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

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Economic Affairs Interim Committee
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MONTANA STATE LEGISLATURE

SJR 27: THE FUTURE OF MONTANA STATE FUND

Overview

Recognizing that the Senate Joint Resolution 27 study of Montana State Fund (State Fund) was the latest 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 were 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 mainstream workers' compensation insurers. Competition also was a focus as was whether changes in State Fund's structure would increase or decrease premium rates. Finally, the review included possible changes that would impact the state, State Fund, and employers in Montana who had relied on State Fund either as a first choice or as an insurer of last resort.

Guaranteed Markets and Other Residual Markets

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[i] 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 1 shows how all states handle coverage--except where coverage is by state government: Wyoming, Washington, Ohio, and North Dakota.

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.

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		

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

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 is in place for the state fund to become a mutual insurer in January 2018 with a three-year transition to contracted services for the residual market.

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
- 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 become first a mutual insurer and then to 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. As seen in Table 1, Florida is the only state that uses a joint underwriting agreement. 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.

A Key Player: NCCI

The National Council on Compensation Insurance (NCCI) 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. Each of the sample of regional states (at right) participates in both programs.

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.

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.

Utah Case Study	What Changed
Workers' Compensation [State] Fund – Temporary Guaranteed Market	• Served as the guaranteed market as a quasi-public corporation. • As of Jan. 1, 2018, the company was to convert to a mutual insurance corporation. • Under 31A-22-1001, the company was to serve as the guaranteed market under contract for no more than 3 years subject to the Commissioner determining by rule a new residual market mechanism and implementing that mechanism. • 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]. • 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]

How Rates Are Developed

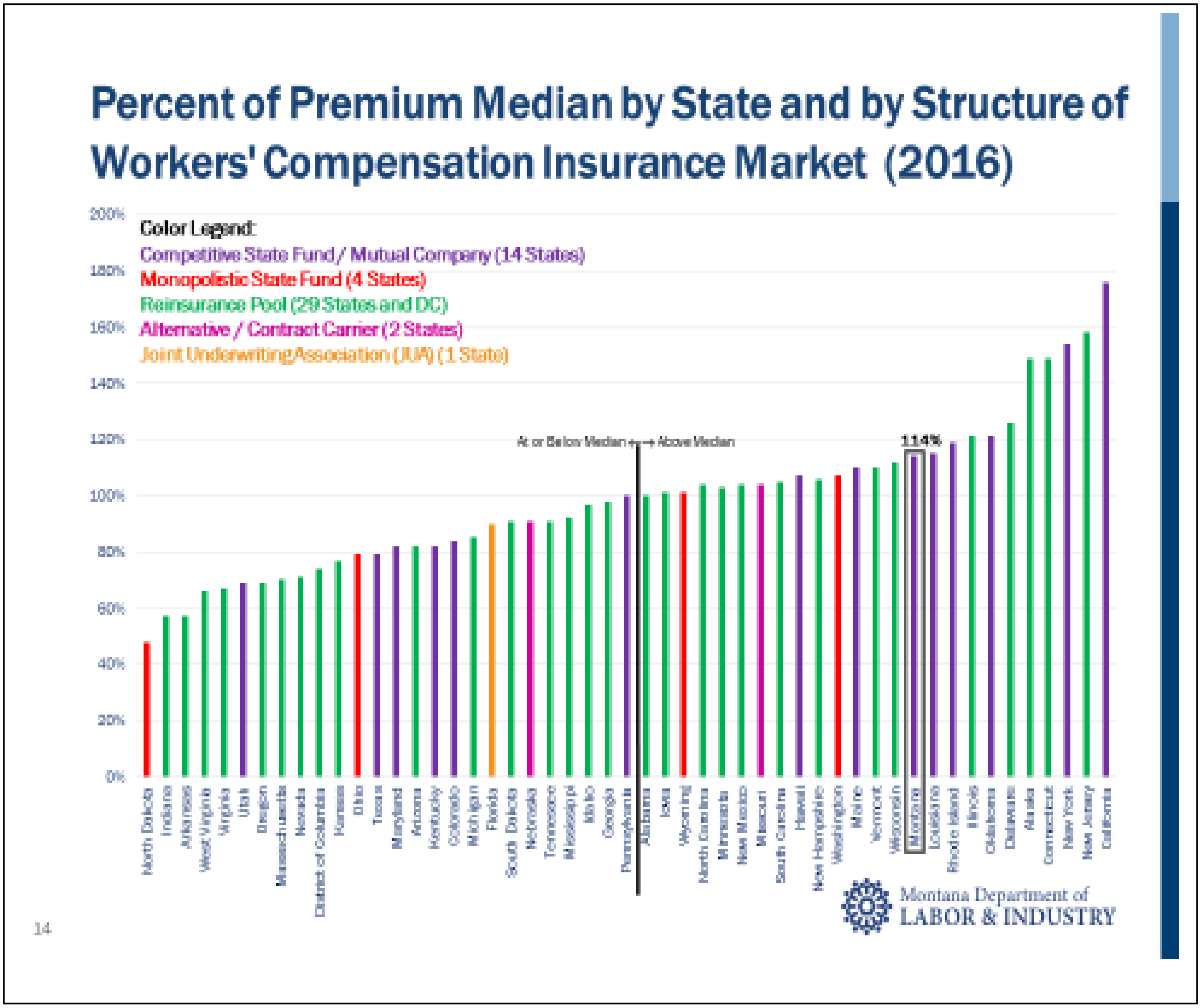
In Montana, the state's workers' compensation advisory organization is the National Council on Compensation Insurance, NCCI. That organization files what is called a loss cost filing with the State Auditor's Office, usually early in the year. This year NCCI submitted that information on Feb. 5. Montana 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.

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.

What has happened to Rates in States That Revised State Fund Structures?

No specific answer is available that would remove all extraneous factors that also impact rates, including changes in the medical inflation index, improved safety ratings, and higher salaries that impact premiums. So simple answers do not work. But this section will provide an overview of how rates are developed, 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.

But one indication of rates is available in the material provided to the EAIC at its February 2018 subcommittee meeting. The researchers from the Department of Labor and Industry included the chart below that shows rates for various states by structure. See below. Montana, at the right of the chart, at 114% of the premium median has a rate slightly less than the competitive state fund/mutual in Louisiana. Five of the reinsurance pool states have higher premium rates, 25 lower. Five mutual, competitive state fund states have higher rates, and nine have lower.



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i According to the U.S. Chamber of Commerce's *2016 Analysis of Workers' Compensation Laws*, all states except for 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.