenges in other states (see more under "Presentations") and a briefing paper on the path taken by selected other states that made their state funds into mutual insurers.
- Background material provided to the committee with both a current and a historic look at costs and issues related to State Fund being an entity of state government and what would happen if State Fund no longer was part of state government. These materials included potential impacts seen by the Department of Administration in 2014, with the State Fund assessment, and in 2018, with a State Fund response and a related graphic.
- A copy of the lawsuit that was filed by State Fund policyholders against State Fund and the state because of Senate Bill 4 in the 2017 special session, which took approximately $15 million in each year of the FY 2019 biennium for Board of Investment management fees, above the amount already paid. Because the lawsuit contends the money is that of policyholders and not something that the state can access, the interim discussion about whether State Fund's surplus could be tapped by the state lapsed into lawsuit limbo.
- Information on costs to the state of paying Old Fund claim benefits.
- A 2014 actuarial analysis, which is the only report done to date, regarding projected differences in the state's self-insuring workers' compensation, continuing to have policies with State Fund, or going to private sector, also called Plan 2, insurers.

**After a lawsuit was filed following 2017 special session actions, the SJR 27 discussion on whether Montana State Fund's surplus could be tapped by the state lapsed into lawsuit limbo.**

- A description of State Fund board member appointments and the role the appointments have in meeting criteria for a federal income tax exemption given providers of a workers' compensation guaranteed market.
- A briefing paper incorporating various coverage and benefit differences among selected states, explaining that not all states have the same independent contractor exemptions, require fee schedules for health care practitioners involved in workers' compensation claims, or pay the same for temporary or permanent total disability claims. A spreadsheet incorporated information provided by the Department of Labor and Industry regarding workers' compensation system components in various states.

### Dissolution

- Senate Bill 371, introduced in the 2017 session, which would have dissolved State Fund and assigned assets and management responsibility to the Department of Labor and Industry.
- Fiscal information projected from SB 371 as prepared by the Department of Labor and Industry and by State Fund.

### Incremental Changes

- Projected impact of a premium tax on State Fund, based on a fiscal note prepared for Senate Bill 11 in the 2017 special session.
- The most recent calculation of State Fund dividends issued in 2017 for policies held by state agencies from July 2014 to June 30, 2015.
- A 2008 Finance Committee report on other state agency workers' compensation policy options and a 2010 response from State Fund and separately from the Department of Administration to the Economic Affairs Interim Committee studying State Fund and other workers' compensation issues.

**Briefing papers and presentations ranged from broad system overviews to impacts on state budgets and state employees if the Legislature changed the state's workers' compensation structure.**

## Presentations

**September 2017**

- Staff presented an overview of past studies of State Fund.

**November 2017**

- Members received an options paper for moving forward. This was similar to the decision chart later provided but minimally discussed at the February meeting.
- Deputy State Auditor Nancy Butler, who previously had been chief legal counsel at State Fund, provided an overview of the workers' compensation system in Montana, including information on: Plan 1, the self-insured employers; Plan 2 or the private insurer market; and Plan 3, State Fund. Her presentation also briefly touched on regulation plus claims and benefits.
- Discussing how other states continued to provide a guaranteed market after changing their State Funds into mutual insurers was Bruce Hockman, a consultant who has worked in the past with State Fund.

- Presenting alternatives for how states cover employers who are in what is called the residual market, all those employers not receiving policy offers in the voluntary market, was Cliff Merritt, director of reinsurance for the National Council on Compensation Insurance (NCCI).

**February 2018**

- An overview explained what happened when the Legislature allowed Montana University System to run its own workers' compensation program instead of using State Fund and when university employees were allowed to change their pension system, thus creating concerns about actuarial soundness in the pension system they were leaving. The experience was to draw some relationship to the idea of pulling State Fund employees from the Montana Public Employees' Retirement System and the impact that might have on the MPERS actuarial status.
- Reviews of the share of state costs borne by State Fund included information from both the Department of Administration and State Fund. An attachment showed the various areas in which State Fund interacts with the state government or state agencies.
- An actuary hired by MPERS provided a letter estimating what the cost would be to avoid shortchanging MPERS if all the State Fund employees were no longer state employees. The committee had a similar 2014 letter from an actuary asked to estimate costs to the system if future State Fund hires no longer were allowed to participate in MPERS.
- Department of Labor and Industry analysts provided information on the Oregon Study, which provides a national comparison of workers' compensation premium rates in each state and uses Oregon information as the starting point. While cautioning that the often-used data, which most recently showed Montana as having the 11th highest premiums in the nation (in 2016), had some shortfalls, the analysts also pointed out areas of comparison and areas in which comparison might be on less solid ground particularly because each state's economic factors vary, which influences workers' compensation costs.
- A Department of Labor and Industry epidemiologist provided a reminder to committee members that Montana's high fatality and accident rates are one of the reasons workers' compensation costs are high in Montana. She provided both a fact sheet and a presentation.

**Montana's ranking in the Oregon study has gone from among the worst five states in the nation for premiums to 11th in 2016. But analysts caution that blanket comparisons miss key economic details like needing more premium if payroll is low.**

**April 2018**

- A presentation from the State Auditor reviewed the role of that office in regulating State Fund and all workers' compensation insurance, particularly for reviewing rates, reserves, and surplus to make certain the insurers are able to pay claims and have sufficient risk-based capital. Also provided to the Economic Affairs Interim Committee were a copy of the 2017 examination report conducted by the State Auditor's Office on State Fund and a list of 89 of the most active workers' compensation providers in Montana and their market share here.

- Information from a group called Fair Montana that backs structural reform of Montana's three-plan system (Plan 1 of self-insurers, Plan 2 of private insurers, and Plan 3 of State Fund). The presentation included attachments and letters of support for system changes from two former NCCI officials and a Montana third-party administrator.
- Background information from NCCI on rate differentials in the residual market, which serves employers whose workers' compensation policies are not voluntarily written in the competitive market. NCCI representatives also provided information on residual market mechanisms, maps of which states offer what types of coverage, and how NCCI sets the basic loss cost information on which all insurers base their premium rates. An overview included an explanation of the components for loss costs and manual rates, which are those filed by workers' compensation insurers.

## Study Origins

During the 2017 Legislature, the Senate Business, Labor, and Economic Affairs Committee heard SB 371, which proposed to dissolve Montana State Fund without preamble and, initially, upon passage and approval. The existing workers' compensation claims held by Montana State Fund would have been assigned to the Department of Labor and Industry to administer, whether by contracting with a third-party administrator or hiring personnel to do the job in-house. Nothing was specified; information prepared for a fiscal note by the Department of Labor and Industry did not reflect costs of hiring new staff.

One thesis behind SB 371 was that private insurers and the use of an alternative to a guaranteed provider of workers' compensation insurance would move Montana's system of workers' compensation toward a model used by a majority of other states. Another theory was that dissolving Montana State Fund would lower average rates. Additionally, backers of SB 371 implied that Montana State Fund's current premiums were higher than they needed to be, in part because their analysis indicated Montana State Fund claims were open longer than many other insurers' workers' compensation claims and that Montana State Fund's costs were higher as a percentage of premiums. Some of these issues are discussed later under "Other Data Points."

The SJR 27 study sought to explain residual markets, look at premium components, and address State Fund operations.

Those opposed to SB 371 countered that the state's overall mix of small businesses and high-risk enterprises is not replicated in other states so that general comparisons of open claims, premiums, and overall costs were off-kilter. The concern voiced by opponents was that a big change in the system might not result in lower costs and might throw the small businesses and high-risk employers into an even higher-cost residual market.

As a result of the interest generated by SB 371, questions arose about residual markets and what they would be, what components really impacted premium rates, and whether changing the structure of the system in Montana would hurt or help employers. To find out some of the answers to these questions, the Senate Business, Labor, and Economic Affairs Committee decided to table SB 371 and, instead, move forward with a study of workers' compensation. Assigned in mid-2017 to the Economic Affairs Interim Committee by Legislative Council, the Senate Joint Resolution 27 study became primarily about Montana State Fund's future. Legislators learned early that the SJR 27 study was just the latest in a long line of studies that began just a few years after creation of Montana State Fund as a nonprofit, independent public corporation, first as a mutual domestic insurer in 1989 and then in May 1990 as the entity that exists today. The ensuing study sought to explain residual markets, look at premium components, and address myriad other factors critical to a change in systems, whether through dissolution or privatization of State Fund.

## State of Montana's Workers' Compensation Market

Montana's workers' compensation market consists of self-insurers (Plan 1), private insurers (Plan 2), and Montana State Fund (Plan 3), which is the guaranteed provider of workers' compensation. All plans use the same benefit structure, which the Department of Labor and Industry oversees. If mediation between the injured employee and the insurer is necessary, the Department of Labor and Industry supplies mediators. The workers' compensation court is attached to the Department of Labor and Industry as well.

In the "old days" of workers' compensation in Montana prior to 1987, a unit of the Department of Labor and Industry served as the Plan 3 guaranteed provider of workers' compensation; the department also oversaw the injured workers' benefit system. However, a nearly $500 million liability developed when political pressure ended up keeping premiums artificially low, according to most reviews of how the "Old Fund" liability developed. With creation of Montana State Fund as a separate entity operating under a board appointed by the governor but not tied to the Department of Labor and Industry, the current structure made Montana State Fund the insurer of last resort while the department handled tracking of uninsured employers, claim complaints, and appropriate application of benefits across all plan types. The Department of Labor and Industry also compiles data ranging from claim payouts to most frequent types of injuries.

In 6 years, Montana's workers' compensation premiums went from 63% above the median to 14% above.

The following tables provide background information related to Montana's ranking in the biennial Oregon Study since 2000, the market share fluctuations since 2008, and the changes in number of claims since 2008. The year 2000 is not magical except that it represents 10 years of experience under the 1990 legislative changes that made Montana State Fund essentially the type of state-related insurer that it is today. The year 2008 gives 10 years of recent data.

### Oregon Study

The Oregon Study compiled by that state's Department of Consumer and Business Services receives some criticism in Montana for its Oregon-centric approach, but the study remains a consistent tool for comparing workers' compensation premiums over time in all 50 states plus the District of Columbia. In addition to ranking which states have the highest and lowest premiums, the study also shows how states over time have improved, based on the index rate of premium to $100 of payroll. Table 1 below shows changes in Montana's ranking under the Oregon Study over time along with its ranking among all states and the District of Columbia.

Table 1 takeaways (other than Montana's swings from number 12 ranking in 2000 to worst premium ranking in 2010 to number 11 ranking in 2014 and 2016):

- Between 2014 and 2016, Montana's index rate of premium to $100 worth of payroll dropped 5%.
- In 2006, Montana's premium to $100 payroll was $1.21 higher than the national median, but in 2016 that premium to $100 payroll differential with the national median dropped to 26 cents.

**Table 1: Oregon Rankings for Montana by Premium and Index Change, 2000-2016**

| | 2000 | 2002 | 2004 | 2006 | 2008 | 2010 | 2012 | 2014 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| **Premium Ranking** (lower #=higher premium) | 12th | 9th | 8th | 5th | 2nd | 1st | 8th | 11th | 11th |
| **Premium/$100 payroll** | $2.75 | $3.05 | $3.41 | $3.69 | $3.50 | $3.33 | $2.50 | $2.21 | $2.10 |
| **Premium/payroll** (based on median nationally) | n/a | n/a | n/a | $2.48 | $2.26 | $2.04 | $1.88 | $1.85 | $1.84 |
| **Percent of study median** | n/a | n/a | n/a | 149% | 155% | 163% | 133% | 119% | 114% |
| **Highest premium/payroll** | $4.08 | $5.23 | $6.08 | $5.00 | $3.97 | $3.33 | $3.01 | $3.48 | $3.24 |

Source: Oregon Department of Consumer and Business Services, compiled every 2 years.

## Market Share Fluctuations

While there are 220 or so companies authorized to write workers' compensation insurance in Montana, some of these are part of an insurance "group" and, as such, do not compete directly with members of their own group. Thus, there are not 220 competitors. For 2017, the Montana workers' compensation market had about 90 groups or individual insurers writing policies, although some wrote just for a special interest group like pharmacists or contractors. Typically, fewer than 20 insurers or insurance groups write at least $1 million worth in the not-quite $300 million direct written premium market in Montana ($287.6 million direct written premiums in 2018), representing about 95.6% of the market. Those writing more than $1 million have increased over time, whether due to inflation or more competition. The order shown in Table 2 is based on 2017 rankings.

Self-insuring firms pay 18% of workers' comp benefits but are not counted in reports of workers' comp insurers' market share.

**Table 2: Montana's Workers' Compensation Market Share, Plan 2 and Plan 3, 2008-2017***

| (insurer order is based on 2017 rankings) | **2008** *Direct Written Premium /Market Share* | **2009** *Direct Written Premium/ Market Share* | **2010** *Direct Written Premium/ Market Share* | **2011** *Direct Written Premium/ Market Share* | **2012** *Direct Written Premium/ Market Share* | **2013** *Direct Written Premium /Market Share* | **2014** *Direct Written Premium/ Market Share* | **2015** *Direct Written Premium/ Market Share* | **2016** *Direct Written Premium /Market Share* | **2017** *Direct Written Premium /Market Share* |
|---|---|---|---|---|---|---|---|---|---|---|
| MT State Fund, Plan 3 | $231.2 **67.2%** | $192.4 **63.1%** | $178.6 **61%** | $164.4 **59%** | $153.4 **57.4%** | $165.4 **60.1%** | $170.9 **60.5%** | $176.0 **61.4%** | $177.0 **61.6%** | $172.3 **59.9%** |
| All Plan 2 | **32.8%** | **36.9%** | **39%** | **41%** | **42.6%** | **39.9%** | **39.5%** | **38.6%** | **38.4%** | **40.1%** |
| Liberty Mutual Grp | $51.1 / 45.5% | $47.2 / 39.9% | $43.1 / 37.7% | $40.6 / 35.2% | $38.4 / 33.8% | $26.4 / 24.5% | $19.5 / 17.5% | $20.8 / 18.6% | $16.4 / 5.7% | $15.9 / 5.5% |
| Victory Insurance | $2.5 / 2.2% | $4.3 / 3.6% | $5.1 / 4.5% | $4.8 / 4.5% | $7.4 / 6.5% | $10.7 / 9.9% | $11.0 / 9.9% | $11.4 / 10.2% | $11.0 / 3.8% | $12.5 / 4.3% |
| | 0.73%** | 1.41%** | 1.75%** | 1.73%** | 2.77%** | 3.89%** | 3.89%** | 3.98%** | 3.81%** | 4.31%** |
| Zurich Insurance Grp | $9.0 / 8.0% | $11.8 / 10.0% | $11.4 / 10.0% | $10.5 / 9.9% | $9.2 / 8.1% | $8.3 / 7.7% | $11.6 / 10.4% | $9.2 / 8.3% | $8.3 / 2.9% | $11.3 / 3.9% |
| AmTrust NGH Group | $3.4 / 3.0% | $5.3 / 4.5% | $5.3 / 4.6% | $4.4 / 4.1% | $5.2 / 4.6% | $6.4 / 6.0% | $9.8 / 8.8% | $11.3 / 10.1% | $10.9 / 3.8% | $11.2 / 3.9% |
| Travelers Group | $5,0 / 5.3% | $6.8 / 5.7% | $7.1 / 6.2% | $7.1 / 6.6% | $9.4 / 8.3% | $10.7 / 9.9% | $11.1 / 10.0% | $9.5 / 8.5% | $9.3 / 3.2% | $10.1 / 3.5% |
| Hartford Fire &Casualty Grp | $5.8 / 5.1% | $6.2 / 5.2% | $7.0 / 6.2% | $5.7 / 5.4% | $6.0 / 5.3% | $5.8 / 5.4% | $5.8 / 5.2% | $6.4 / 5.8% | $8.7 / 3.0% | $7.95 / 2.8% |
| Employers Holdings Grp | $4.7 / 4.2% | $4.8 / 4.1% | $5.4 / 4.8% | $6.1 / 5.7% | $7.1 / 6.3% | $8.4 / 7.8% | $7.9 / 7.1% | $8.3 / 7.4% | $7.9 / 2.7% | $7.8 / 2.7% |
| American Internat'l Grp | $13.0 / 11.5% | $14.8 / 12.5% | $12.6 / 11.0% | $7.9 / 7.4% | $7.7 / 6.8% | $6.2 / 5.8% | $6.9 / 6.2% | $5.0 / 4.5% | $.8 / 2.0% | $6.7 / 2.3% |
| Chubb Ltd. Group | $1.9 / 1.6% | $2.7 / 2.3% | $3.7 / 3.2% | $2.3 / 2.2% | $1.2 / 1.0% | $1.4 / 1.3% | $1.6 / 1.4% | $1.6 / 1.4% | $3.3 / 1.1% | $3.3 / 1.1% |
| Western Nat'l Mutual Group | | | | <$0.2 or n/a | $1.2 / 1.1% | $2.7 / 2.5% | $3.0 / 2.7% | $3.6 / 3.3% | $3.6 / 1.3% | $3.1 / 1.1% |
| Associated Loggers Exch. | $2.0 / 1.7% | $1.4 / 1.1% | $1.6 / 1.4% | $1.9 / 1.8% | $2.5 / 2.2% | $2.6 / 2.4% | $2.8 / 2.5% | $2.8 / 2.5% | $2.6 / 0.9% | $3.1 / 1.1% |
| WR Berkley Corp. Group | | | | $0.4 / 0.4% | $0.9 / 0.8% | $1.3 / 1.2% | $1.5 / 1.3% | $1.7 / 1.6% | $1.8 / 0.6% | $2.1 / 0.7% |
| Berkshire Hathaway Grp | | $0.1 / 0.1% | $0.2 / 0.2% | $0.4 / 0.4% | $0.3 / 0.3% | $0.8 / 0.7% | $0.7 / 0.6% | $1.5 / 1.3% | $1.6 / 0.6% | $1.8 / 0.6% |
| Farmers Insurance Grp | | | | | | $1.4 / 1.3% | $1.3 / 1.2% | $1.3 / 1.1% | $1.5 / 0.5% | $1.5 / 0.5% |
| Old Republic Group | $0.8 / 0.7% | $0.7 / 0.6% | $0.5 / 0.5% | $1.2 / 1.1% | $0.3 / 0.3% | $0.9 / 0.9% | $0.5 / 0.5% | $0.7 / 0.6% | $1.6 / 0.6% | $1.5 / 0.5% |
| Church Mutual Group | | | | | $0.2 / 0.2% | $0.6 / 0.5% | $0.9 / 0.8% | $1.1 / 0.9% | $1.0 / 0.4% | $1.5 / 0.5% |
| Starr Group | | | | | | $0.3 / 0.2% | $0.4 / 0.4% | $0.2 / 0.2% | $0.6 / 0.2% | $1.2 / 0.4% |

* For 2008 through 2015, the Montana State Fund market share is as reported by the Department of Labor and Industry in its Workers' Compensation Annual Report. Direct Written Premium is in millions. Prior to 2016, Montana State Fund was not regulated by the State Auditor's Office, which did not report its data to NAIC. The 2016 and 2017 market share shows all of the market. Prior to 2016, the percent of market for Plan 2 insurers is the share of the Plan 2 market. The insurers with blank boxes have either less than $200,000 direct premium or were not in Montana in that year.

**These percentages for Victory Insurance reflect the portion of the entire Montana workers' comp market, not just the Plan 2 market in the row above.

Sources: The National Association of Insurance Commissioners and for 2008-2015 State Fund market share, the Department of Labor and Industry.

Table 2 takeaways include:

- Montana State Fund's market share has fallen from 67% in 2008 to nearly 60% in 2017.

- Victory Insurance Co., the only other Montana-based workers' compensation insurer, hit market share highs of about 10% among private insurers in 2013-2015, behind Liberty Mutual companies and generally in the top four of private insurers in the state during those years.
- The number of workers' compensation insurers that write more than $1 million in direct written premiums has increased over time, indicating a more competitive market in some ways and less market share by the private insurers, such as Liberty Mutual Group, which in 2008 wrote almost 50% of the Plan 2, private workers' compensation insurance market, in Montana. In the last year in which Montana State Fund is not reflected in the market share provided by the National Association of Insurance Commissioners (2015), Liberty Mutual Group's market share had dropped below 20%.

Less obvious in Table 2 is how market share fluctuates because of the overall economy or because of corporate decisions to refocus attention on markets in other states (said to be one of the reasons that Liberty Mutual's market share dropped in Montana). A state like Montana with high work-related accident rates and small population, among other factors, is not always the ideal draw for workers' compensation insurers.

Also not reflected in Table 2 are the impacts of self-insurers who may cover workers' compensation benefits on a pay-as-you-go basis, without paying premiums to a separate insurer. Self-insurers are not included in any of the premium data in Table 2 above, but information compiled by the Department of Labor and Industry shows that the self-insurers, as Plan 1, paid roughly 18% of all workers' compensation benefits in Fiscal Year 2016. The Department of Labor and Industry's annual workers' compensation reports also show that gross annual payroll reported by Plan 1 employers grew from $3.24 billion in 2011 to $3.9 billion in 2017 (calendar years). Additional Department of Labor and Industry estimates for Plan 2 and data for Plan 3 show payroll growing from $2.4 billion for Plan 2 insurers in 2014 to $2.765 billion in 2017 (up 15%), with Plan 3 payroll up slightly (2%) from $5.04 billion in 2014 to $5.117 billion in 2017, after a 2016 high of $5.186 billion.

## Other Data Points

Seeing other data points helps to identify insurer impacts on the market. For example, market share does not reflect how many employers or employees each insurer covers; for Plan 2 and Plan 3 policyholders the premiums are based on a job classification's risks and payroll. What this means for the purpose of the SJR 27 study is that an insurer that no longer writes high risk may have a bigger impact in leaving a market than an insurer who writes dozens of policies on office workers, even if the premium for 10 miners looks similar to the overall premium for 100 office workers. This presumes other insurers will pick up lower risk accounts.

**Table 3: Market Share as Represented by Workers' Compensation Benefits Paid**

| $ amount in millions | FY 2006 Amount--% | FY 2008 Amount--% | FY 2010 Amount--% | FY 2012 Amount--% | FY 2014 Amount--% | FY 2016 Amount--% |
|---|---|---|---|---|---|---|
| **Self-Insurers** (Plan 1) | $40.5– 18% | $43.8 – 18% | $42.5– 17% | $30.9– 17% | $39.1– 17% | $46.5– 18% |
| **Private Insurers** (Plan 2) | $72.4– 32% | $74.9– 30% | $82.5– 33% | $82.8– 35% | $77.0– 34% | $85.6– 33% |
| **Montana State Fund** (Plan 3) | $114.8–50% | $129.1– 52% | $126.4–50% | $115.0– 48% | $109.3– 48% | $129.3 – 49% |

Source: Department of Labor and Industry's Annual Workers' Compensation Reports

Table 3 and other information shown in this section provide various ways of looking at how the workers' compensation market is "shared." Table 3 indicates market share through benefits paid, from the Department of Labor and Industry annual workers' compensation report.

Table 3 takeaways:

- Montana State Fund pays roughly half the claims benefits in the Montana workers' compensation system.
- Self-insurers have remained fairly constant in paying 17% to 18% of the system's claims.

A question that appears to be suggested by the Fair Montana reports to legislators and that is related to the benefits issue is whether other insurers would settle benefits more quickly than Montana State Fund does or whether Montana State Fund as the default insurer gets those cases that are least likely to be in a large enough company to allow for modified return-to-work status, thus ending total temporary disability indemnity payments. Other, related reasons also may be behind Montana State Fund paying nearly 50% of the claims benefits. If Montana State Fund were to be dissolved, would these claims be settled more quickly through a pay-off type of settlement, which may leave an injured worker unable to return to work but no longer a "claim"? Or would the impact make the residual carrier, whoever it might be, hike rates if experience shows Montana State Fund was the unlucky recipient of the hardest-to-return-to-work cases.

Another way of looking at how Montana's market is divvied up is to examine the small, medium, and large accounts. Table 4 cites copyrighted information from the National Council on Compensation Insurance to delineate the number of policies, percent of premiums, and average policy size for a range of account sizes.

**Table 4: Market Share as Represented by Premium Size for Plan 2 & Plan 3 Insurers, 2015**

| | $0-$4,999 | $5,000-$9,999 | $10,000 - $19,999 | $20,000 - $49,999 | $50,000 - $99,999 | $100,000 and up |
|---|---|---|---|---|---|---|
| **Private Insurers (Plan 2)** | | | | | | |
| **Number (%) of Policies** | 6,514 (66.7%) | 1,175 (12%) | 927 (9.5%) | 713 (7.3%) | 250 (2.6%) | 183 (1.9%) |
| **Percent of Premium** | 7.1% | 7.3% | 11.3% | 19.2% | 15.1% | 40% |
| **Average Policy Size** | $1,253 | $7,202 | $14,069 | $31,002 | $69,859 | $137,871 to $445,578 |
| **Montana State Fund (Plan 3)** | | | | | | |
| **Number (%) of Policies** | 17,392 (76.6%) | 2,476 (11%) | 1,449 (6%) | 898 (4%) | 297 (2.2%) | 190 (0.8%) |
| **Percent of Premium** | 14.0% | 11.5% | 13.3% | 18.2% | 13.6% | 29.3% |
| **Average Policy Size** | $1,226 | $7,029 | $13,821 | $30.546 | $69,223 | $138,972 to $382,303 |
| **Statewide** | | | | | | |
| **Number (%) of Policies** | 23,906 (73.6%) | 3,651 (11%) | 2,376 (7%) | 1,611 (5%) | 547 (1.7%) | 373 (1.1%) |
| **Percent of Premium** | 11.0% | 9.7% | 12.4% | 18.6% | 14.3% | 34% |
| **Average Policy Size** | $1,226 | $7,085 | $13,918 | $30,748 | $69,514 | $138,426 to $412,819 |

Source: National Council on Compensation Insurance, Inc., referencing plan year 2015 as of Dec. 31, 2016 (copyright 2018).

Table 4 takeaways:

- Montana's private (Plan 2) workers' compensation insurers write 40% of their premiums for accounts above $100,000 while Montana State Fund writes 29% of its premium in those accounts. In terms of policy counts, the highest-dollar accounts comprise only 1.9% of Plan 2 policies and less than 1% of Montana State Fund policies.
- Both Plan 2 and Plan 3 write about 20% of their business in the $20,000 to $49,999 account range.
- Montana State Fund writes twice the percentage of premiums in the smallest account range (up to $4,999) than private insurers do. The smallest account group accounts for the majority of both plans' business.

There may be several ways of interpreting Table 4. Because policies that cost more than $100,000 a year are more likely to move in and out of the self-insured market, it is not clear whether changes in Plan 3 would impact those largest accounts. Another consideration is whether the $100,000-plus accounts are for more employees but not necessarily high risk. Another assumption is that these accounts are higher risk, but that makes less sense because Montana State Fund as the insurer of last resort is more likely to have to cover higher risks. Table 5 the number of claims in conjunction with benefit amounts, essentially adding claim numbers to Table 3, as a way of considering whether some accounts may be riskier.

**Table 5: Workers' Compensation Claim Numbers and Benefits Paid**

| $ amount in millions | FY2006 Claims/$ Paid | FY2008 Claims/$ Paid | FY2010 Claims/$ Paid | FY2012 Claims/$ Paid | FY2014 Claims/$ Paid | FY2016 Claims/$ Paid |
|---|---|---|---|---|---|---|
| **Self-Insurers** (Plan 1) | 7,742 / $40.5m | 7,420 / $43.8m | 7,009 / $42.5m | 6,371 / $30.9m | 5,946 / $39.1m | 5,947 / $46.5m |
| **Private Insurers** (Plan 2) | 10,345 / $72.4m | 10,600 / $74.9m | 8,839 / $82.5m | 9,308 / $82.8m | 9,760 / $77.0m | 9,357 / $85.6m |
| **Montana State Fund** (Plan 3) | 15,019 / $114.8m | 14,250 / $129.1m | 10,404 / $126.4m | 10,004 / $115.0m | 9,747 / $109.3m | 9,667 / $129.3m |

Source: Department of Labor and Industry's Annual Workers' Compensation Reports (2009 for FY 2006, FY 2012, FY 2016).

Table 5 takeaways:

- There has been a significant decrease in claims for Montana State Fund (from 15,000 to 9,700) in the 10 years shown here. All insurers have seen a drop in claims, which is one reason Montana's lost-cost filing by NCCI has been dropping. This is not just because of House Bill 334 in 2011, which revised some benefits and claims payouts, but may be related to more attention to safety.
- In FY 2014, private insurers had more claims than Montana State Fund but paid $30 million less in benefits. (Similarly, in FY 2016, private insurers had 310 fewer claims but paid $44 million less in claims.) As pointed out in comments to this report, benefits paid on claims in any one year may include claims from past years, thus indicating either longevity of claims for one insurer or a bad run of claims for another insurer in one year. Other explanations for paid benefits may include lower severity in claims, more rigor in addressing the claims, or more ability to get people back to work.

(Montana State Fund has said that many of its small accounts do not have the alternate job placements that enable injured workers to heal on the job by doing an alternate job with fewer physical requirements.)

One of the Fair Montana presentations sought to show that Montana State Fund had open claims for longer than some of the other insurers and in particular that Montana State Fund's "dominant effect" on the temporary-total claim frequency "imposes a vastly higher overall cost on the state." See the handout at the July meeting from Fair Montana under "Method 3." Temporary total disability benefits include indemnity (wage loss) benefits, if allowed, as well as medical benefits. While the extrapolation to the cost to the whole state from extended temporary-total claims may be inappropriate because the cost is to the employer and not shared by other insurers, the Department of Labor and Industry data in the department's annual report on temporary disability paid duration at 1 and 3 years of maturity do not support the idea that Montana State Fund is an outlier as compared with private plans, except perhaps in some years (see Table 6).

**Table 6: Workers' Compensation Temporary Disability Claim Duration, 1- and 3-yr maturity**

| | FY 2011 | | FY 2012 | | FY 2013 | | FY 2014 | | FY 2015 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1 year | 3 year | 1 year | 3 year | 1 year | 3 year | 1 year | 3 year | 1 year | 3 year |
| **Self-Insurers** (Plan 1) | 14.7 | 19.0 | 13.2 | 15.6 | 14.1 | 18.9 | 12.4 | NA | 11.6 | NA |
| **Private Insurers** (Plan 2) | 16.1 | 20.8 | 14.9 | 19.2 | 16.1 | 20.6 | 15.2 | NA | 15.0 | NA |
| **Montana State Fund** (Plan 3) | 16.4 | 20.6 | 16.4 | 21.1 | 16.8 | 20.8 | 15.5 | NA | 14.6 | NA |
| **Average All Plans** | 16.0 | 20.4 | 15.3 | 19.5 | 16.1 | 20.4 | 15.0 | NA | 14.4 | NA |

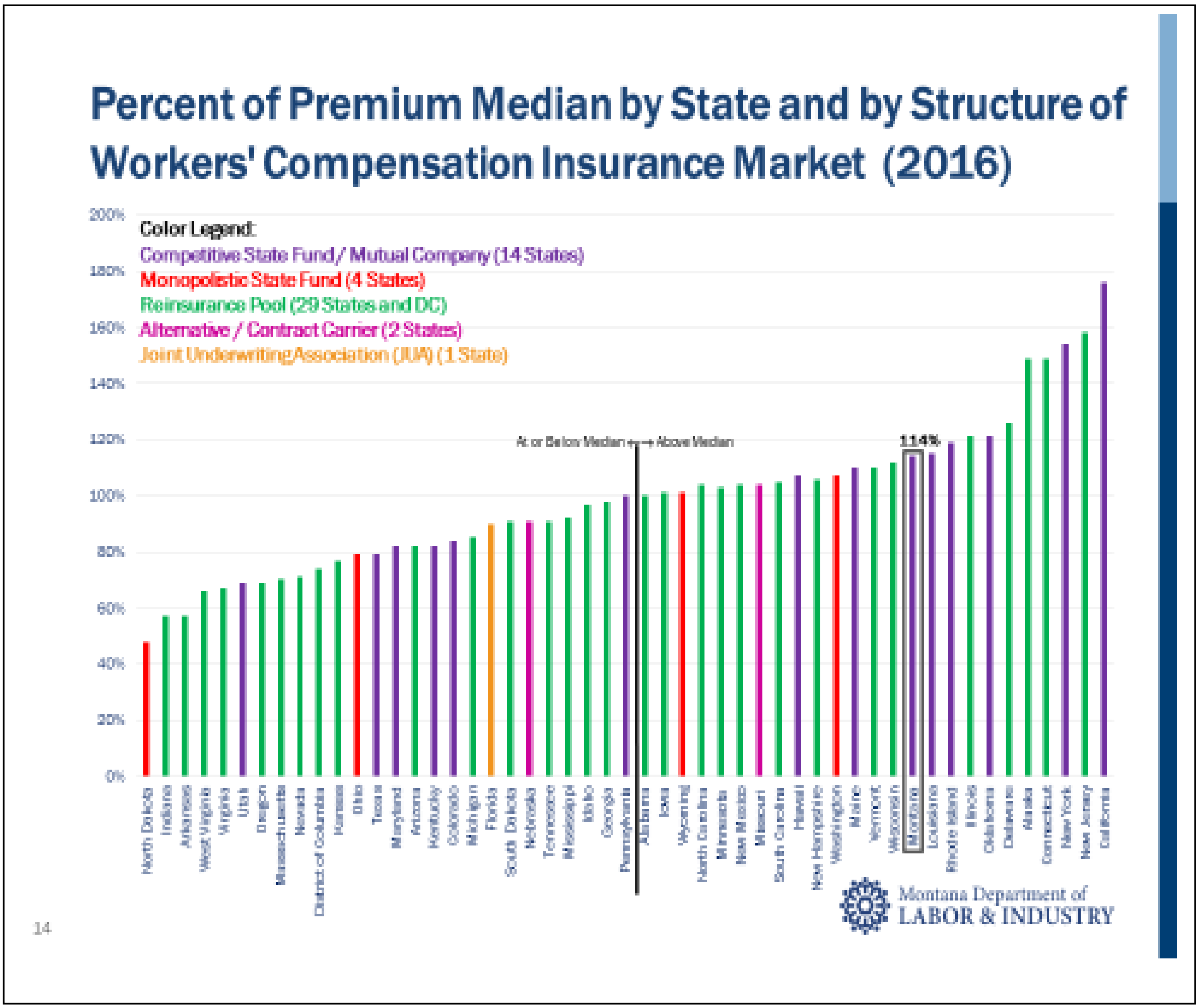
Source: Department of Labor and Industry's Annual Workers' Compensation Reports (FY 2016).

Table 6 takeaways:

- In most, but not all years, Montana State Fund has a longer claim duration for temporary total disability claims.
- In FY 2014 and FY 2016, the duration at 1 year of temporary total disability claims dropped from the previous year across all plans.

## Guaranteed Markets and Other Residual Markets

One of the questions raised at an Economic Affairs Interim Committee meeting was whether a change in the workers' compensation system's structure in a state made a difference—in particular in premiums. The typical comparison point for premiums is the Oregon Study. Researchers at the Department of Labor and Industry reviewed cautions about use of the Oregon Study at the February 2018 SJR 27 subcommittee meeting and within their presentation used the accompanying graphic that compared premiums by state and by type of workers' compensation structure. Their takeaway was that the structure did not matter as much as other components —pointing out that the monopoly states (in red) had the lowest premiums in North Dakota but higher premiums in Washington State, another monopoly workers' compensation state. Competitive state funds ranged from low-premium Utah (which was phasing out of its state fund status) to the highest-premium state, California. States with residual market mechanisms had some of the lowest—Indiana and



Arkansas—and some of the highest—New Jersey, Connecticut, and Alaska. Montana, at the right of the chart, has a rate at 114% of the premium median that is slightly less than the competitive state fund/mutual in Louisiana. Five of the reinsurance pool states have higher premium rates; 25 have lower. Five mutual, competitive state fund states have higher rates, and nine have lower.

Table 7: Comparisons Among Selected States' Workers' Compensation Markets*

| State | Net Premiums Earned | Losses Incurred (%) | Loss Adjustment Expense (%) | Underwriting Profit (%) | Earned Premium to Net Worth |
|---|---|---|---|---|---|
| Florida | $2,227,836,000 | 50.8 | 11.8 | 9.2 | 45.8 |
| Idaho | $315,291,000 | 64.1 | 11.5 | minus 0.7 | 56.6 |
| Maine | $201,054,000 | 67.9 | 13.0 | minus 11.4 | 36.6 |
| Michigan | $1,126,048,000 | 45.4 | 9.6 | 20.3 | 48.7 |
| Montana | $106,066,000 | 46.8 | 2.3 | 28.0 | 34.2 |
| **National** | $42,934,365,000 | 58.5 | 14.4 | 1.1 | 40.4 |

*The number for Montana's market in 2014 included only private insurers (Plan 2), not Plan 1 or Plan 3.

Source: National Association of Insurance Commissioners, copyright 2014.

Another way of viewing differences in states is to look at profitability reports from the National Association of Insurance Commissioners. For selected states in Table 7, the overall markets for workers' compensation showed Montana with one of the smaller markets. The data for that year was prior to Montana State Fund being regulated by the State Auditor's Office; accordingly, Table 7 does not include data from Montana State Fund.

## Residual Market Basics

Many of the Economic Affairs Interim Committee meetings as the SJR 27 subcommittee focused on residual markets and how those markets operate in comparison to a market where a state fund or other insurer of last resort operates (also part of the broad residual market but distinguished here as a guaranteed market). Nuances about the different structures were part of presentations at the November meeting by Bruce Hockman and Cliff Merritt, both with extensive experience in the workers' compensation insurance field.

**Employers unable to obtain workers' compensation coverage in the competitive market by default are in the residual market.**

If an employer cannot get a competitive bid for workers' compensation insurance, then the employer is in the residual market. States that require workers' compensation coverage (see endnote) may use either a guaranteed market provider or an assigned risk pool or contractors who provide coverage for a surcharge. One state, Florida, uses a joint underwriting association. Table 8 shows how all states handle coverage—except where coverage is by state government: Wyoming, Washington, Ohio, and North Dakota.

**Table 8: State-by-State Approach to Guaranteeing Workers' Compensation Coverage**

| State Fund/ Mutual Insurer | | Assigned Risk / Reinsurance Pool | | | | Alternative Market / Contract Carrier | Joint Underwriter |
|---|---|---|---|---|---|---|---|
| California | Montana | *Alabama* | *Idaho* | Minnesota | *Oregon* | Missouri | Florida |
| Colorado | New York | *Alaska* | *Illinois* | *Mississippi* | *S. Carolina* | Nebraska | |
| Hawaii | Oklahoma | *Arizona* | Indiana | *Nevada* | *S. Dakota* | Utah (after 1/1/2021) | |
| Kentucky | Pennsylvania | *Arkansas* | *Iowa* | *N. Hampshire* | *Tennessee* | | |
| Louisiana | Rhode Island | *Connecticut* | *Kansas* | New Jersey | *Vermont* | | |
| Maine | Texas | *Delaware* | Massachusetts | *New Mexico* | *Virginia* | | |
| Maryland | Utah ('til 2021) | *Georgia* | Michigan | N. Carolina | *W. Virginia* | | |
| | | | | | Wisconsin | | |

Source: National Council on Compensation Insurance data given Nov. 8, 2017, to EAIC. Italics reflect NCCI residual clients.

Factors that insurers weigh in determining whether to voluntarily extend coverage include the potential risk inherent in either the occupation or the small size of premium. There is a balancing act in insuring a small business in which the insurer estimates the potential risk of a catastrophic accident against the projected premium revenues. Although insurance is designed to be a pooling of that risk, too many risky members in the pool make for an unsafe hazard. Similarly, one catastrophic accident for a company with an otherwise spotless record may mean that the premiums never will cover the long-term, ongoing cost of the accident.

## Dissecting State Funds

As Bruce Hockman, a national consultant on workers' compensation coverage, told the Economic Affairs Interim Committee in November 2017, state funds are not uniform. Some face greater competition than others. Those with more than 50% of the market share in their home state are Colorado (59%), Maine (66%), Montana (61.6%), Rhode Island (71%), and Utah (51%). Utah is a special case because legislation provided for the state fund to become a mutual insurer in January 2018 with a 3-year transition to contracted services for the residual market.

**Table 9: Policy and Premium Variation in Selected Residual Markets**

| State | Residual Policies 2017 | 3rd Qrtr Policy # 2017 | 3rd Qrtr Premiums 2017 | Small* Firm Av. Premium | Of which % of All Policies |
|---|---|---|---|---|---|
| Arizona | 5,854 | 1,445 | $8,646,200 | $1,189 | 54.3% |
| Idaho | 883 | 232 | $607,420 | $495 | 79.7% |
| Nevada | 5,017 | 1,323 | $4,954,329 | $949 | 70.1% |
| Oregon | 8,620 | 2,207 | $9,433,871 | $755 | 68.6% |
| S. Dakota | 1,464 | 323 | $2,008,869 | $1,140 | 55.7% |

*"Small" means premium ranges from $0 to $2,499.

Distinctions among these state funds, which except for Maine have a three-legged system (state fund, private insurers, and self-insurers) include:

- Colorado – a political subdivision of the state but not a state agency;
- Maine – a mutual insurer, not a state agency;
- Montana – a political subdivision of the state and a state agency for some purposes but not for all purposes;
- Rhode Island – a "nonassessable" mutual insurer; and
- Utah – as of 2018 a mutual insurer with a guaranteed market until 2021, when a contract servicer will handle residual market policies (see box on Utah Case Study).

Utah's Legislature provided a 3-year transition for its state fund to first become a mutual insurer and then give up guaranteed market responsibilities. The residual market will be contracted out.

## Dissecting the Residual Market

Excluding the concept that a guaranteed market is one form of a residual market, the term "residual market" will indicate for most of this report either an assigned risk pool or a contracted servicer. States differ in how they determine the assigned risk pool and, as seen in Table 9, the percentage of policies written in the residual pool also vary. There is only one state, Florida, that uses a joint underwriting agreement (see Table 8). Three states use alternative approaches, 29 states have assigned risk/reinsurance pools, and 11 states have state funds serving as the insurer of last resort. Idaho, which is in the assigned risk, reinsurance pool column, also has a state fund, which writes some of the small businesses in that state.

| Utah Case Study | What Changed |
|---|---|
| **Workers' Compensation [State] Fund –Temporary Guaranteed Market** | • Served as the guaranteed market as a quasi-public corporation.<br>• As of Jan. 1, 2018, the company was to convert to a mutual insurance corporation.<br>• Under 31A-22-1001, the company was to serve as the guaranteed market under contract for no more than 3 years subject to the Insurance Commissioner determining by rule a new residual market mechanism and implementing that mechanism.<br>• Commissioner required to provide a written report to the Legislature's Business and Labor Interim Committee. |
| **Automatic Certificate of Authority to Be Granted** | • Upon filing of the new organization's restated articles of incorporation, the insurance commissioner was required to reauthorize the existing filings, rates, forms, etc., and "may, because of the Workers' Compensation Fund's developed status, waive or otherwise not impose requirements imposed on mutual insurance corporations … to facilitate the conversion … so long as the commissioner finds those requirements unnecessary to protect policyholders and the public" [31A-22-1014]. |
| **Retained Assets and Liabilities – But State Not Responsible** | • After conversion, the Workers' Compensation Fund was to retain all assets of and remain responsible for all liabilities incurred by the Workers' Compensation Fund as a quasi-public corporation before its conversion [31A-22-1014].<br>• Specifically provided the state is not liable for debts or liabilities of the Workers' Compensation Fund or its successor mutual corporation. |
| **State Workers' Coverage Option** | • Instead of departments or other state agencies paying premiums for state employees directly to the Workers' Compensation Fund, the state would either insure with any workers' compensation insurer or self-insure [34A-2-203]. |

## A Key Player: NCCI

The National Council on Compensation Insurance is the pool and plan administrator for 22 of the 29 states that have assigned risk or reinsurance pool types of residual markets. Of those states, 20 participate in both the NCCI Workers Compensation Insurance Plan and the National Workers Compensation Reinsurance Pooling Mechanism.

NCCI also handles certain services (financial, actuarial, or carrier oversight) for 10 other states: Delaware, Indiana, Maine, Massachusetts, Michigan, Missouri, New Jersey, New Mexico, North Carolina, and Wisconsin.

The reinsurance pool, serving 23 of the state plans, operates on a quota, determined by an insurer's share of direct written workers' compensation premium in the voluntary market.

## What's Happened to Rates in States That Revised State Fund Structures?

No specific answer is available to the question of what has happened to rates in states that revised their state fund structure because an accurate answer would have to remove all extraneous factors that also impact rates, including changes in the medical inflation index, improved safety ratings, and higher salaries that impact payroll and thus premiums. Plus any comparison among states would have to account for different laws as to which employers must provide workers' compensation; some states, for example, do not require businesses with fewer than three employees to carry workers' compensation. Simple answers do not work. But this section will provide an overview of how rates are developed and how they have changed over time in general, and then some examples of where rates have headed in states that have changed the structure of their state funds (without explanation of why).

### How Rates Are Developed

In Montana, the state's workers' compensation advisory organization is the National Council on Compensation Insurance. That organization files what is called a loss cost filing with the State Auditor's Office, usually early in the year. In 2018, NCCI submitted that information on Feb. 5. Montana statutes do not define "loss cost" but do include that concept in the definition of "pure premium rate," which represents the loss cost, per unit of exposure, including loss adjustment expense.

Premium Rates =
Loss Costs +
Production Expense +
General Expense +
Taxes, Licenses, Fees
+
Profit (or Surplus)

From material provided by Montana State Fund to its board in March 2018, the term "loss cost" represents NCCI's "actuarial estimate of the amount needed to cover the cost of claims" that are anticipated to be incurred in the coming year. Montana State Fund further describes loss costs as "composed of the benefits paid to or on behalf of injured employees plus the lifetime cost of administering those claims." NCCI's loss costs represent a rate for each $100 of payroll and are calculated for various job classifications as well as averaged for one state estimate.

NCCI provided a handout at the April 2018 Economic Affairs Interim Committee meeting showing the variations on loss costs for industries. Contractors had an even greater drop than office or clerical workers (11.8% drop compared to 11.7% drop). The handout further explained that the good experience (fewer claims or shorter duration) contributed to the recent downward trend and resulted in NCCI's actuaries suggested an 11.7% drop in rates, but with a potential increase for medical costs or other benefit costs of 0.8% and a potential 0.3% increase in expenses. The resulting average NCCI proposed loss cost for Montana this year (starting July 1, 2018) was a 10.7% drop. Another NCCI handout listed components of the manual rate, all used in determining the amount multiplied against payroll to determine the cost of the premium.

Montana State Fund's Board of Directors looked at whether to provide the full 10.7% drop or variations and decided at their June 2018 meeting to adopt an 8% average decrease. That did not mean that all premiums dropped. Montana State Fund has a minimum premium, which the Board of Directors froze for 2018 at the 2017 rate of $420, which reflects a $240 loss-based component and a $180 expense constant. This minimum premium has increased by $30 in the last 10 years (from $390 in 2008).

Another way of seeing how the 8% average reduction varied across policy types is to see the impact on Montana State Fund's different "tiers" of policyholders. The Legislature allowed Montana State Fund to mimic how insurance groups divvy up risk by assigning "good" risks to one insurer and "moderate" risks to another in the group. As a result, Montana State Fund has put businesses in one of five different risk rate tiers. The middle tier, tier 3, represents average risk while tiers 1 and 2 are the better risks and tiers 4 and 5 are the higher risks. Table 10 shows the loss cost modifiers (multiplied against payroll to develop premium costs) for the various tiers. The numbers are for the July 2018 to June 30, 2019, policy year.

**Table 10: Loss Cost Multipliers of Montana State Fund's Five Tiers of Risk with Rate Drops**

| | | Tier 1 | Tier 2 | Tier 3 | Tier 4 | Tier 5 |
|---|---|---|---|---|---|---|
| **Loss and Loss-Adjustment Expense** | **2018** | 0.778 | 0.934 | 1.038 | 1.245 | 1.505 |
| | **2014** | 0.649 | 0.832 | 0.938 | 1.151 | 1.604 |
| **Offsets for Underwriting+General/Acquisition Expense** | **2018** | 0.282 | 0.339 | 0.376 | 0.452 | 0.546 |
| | **2014** | 0.207 | 0.266 | 0.299 | 0.368 | 0.513 |
| **Profit and Contingency** | **2018** | -0.099 | -0.119 | -0.132 | -0.158 | -0.191 |
| | **2014** | -0.031 | -0.039 | -0.044 | -0.054 | -0.076 |
| **Loss Cost Multiplier** | **2018** | 0.961 | 1.154 | 1.282 | 1.538 | 1.859 |
| | **2014** | 0.826 | 1.059 | 1.194 | 1.465 | 2.040 |

Source: Montana State Fund information presented to the Board of Directors at meetings in 2014 and 2018.

## What's Happened to Rates in Montana Over Time?

The loss costs provided by NCCI and the loss cost modifiers developed by individual insurers are the bases to set premiums in Montana by the private insurers (Plan 2), Montana State Fund (Plan 3), and those self-insurers in Plan 1 that use an association like the Montana Municipal Interlocal Authority or the Montana Association of Counties Compensation Trust. NCCI annually reviews various workers' compensation information in state forums. Table 11 provides an overview of Montana's changing loss costs between 2006 and 2017. Notably, some insurers provided decreases based on NCCI's expectations that enactment of House Bill 334 in 2011 would result ultimately in an overall minus 22.4% impact on rates.

Among the reasons for the lower loss cost filings have been general drops in frequency (experience) and a lower rather than higher trend for indemnity and medical payments. So even though NCCI indicates benefit changes are inching upward and the costs of running a business are increasing slightly, as reflected in loss-adjustment expenses, the efforts at safety and return-to-work appear to have helped to prevent steep climbs even when Montana's fatality rates are among the worst in the country.

| Table 11: NCCI-Recommended Voluntary Loss Cost Changes in Montana, FY 2006-2019 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| 12.1% | 2.4% | -1.3% | -1.8% | -2.2% | -6.4% | 26.7%* | 0% | -5.4% | -3.6% | -4.8% | -3.4% | -7.8% | -10.7% |

*For the rate year beginning in July 2011 (FY 2012), NCCI projected that HB 334's enactment would provide actual loss costs of minus 22.4%. When combined with the initial filing, the overall loss cost amounted to minus 26.7%.
**For the rate year beginning in July 2012 (FY 2013), NCCI recommended class-related changes only, not an across-the-board recommendation.

Of course insurers do not have to use the same loss costs that NCCI recommends. They add their loss adjustment expenses and other factors, like profit or contribution to equity or surplus, to develop loss cost modifiers used to determine rates for every $100 of payroll. Table 12 shows what Montana State Fund's average rate-level changes were for the same period.

| Table 12: Montana State Fund's Overall Rate-Level Changes, FY 2006-2019 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| 3% | 2.4% | -1.0% | -3.0% | 0% | -4% | -20% | 0% | -6.0% | -0% | -5% | 0% | -5% | -8% |

In reports to the Board of Directors at ratemaking time, Montana State Fund has typically provided information regarding its rates as compared with private insurers. For example, at its May 2014 meeting, Montana State Fund provided a graphic showing that its weighted average loss cost multiplier was $3.54 compared with private carriers' average rate of $4.07. At Montana State Fund's March 2018 meeting, that differential had narrowed to 18 cents, or $3.40 for Montana State Fund and $3.58 for private carriers.

## Impacts in States That Revised State Fund Structures

While the Oregon study can indicate comparative premiums for states that removed their state funds as a guaranteed market, and while the Department of Labor and Industry chart provided earlier indicates that structure is not a great predictor of where a state will rank in the Oregon Study, there are some other factors useful in understanding what happens when a state fund either is sold or becomes a mutual. There are no examples of a state fund being entirely dissolved and not turned into another type of workers' compensation entity. Table 13 incorporates information compiled by Bruce Hockman for his November 2017 presentation to the Economic Affairs Interim Committee along with some basic information provided to the committee on the changes in state funds presented at the February 2018 meeting. Although impacts on actual premium after structural changes might be helpful, Table 13 shows other, more easily obtainable data many years after changes. These include overall net written premium and market share. For Arizona and West Virginia, the change might have been responsible for fewer policies written. West Virginia's Brickstreet Mutual, however, retained a majority market share. All of the selected states had an average Oregon ranking for premiums in 2016 that counted among the most favorable 50%.

**Table 13: Selected States and Changes Since Decoupling of Their State Funds**

| | | Year of Change | 2012 Writings | 2016 Writings | Oregon 2016 Ranking | Market Share |
|---|---|---|---|---|---|---|
| Michigan | Sold its state fund to a private insurer | 1995 | $184,000 | $220,000 | 34 | 19% |
| Nevada | Mutualized its monopoly-based state fund | 1999 | $16,000 | $17,000 | 43 | 3.8% |
| West Virginia | Mutualized its monopoly-based state fund | 2005 | $187,000 | $134,000 | 48 | 51.0% |
| Arizona | State fund was not a guaranteed market and was changed to a mutual insurer. | 2014 | $384,000 | $205,000 | 38 | 24.0% |

Source: Briefing Paper on other states' experiences and Bruce Hockman November 2017 presentation.

## Maturation of Montana State Fund and the Debate Over Assets

Montana State Fund started life as a reformulated entity in 1990 with $20 million from the state Legislature (see the Flow of Funds document presented to the Economic Affairs Interim Committee in February.) Since then, Montana State Fund has repaid that money. (The argument about how much more has exchanged hands may be part of the lawsuit over the fees imposed by Senate Bill 4 in the 2017 special session.) Shown below is one indication of Montana State Fund's growing financial soundness, reflected in its contributions to equity (also called surplus). Contributions to equity provide "banked" money for use when reserves (planned expenditures for claims) are inadequate to cover claims years beyond the date they were incurred.

**Table 14: Montana State Fund's Contribution to Equity and Reserve-to-Equity Ratio**

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2015.5 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| **Reserve to Equity Ratio** | 3.98 | 3.47 | 2.95 | 2.80 | 2.43 | 2.08 | 1.73 | 1.78 | 1.75 |
| **Equity Contribution** (millions) | $204.4 | $241.5 | $296.3 | $317.7 | $372.3 | $443.8 | $516.9 | $505.1 | $526.6 |

Over time, Montana State Fund's contribution to equity went from 3.98 to 1 (indicating the equity "cushion" was just one-fourth that of the reserves) in 2009 to the 2016 rate of 1.75 to 1, as shown in Table 14. Montana State Fund's actuary wrote in April 2018 that every workers' compensation insurer has to maintain policyholder equity because without that fund an "entity would be technically insolvent." Additionally, the Willis Towers Watson actuary noted that Montana State Fund's current level of policyholder equity indicates a "low likelihood of insolvency" and that as an insurer of last resort that must write all businesses that apply "it is reasonable to expect it [Montana State Fund] to carry a more secure level of policyholder equity" (see letter from Willis Towers Watson under the April 2018 materials for SJR 27).

The questions of how much equity is too much arose during the Economic Affairs Interim Committee's subcommittee study of SJR 27, but the question is difficult to answer. The State Auditor's Office, which monitors Montana State Fund's risk-based capital (another way of calculating whether the business has sufficient money to cover claims into the future), indicated at the April 2018 EAIC meeting that more cushion is preferable. However, the greater the cushion, the higher the premiums may be than otherwise (even if premiums drop) to make sure adequate funds are available. As Montana State Fund also saw happen during the 2017 special session in November, high surplus meant the Legislature had few qualms about adding an investment fee for managing the surplus (even though Montana State Fund already paid a management fee of more than $1 million. See handout from Montana State Fund. Note: Montana State Fund calls this Policyholder Equity, but the term is because Montana State Fund says all the money accrued belongs to the policyholders and that is part of the discussion in an ongoing lawsuit.)

Montana State Fund receives from its actuary a high-medium-low estimate of the amount to put into its equity position. A 2017 analysis by its Willis Towers Watson actuary included a comment that Montana State Fund's Dec. 31, 2016, equity of $528 million more than met minimum regulatory requirements and "significantly exceeds the 'regulatory solvency perspective' equity benchmarks." The slide showed the following information:

| | | |
|---|---|---|
| Kenney rule (2-to-1 premium-to-equity) | $85 million | Regulatory Solvency Perspective |
| Early Warning Test (Premium-to-equity of 3-to-1) | $67 million | |
| National Association of Insurance Commissioners RBC (Risk Based Capital) Company Action Level* | $217 million | |

Projected Dec. 31, 2017, equity of $540 million will also exceed the 2017 regulatory equity benchmarks by a substantial margin

*Statute puts Montana State Fund's Risk Based Capital Company Action Level at 4 times the authorized control level RBC.

As mentioned above, an April 2018 letter from the actuaries for Montana State Fund at Willis Towers Watson also indicated that there are two state funds (Hawaii and Louisiana) that have a reserve-to-equity ratio at or below 0.5. For Montana State Fund, the letter said, "with $920 million of loss and LAE (loss-adjusted expense) reserves, this [0.5] level of security would require over $1.8 billion of policyholder equity. In our opinion, $1.8 billion of equity would provide a very high level of security to businesses and workers in the state of Montana, and increasing equity above this level would not have a meaningful increase in the security provided."

As indicated by this statement, if an insurer has more reserves, which represent what are considered to be the expected costs, solvency is greater if the insurer also increases the equity "cushion." But that solvency comfort may mean higher premiums than otherwise required. A 2015 analysis done by an actuary hired by the State Auditor's Office assessed whether Montana State Fund's reserving was reasonable. That firm, Financial Risk Analysts, LLC, found the reserving was reasonable and, in its opinion, Montana State Fund's actuary estimated lower reserving than Financial Risk Analysts did. If underreserving occurs, then equity increases in importance. Actuarial estimates typically vary, and often by hundreds of millions of dollars across low, central, and high estimates. Table 15 shows the 2015 estimates of both Willis Towers Watson and Financial Risk Analysts regarding high-medium-low reserves and equity contributions.

**Table 15: Actuarial Estimates on Montana State Fund's Reserves and Equity Contribution**

| | Reserves ( undiscounted) | | | Contribution to Equity (at projected 3.0% investment yield) | | |
|---|---|---|---|---|---|---|
| | Low Range | Central Estimate | High Range | Low Range | Central Estimate | High Range |
| **Towers Watson as of 6/2015*** | $703.3 million | $780.6 million | $888.3 million | 7.6% | 1.7% | -5.5% |
| **Financial Risk Analysts (6/2015)** | $784.9 million | $859.1 million | $933.2 million | 6.7% | 3.8% | 0.4% |

*In 2015, Montana State Fund added $32.1 million to the Towers Watson central estimate of reserves. FRA noted that using undiscounted reserving allows for investment income to make up any difference if the reserving is too low.
Source: Financial Risk Analysts, LLC Actuarial Report on Montana State Fund for State Auditor's Office, 11/19/2015.

## Workers' Compensation: How Much a Barrier for Businesses in Montana?

Montana notably requires most employers with employees on staff to provide workers' compensation as part of the exclusive remedy that provides a quick recourse for an injured worker to partial wage replacement while recuperating, as well as medical benefits in exchange for the injured worker not taking the employer to court for retribution for an unsafe workplace (as one scenario). While there are nuances for both the employer and the employee, the obligation to provide workers' compensation is a cost that employers face and that they prefer to keep as low as possible. Not all states have as extensive a requirement for businesses. However, Montana has 26 exemptions to the requirement to provide workers' compensation. For those questionable cases of coverage requirements, the Department of Labor and Industry can pursue an employer as an uninsured employer or the injured worker can take action against the person for whom a job was undertaken.

While the Montana Chamber of Commerce and other business-oriented organizations seek to make the state a business-friendly environment and recognize the role of affordable workers' compensation rates, the costs of workers' compensation is not the only consideration a business has when deciding where to locate. A *State Policy Reports* publication provided the information in Table 16 about Montana's ranking compared with national rankings on various economic aspects. Montana's lowest position was 46$^{th}$ in the nation in employment growth. The highest reflected a 3.3% increase in personal income between the first quarters of 2017 and 2018 to rank 20$^{th}$ in the nation in that category of growth.

| Table 16: Montana Rankings in Selected Economic, Work Comp Areas | | | |
|---|---|---|---|
| Economic/Work Comp Area of Interest<br>(based on information in *State Policy Reports* | **Date** | **Montana ranking** | **National Ranking** |
| **Economic Momentum** | 6/2018 | 23 | 0.31 greater |
| **Personal Income Growth**<br>(comparing first quarter 2018 and first quarter 2017 ) | 6/2018 | 20, up 3.3% | Up 3.6% |
| **Employment Growth** | 6/2018 | 46, up 0.6% | 1.7% |
| **Unemployment Rate** | 5/2018 | 23 at 3.9% | 3.8% |
| Source: *State Policy Reports,* Vol. 36, Issue 12 | | | |

## Summary

Workers' compensation is a complex subject that involves not just the operations of insurance companies but rules and regulations regarding who must insure and what types of coverage must be offered. All insurers must pay the same benefits. All insurers in Montana use the same loss cost estimates on which they base their premiums. Insurers compete in the ways that they price premiums—perhaps by seeking higher payroll industries or white collar, potentially less hazardous industries. They also compete in trying to get workers back on the job, which is made easier in companies that have more than 20 workers or so simply because the mid-sized small firms and larger firms may have alternate employment that allows an injured worker to phase back into full-time heavy lifting or other job requirements they may not be able to do while injured. Some insurers also compete in their business management practices, by using dedicated insurance agents to write workers' compensation policies, employing case managers to monitor an injured workers' progress, or benefiting from asset management that can take advantage of stock market and real estate trusts.

Deciding to change the structure of Montana's workers' compensation system from three plans to two plans (private and self-insured) requires a broad understanding of Montana's workers' compensation market. The SJR 27 report was designed to provide background information not only on Montana State Fund but on Montana's workers' compensation market and to answer questions raised by legislators on the Economic Affairs Interim Committee.

**Endnote:**

(p. 15) According to the U.S. Chamber of Commerce's *2016 Analysis of Workers' Compensation Laws*, all states except New Jersey and Texas require workers' compensation coverage for most employers. New Jersey presumes coverage but allows mutual dissolution of contracted coverage prior to an accident happening. Texas requires coverage for political subdivisions but lets courts determine liability for uncovered employers.