DRAFT 2018

Economic Affairs Interim Committee
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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 2017-18 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 the 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:

- That Montana State Fund:
    - A. As an entity of state government serves an important role as the guaranteed market for workers' compensation in a state where the majority of workers' compensation policyholders are small accounts of less than $10,000 in premiums a year and that Montana State Fund should be retained in its current status to avoid market confusion.
    - B. Serves an important role as the guaranteed market in a state where the majority of workers' compensation policyholders are small accounts of less than $10,000 in premiums a year and has matured as a quasi-governmental nonprofit corporation in a way that the Economic Affairs Interim Committee finds to be worthy of additional independence from state-related constraints, specifically by meeting the responsibilities of private workers' compensation insurers in paying premium taxes, electing at least some of its board members from among policyholders, and not being subject to certain state controls, such as procurement and information technology requirements, or having a guaranteed book of business of providing workers' compensation policies for all state agencies..
    - C. Serves in a workers' compensation market that has matured in such a way that the state no longer needs to be in the workers' compensation business and, to that end the Economic Affairs Interim Committee recommends:
        - Allowing Montana State Fund to begin a transition to a mutual insurer (owned by its policyholders); or
        - Dissolving Montana State Fund over a period of years that takes into account a transition for Montana State Fund policyholders and employees as well as other workers' compensation insurers and regulators that have depended on Montana State Fund's role in handling high-risk or low experience accounts as well as the Old Fund (benefits due to workers insured by the state compensation insurance fund and injured prior to July 1, 1990).

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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 on 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 (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 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 the 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 information included a report on money flows related to the Old Fund and the New 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.

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 copy of language added to Montana State Fund policies regarding Montana State Fund's ownership of "premiums and other money paid to MSF, all property and securities acquired through the use of money belonging to MSF, all interest and dividends earn on money belonging to MSF."
- 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."
- 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 below under presentations).
- A review of legal challenges in other states (see 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 an 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 FY2019 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.

After a lawsuit was filed following 2017 special session actions, any SJR 27 discussion on whether Montana 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 self-insuring workers' compensation, continuing to have policies with State Fund, or going to the private sector, also called Plan 2, insurers.

- 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 spreachseet incorporated information provided by the Department of Labor and Industry regarding workers' compensation system components in various states.

Dissolution

- SB 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 SB 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

- At the September 2017 meeting staff presented the 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.
- The 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, the 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 at the February 2018 meeting 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 calculation of workers' compensation premium rates in each state, using 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 were 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 payrolls are skimpy.

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. Also provided by NCCI representatives were 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.

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.

Table 1: 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		

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.

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.

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.)

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

Table 2: 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.

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.

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.

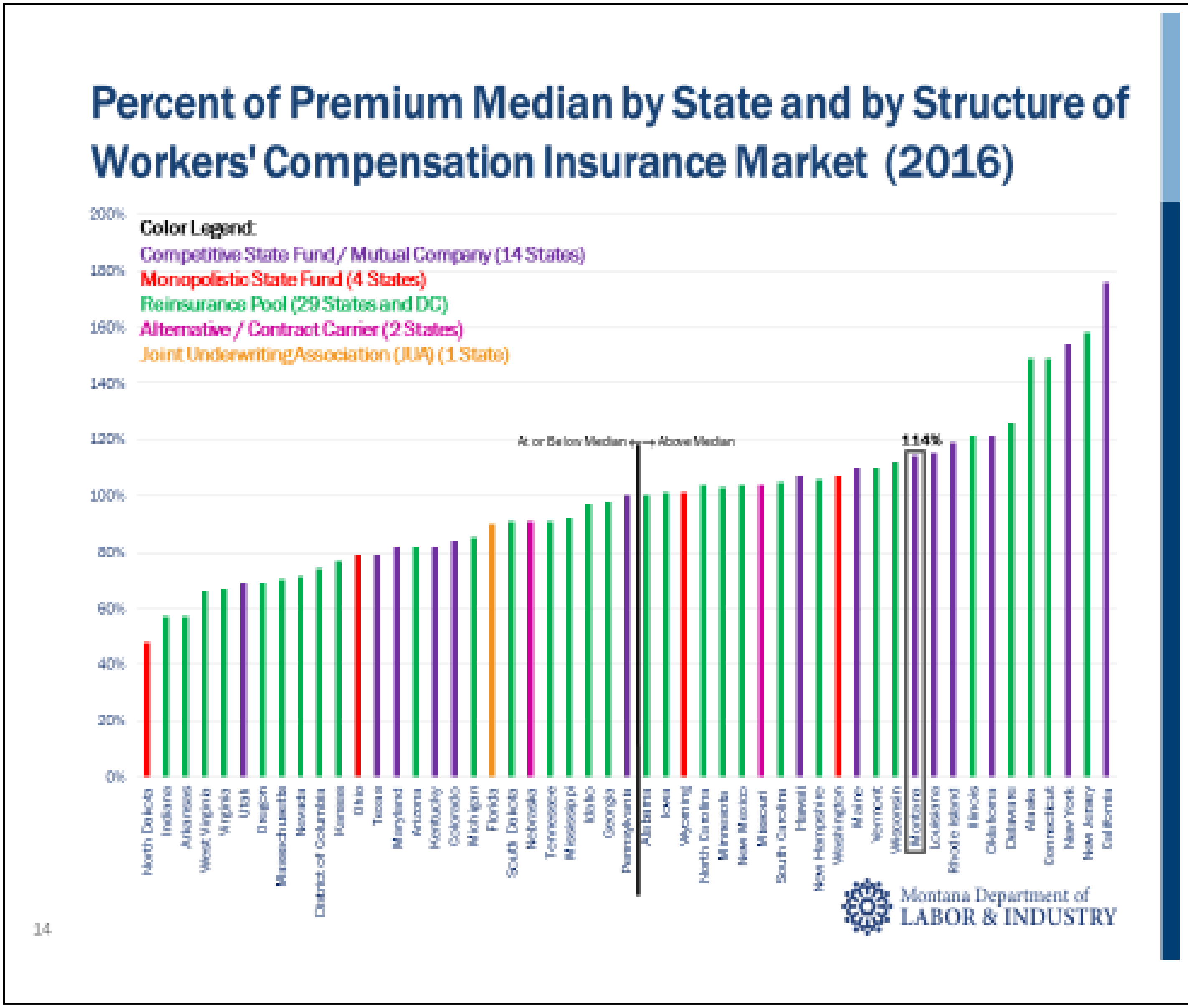
What's Happened to Rates in States That Revised State Fund Structures?

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.

What's Happened to Rates in Montana Over Time?

Determining causes for rate changes is best left to experts, but data show trends in rates as determined by NCCI in its annual reviews for its member states of loss cost modifiers. The loss cost modifiers are the bases for which Plan 2, the private market, insurers and State Fund based their rates in Montana.



What's Happened to Market Share in Montana Over Time?

Market fluctuations depend partly on the overall economy and sometimes on company decisions to refocus attention on markets in other states. A state like Montana with high work-related accident rates is not always the ideal place for a workers' compensation insurer to operate.

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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.