

# **MONTANA STATE FUND WORKERS' COMPENSATION PREMIUM ASSESSMENT**

A Report Prepared for the  
**Economic Affairs Interim Committee**

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## INTRODUCTION

The purpose of this report is to provide information on the overall rating process used by Montana State Fund (MSF) as compared to the process used by private insurance companies including the requirement that state agencies insure with MSF. In addition, the report provides information on the differences in premium rate regulatory oversight between MSF and private insurance companies.

## ESTABLISHING PREMIUM RATES

Premium rates are established in a given year to provide the insurer with sufficient resources to pay the costs for benefits to injured workers. Premiums collected in 2010 must be sufficient to pay for indemnity and medical benefits to workers injured in 2010 over the next 50 to 60 years. Businesses in Montana pay premiums based on a number of factors included in their rates.

The estimated cost of providing benefits is referred to as loss costs. The final premium rate established by insurers is based on changes to the loss costs, either increases or decreases, for defined factors. The general formula for the rate is illustrated below:

- Loss costs X loss cost multiplier = manual rate
- Manual rate X increased limits of employers liability (if applicable)
- X experience modification factor (if applicable)
- X construction credit factor (if applicable)
- X scheduled rating modifier
- volume discounts (if applicable)
- + terrorism charge
- + expense constant = final premium

Further information on the various components and their effect on premiums for Montana employers as well as the differences between premium calculations for private insurers and MSF is discussed below.

## DIFFERENCES BETWEEN PRIVATE INSURANCE COMPANIES AND MSF

Montana State Fund generally follows the same process for assessing premium rates as private insurance companies. However, MSF is statutorily granted additional latitude beyond that of private insurance companies. Figure 1 provides a summary of the similarities and differences between Plan 2 and Plan 3 premium rate assessment. The individual components are discussed in the following narrative.

|                               | Private<br>Insurance<br>Companies | Montana<br>State<br>Fund |
|-------------------------------|-----------------------------------|--------------------------|
| Rating Tiers                  | Allowed                           | Yes                      |
| Loss Costs                    | Yes NCCI                          | Yes Board adopted        |
| Loss Cost Multpliers          | Yes                               | Yes                      |
| Experience Modifications      | Yes                               | Yes                      |
| Scheduled Rate Modifications  | Yes + or - 40 %                   | Yes + 220 % or - 100 %   |
| Volume Discounts              | Yes                               | Yes                      |
| Terrorism Charges             | Yes                               | Yes                      |
| Retrospective Rating Plans    | Yes                               | Yes                      |
| State Agency Book of Business | No                                | Yes                      |
| Regulatory Oversight          | Yes                               | No                       |

### Rating Tiers

Private insurance companies providing workers' compensation insurance place employers into various insurance companies based on the experience and loss costs of the business applying for insurance. If a business has a high number of claims over the last three years the private insurer provides workers' compensation insurance in one of its companies that charges higher rates to offset the risk the insurer faces in providing the insurance.

Montana State Fund mimics the flexibility provided through the use of multiple companies through rating tiers. If a business has low experience in terms of numbers of workers' compensation accidents and the associated benefit claims they are placed into a rating tier with lower workers' compensation costs for premiums. As the experience increases the businesses are placed in higher rating tiers. Overall MSF uses 5 different rating tiers to

determine the manual premium it will assess Montana employers. Tier 1 is used for the lowest risk employers and tier 5 is for the highest risk employers.

MSF uses National Council on Compensation Insurance (NCCI) experience modifiers to place 27 percent of the employers into various rating tiers. The experience modifier is a percentage which increases or decreases based on the employer's workers' compensation accident history over the previous 3 years. If an employer has annual premiums greater than \$5,000 they generally are experience rated by NCCI.

Of the 28,377 policies written by MSF in FY 2009, 20,772 policies, or 73 percent, were not experience rated by NCCI. For those policies without an experience rating, the MSF board approves the tier ratings which determine the workers' compensation manual rates for the employers. For the 12,817 or 45 percent of Montana employers with policies of less than \$1,500 in annual premiums, employers are assessed at the two most expensive tiers, tiers 4 or 5. The businesses do not at this time have the opportunity for lower premiums to be assessed through the rating tiers or through the lower experience modification factors. For 7,955 employers with annual premiums between \$1,500 and \$5,000 a year, premiums are based on tier 4 rates in the first year of the policy. The rating can stay at tier 4, move as far up as tier 2 or down to tier 5 based on the number of claims filed for the employer's workers and the costs of those claims paid by MSF.

Beginning in July 2010, the 20,772 businesses that are not experience rated can qualify for the pooled risk safety group provided they meet the requirements outlined in statute including adopting a written, comprehensive safety plan by July 2009, and transitional and return-to-work programs.

## Loss Costs

As discussed previously, the first component of the premium rate is the loss costs or the cost of providing indemnity and medical benefits to the injured worker. The NCCI develops advisory loss costs for workers' compensation in Montana, including provisions for the costs of administering and managing claims. The costs are issued by industry classification broken into specific job classifications, also referred to as a class code. Private insurers must either adopt NCCI loss costs or file their own loss costs based on the insurer's experience. According to the Insurance Commissioner, loss cost modifications must include:

- Historical experience,
- Actuarial justification for any modifications or deviations, the sole rationale of underwriting judgment for loss cost modifications is not sufficient

The majority of private insurers in Montana use the NCCI loss costs.

The MSF board adopts the NCCI filing for classification codes with certain exceptions. MSF has two special class codes for which NCCI does not file a loss cost including:

- Farm or ranch for agricultural producers
- State agencies (private insurers are excluded from providing workers' compensation to state agencies)

In addition, the MSF board adopts modifications to certain advisory loss costs based on management analysis. According to the MSF board meeting minutes from May 2009:

- *We (MSF management) test the appropriateness of NCCI loss costs and we generate a preliminary request for review. This year, MSF had 16 class codes that were on the initial list for review. We assemble a team of actuarial and underwriting experts and we go through the class codes with a fine-tooth comb..... The consulting actuary provided a letter certifying both the process by which management developed their recommendations as well as the specific proposed loss cost rates.*

Based on this discussion and management recommendations for FY 2010, the MSF board adopted modified loss costs for 13 NCCI class codes.<sup>1</sup>

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- <sup>1</sup> Coal mining – surface drivers – 62.2 percent reduction
  - Street/road construction – paving & drivers flagging – 21.0 percent reduction
  - Street/road construction – surface work drivers – 19.5 percent reduction
  - Carpentry – detached 1 or 2 family dwellings – 6.6 percent reduction
  - Drilling NOC & Drivers – 36.1 percent increase
  - Lumber Yds, Bldg Mtrls, Concrete, Fuel & Matrl – 6.2 percent increase

## Manual Premium

The manual premium calculated for employers is the loss costs times the loss cost multiplier. The loss cost multiplier includes production and general expenses, licenses and fees, profit and contingencies costs.

## Private Insurance Companies

Because the vast majority of private insurers adopt NCCI loss costs, almost all private insurers' manual premium is determined based on NCCI recommended loss costs per \$100 of payroll for each specific classification multiplied by the loss cost multiplier for the insurer. Private insurers file their loss cost multipliers with the Insurance Commissioner (IC). The loss cost multiplier may either increase or decrease pure loss costs. Insurers must file their loss cost multipliers with a reference filing adoption form and summary of information when they commence writing workers' compensation. Thereafter, if the loss cost multiplier is 1.0 or greater and the loss cost multiplier applies to all future revisions of the loss costs and is not revised the insurer when adopting current loss costs, does not have to file additional information unless required by the Insurance Commissioner. However, if the loss cost multiplier is less than 1.0 or the loss cost multiplier has been revised the insurer must file a reference filing adoption form and summary of information.<sup>2</sup> For FY 2010, of the 304 private insurance companies that filed loss cost multipliers with the IC, 7 companies with 3.5 percent market share had loss cost multipliers less than 1.0.

## MSF

MSF's manual premium is determined based on the board approved loss costs per \$100 of payroll for each specific class code and the tier the employer has been assigned. The rating tier determines the loss cost multiplier applied to the loss costs of MSF. The rating tiers for MSF based on the NCCI experience modifiers for FY 2010 and the corresponding loss cost multiplier for experienced rated policies are presented in Figure 2. The loss cost multiplier and the resulting premiums assessed employers increase or decrease based on the assigned rating tier.

Figure 2  
MSF Rating Tiers  
Experience Rated Policies FY 2010

| Experience From | Modifier To | Tier   | Loss Cost Multiplier |
|-----------------|-------------|--------|----------------------|
| 0.01            | 0.79        | Tier 1 | 0.911                |
| 0.80            | 0.94        | Tier 2 | 0.973                |
| 0.95            | 1.24        | Tier 3 | 1.041                |
| 1.25            | 1.74        | Tier 4 | 1.249                |
| 1.75 & above    |             | Tier 5 | 1.665                |

While the loss costs per \$100 of payroll are the same for each rating tier the loss cost multiplier increases or decreases the loss costs to reach the manual premium. Figure 3 outlines the associated manual premiums for \$1,000 of loss costs at each tier level.

Continued from footnote 1

- Stable, Breeding Farms/Riding Acdmy/Riding Clb – 71.3 percent reduction
- Retirement, Care, Nursing & Convalescent Center – 10.9 percent increase
- Hotel/Motel/Dude Ranch/Commissary Work – 22.4 percent increase
- Restaurant NOC – 20.5 percent increase
- Restaurant: Fast Food – 12.2 percent increase
- Bar, Discotheque, Lounge, Nightclub, Or Tavern – 42.0 percent increase
- Athletic Sports or Park: Contact Sports – 140.6 percent increase

<sup>2</sup> This information includes effects of the proposed revisions to manual rate levels, premium level change or the change in collected premium, loss cost modifications, total production expense, general expense, taxes, licenses, and fees, profit and contingencies, discussion on how investment income is taken into account, expected loss and loss adjustment expense ratio, impact on premium generated by expense constants and minimum premiums, impact on premium of premium discounts and expense graduation included in retrospective rating, loss cost multiplier as indicated by the above data, loss cost multiplier selected by the insurer, expense constant, premium discount, and actuarial support.

Figure 3  
Manual Rate  
MSF Tier Rating - FY 2010

| Tier   | NCCI       |                      | Premium Rate | Variance From Tier 3 |
|--------|------------|----------------------|--------------|----------------------|
|        | Loss Costs | Loss Cost Multiplier |              |                      |
| Tier 1 | \$1,000    | 0.911                | \$911        | -12.49%              |
| Tier 2 | \$1,000    | 0.973                | \$973        | -6.53%               |
| Tier 3 | \$1,000    | 1.041                | \$1,041      | 0.00%                |
| Tier 4 | \$1,000    | 1.249                | \$1,249      | 19.98%               |
| Tier 5 | \$1,000    | 1.665                | \$1,665      | 59.94%               |

Employers in the lower rating tiers pay less pure loss costs than those in the higher tiers. Employers in tiers 4 and 5 are assessed higher premiums through the loss cost multipliers for higher pure loss costs as part of their premium rates. The variation from NCCI loss costs is one of the components included in the loss cost multiplier and is approved by the board. In FY 2010, the other components included in the loss cost multiplier are 14.1 percent provision for underwriting programs, 16.7 percent provision for general overhead expense, and (6.0) percent provision to recognize the effect of investment income and other

contingencies. Figure 4 shows the components of MSF loss cost multiplier for each tier in FY 2010 based on \$1,000 of pure loss costs.

Figure 4  
Montana State Fund  
Loss Cost Multipliers Components  
Costs per \$1,000 of NCCI Loss Costs

| Description              | Tier 1     | Tier 2     | Tier 3     | Tier 4     | Tier 5     |
|--------------------------|------------|------------|------------|------------|------------|
| Loss Costs including LAE | \$730      | \$780      | \$834      | \$1,001    | \$1,334    |
| Additional Costs         |            |            |            |            |            |
| Offsets for Underwriting | 103        | 110        | 117        | 141        | 188        |
| General and Acquisition  | 122        | 130        | 139        | 167        | 223        |
| Profit and Contingency   | (44)       | (47)       | (50)       | (60)       | (80)       |
| Total Additional Costs   | <u>181</u> | <u>193</u> | <u>206</u> | <u>248</u> | <u>331</u> |
| Total                    | \$911      | \$973      | \$1,040    | \$1,249    | \$1,665    |

As shown, because the other provisions of the loss cost multiplier are based on a percentage of the loss costs, employers in tier 5 pay a total of \$331 for underwriting, general and acquisition, and profit and contingency per \$1,000 of loss costs or 83 percent more than employers in tier 1 at \$181 per \$1,000 of loss cost.

## Standard Premium

Once the manual premium has been established, both private insurers and MSF apply the experience modification factor for those businesses that have sufficient premium to be rated. The manual premium with the experience modification factor applied is referred to as the standard premium. The experience modifier increases or decreases the premium costs depending on the workers' compensation experience of the employer over the last 3 years.

Figure 5  
Standard Premium  
MSF Tier Rating - FY 2010

| Tier   | NCCI       |                      |             | Experience Modifier Ranges |         | Standard Premium Ranges |            |
|--------|------------|----------------------|-------------|----------------------------|---------|-------------------------|------------|
|        | Loss Costs | Loss Cost Multiplier | Manual Rate | From                       | To      | From                    | To         |
| Tier 1 | \$1,000    | 0.911                | \$911       | 0.01                       | 0.79    | \$9.11                  | \$719.69   |
| Tier 2 | \$1,000    | 0.973                | \$973       | 0.80                       | 0.94    | \$778.40                | \$914.62   |
| Tier 3 | \$1,000    | 1.041                | \$1,041     | 0.95                       | 1.24    | \$988.95                | \$1,290.84 |
| Tier 4 | \$1,000    | 1.249                | \$1,249     | 1.25                       | 1.74    | \$1,561.25              | \$2,173.26 |
| Tier 5 | \$1,000    | 1.665                | \$1,665     | 1.75                       | & above | \$2,913.75              | & above    |

In FY 2009 MSF applied the experience modification factor to 7,605 employers that were eligible due to the level of their annual premiums (above \$5,000 annually). For those employers in tier 1 the effect of the experience modifier is to further decrease the costs of workers compensation insurance. Employers in tier 5 would have their premiums increased and pay higher loss costs for their premiums based on their experience modifier. Figure 5 shows the ranges of standard premiums assessed Montana employers insuring with MSF after the effect of the experience modifier is considered. The figure is based on \$1,000 of NCCI pure loss costs and shows the ranges of standard premiums included in a tier for experienced rated employers. Private insurers in Montana use tiers on a limited basis, as they are allowed by statute. Most utilize multiple companies to "tier" risks. The effect of the experience modification factor on the premium calculation is similar to that shown in Figure 5.

## Scheduled Rate Modifier

Figure 6  
Schedule Rate Modifiers

| State        | Aggregate |       |
|--------------|-----------|-------|
|              | Allowed   | Limit |
| Alaska       | Yes       | None  |
| Idaho        | Yes       | 25%   |
| New Mexico   | Yes       | 15%   |
| North Dakota | No        | N/A   |
| Oregon       | No        | N/A   |
| South Dakota | Yes       | 25%   |
| Washington   | No        | N/A   |
| Wyoming      | No        | N/A   |

Insurers apply a scheduled rate modifier to the standard premium to determine the final premium amount employers will pay in a given year. The scheduled rate modifier is used to take into account factors which may not be reflected in other modification factors. Figure 6 shows a listing of the comparator states and the aggregate modification allowed for workers' compensation premiums. Half of the comparator states do not allow scheduled rate modifiers. In South Dakota and Idaho the aggregate amount of the modifications are limited to plus or minus 25 percent. In New Mexico the range is plus or minus 15 percent. Alaska does not limit the amount of the scheduled rate modifier.

## Private Insurance Companies

In Montana, private insurers have the latitude to increase or decrease the premiums by plus or minus 40 percent through the scheduled rate modifier. Any amount beyond the 40 percent must be approved by the Insurance Commissioner and according to the commissioner, the office does not approve modifications beyond 40 percent for private insurance companies.

## MSF

MSF is not limited by this requirement. According to MSF, the following general criteria are used to determine the amount of the scheduled rate modifier for policyholders. The total percentage variation to the loss cost multiplier is also shown.

- Premises – plus or minus 20 percent
- Medical Facilities – plus or minus 15 percent
- Safety Devices – plus or minus 30 percent
- Employee Selection/Training – plus or minus 30 percent
- Management Cooperation – plus or minus 20 percent
- Safety Organization – plus or minus 30 percent
- Other Categories – plus or minus 75 percent

If MSF applied maximums of the criteria outlined above, the premium amount could vary from -100 percent to plus 220 percent. For an employer in tier 1 with an experience rating of .79 and a standard premium of \$50,000, the premium could decrease to the minimum premium of \$400 or increase to \$160,000 depending on the schedule rate modifier. According to MSF officials, they are allowed a greater flexibility with pricing using the scheduled rate modifier because they can not decline business.

This portion of the rate determination is considered to be more subjective and is based in part on the judgment of the MSF underwriters and their understanding of the business conditions for the employer they are rating. It is unclear if decreasing the standard premium by 100 percent or increasing it by 220 percent is actuarially sound. Figure 7 shows the distribution of scheduled rating modifiers for MSF for policies written in FY 2008. The vast majority, 91.7 percent of policies in FY 2008 had no schedule rate modification (1.0) while 53 policies were increased above the 40 percent variation allowed private insurers.

## Legislative Option

MSF board policy allows MSF unlimited aggregate limits for its range of modification while private insurers are required by the SAO a range of modification of plus or minus 40 percent. The legislature may wish to examine the impact on actuarial soundness

Figure 7  
Montana State Fund  
Distribution of Scheduled Rating Modifiers  
All Policies Written in FY 2008

| Schedule Rating Range |      | Policies | Average Modifier |
|-----------------------|------|----------|------------------|
| From                  | To   |          |                  |
| 0.00                  | 0.60 | 6        | 0.50             |
| 0.60                  | 0.80 | 110      | 0.72             |
| 0.80                  | 0.90 | 178      | 0.86             |
| 0.90                  | 0.95 | 406      | 0.92             |
| 0.95                  | 1.00 | 768      | 0.97             |
| 1.00                  | 1.05 | 27,154   | 1.00             |
| 1.05                  | 1.10 | 164      | 1.06             |
| 1.10                  | 1.20 | 326      | 1.13             |
| 1.20                  | 1.14 | 256      | 1.26             |
| 1.40                  | 1.60 | 42       | 1.48             |
| 1.60                  | 2.00 | 11       | 1.78             |

and employers of changing or restricting MSF aggregate limits for its modification ranges.

## **Total Estimated Premium**

Once the premium is calculated with the scheduled rate modifier, volume discounts are applied. MSF requires that annual premiums be greater than \$12,000 for volume discounts to take effect. On annual premium between \$12,000 and \$150,000 a discount of 5 percent is used. Between \$150,001 and \$750,000 a volume discount of 7 percent is applied, and for annual premiums above \$750,001 the volume discount is 9 percent. Private insurance companies also provide for volume discounts. The annual premium amounts and percentages vary depending on the company.

A terrorism charge of \$.02 per \$100 of payroll is then applied. The terrorism charge began after September 11, 2001 and will be used should significant acts of terrorism again injure or kill large numbers of workers. It is a federal program that requires mandatory participation by insurance carriers in order to receive the protection of the program should a terrorist event occur and as such is applicable to both MSF and private insurers.

Both MSF and private insurance carriers also provide for a number of other adjustments and programs. If the business is a construction company a separate adjustment is calculated for the construction credit, which is applied before the scheduled rate modifier is determined. Businesses can also elect to participate in the employer's liability insurance or the medical deductible program. Included in the basic premium for all employers is employers liability coverage at basic rates. MSF's employer's liability insurance provides coverage for the legal obligation of an employer to pay damages to employees because of injury by accident or disease not otherwise covered by workers' compensation above the basic limits provided by MSF policies. An employer may elect higher limits within certain guidelines. The MSF Medical Deductible Program provides a premium discount as the employer elects to pay a portion of the medical cost or deductible of each workers' compensation claim filed each year. Private insurance carriers have similar programs.

Larger accounts and groups can elect to participate in the Retrospective Rating Program. A retrospective rated account has an agreed upon minimum and maximum premium that the employer will pay based on loss experience. Through this program businesses share the exposure to loss with the insurer. If the overall loss experience for the year is favorable a portion of the premium is returned to the business. If the loss experience is not favorable additional premium is paid to the insurer for the additional costs associated with the losses.

## **STATE AGENCY PREMIUM ASSESSMENTS**

The legislature requires state agencies excluding the university system to use MSF as their insurance carrier for workers' compensation insurance. 39-71-403, MCA requires state agencies to pay the premiums when required by MSF, whether or not the agency included the expense in the budget, or whether the agency was appropriated funds for these costs. In FY 2010 the total estimated premium for state agencies is \$17,623,917.

## **Loss Costs**

As stated, MSF does not use NCCI classification codes and associated NCCI loss costs for state agencies. MSF has developed loss costs for state agencies based on the state agencies workers' compensation experience and created specific classification codes for the payroll associated with state workers. These classification codes are unique to state agencies.

NCCI loss costs are the costs of workers' compensation claims for indemnity and medical costs spread across all payrolls of Montana employers included in the class codes and the total premium paid for these class codes. One possible effect of only using state agency experience is that it shrinks the pool that losses are spread across which may increase the loss costs to the state. It should be noted, however, that limiting the pool could also have the effect of lowering loss costs because severe or greater numbers or frequency of losses are not included as they might if there was a wider pool of losses. If the state agency loss experience was better or worse than the average for the class code, under MSF current rating process the experience modifier would determine the rating tier and could be used to increase or decrease the premium costs.

Figure 8 shows the various class codes used by MSF to assess state agencies workers' compensation premiums in FY 2010, the associated payroll for each class code, the associated loss costs as determined by MSF, the costs per \$100 of payroll for each tier, and the estimated costs of workers' compensation for each class code.

Figure 8  
MSF State Agency Payroll, Loss Costs, Tier Rating  
FY 2010

|  | State Agency<br>Payroll | Loss<br>Costs | Tier 1 | Tier 2 | Tier 3 | Tier 4 | Tier 5 | Estimated*<br>WC Costs |
|--|-------------------------|---------------|--------|--------|--------|--------|--------|------------------------|
| Loss Cost Multiplier                                   |                         |               | 0.911  | 0.973  | 1.041  | 1.249  | 1.665  |                        |
| 7424 State Aircraft Operational NOC:Flying Crew        | 1,038,200               | 5.81          | 5.29   | 5.65   | 6.05   | 7.26   | 9.67   | 47,965                 |
| 7704 Firemen, Fire Patrol, Municipal Firemen & Drivers | 7                       |               |        |        |        |        |        | 399                    |
| 7721 State Penal Institutional : All Other Employees   | 35,763,035              | 5.71          | 5.20   | 5.56   | 5.94   | 7.13   | 9.51   | 1,931,184              |
| 7722 State Highway Patrol Officers                     | 14,554,979              | 4.3           | 3.92   | 4.18   | 4.48   | 5.37   | 7.16   | 671,242                |
| 8744 State, Hosp, Penal: Prof Or Adm                   | 251,358,446             | 1.24          | 1.13   | 1.21   | 1.29   | 1.55   | 2.06   | 2,842,239              |
| 8811 State : Clerical Office Employees                 | 100,445,679             | 1.82          | 1.66   | 1.77   | 1.89   | 2.27   | 3.03   | 1,778,741              |
| 8834 State Hospital: All Other Employees & Drivers     | 31,435,965              | 13.78         | 12.55  | 13.41  | 14.34  | 17.21  | 22.94  | 4,116,893              |
| 8868 College/Sch/Church:Prof & Cl                      | 4,016,364               | 1.22          | 1.11   | 1.19   | 1.27   | 1.52   | 2.03   | 47,166                 |
| 9101 Clg/Sch/Church: All Other                         | 1,328,450               | 5.96          | 5.43   | 5.80   | 6.20   | 7.44   | 9.92   | 68,032                 |
| 9411 State Highway Dept: Admin Or Non-Professional     | 49,542,649              | 2.1           | 1.91   | 2.04   | 2.19   | 2.62   | 3.50   | 939,825                |
| 9412 State: Administrative or Non-Professional         | 59,910,400              | 2.26          | 2.06   | 2.20   | 2.35   | 2.82   | 3.76   | 1,203,840              |
| 9421 State Highway Dept: All Others & Drivers          | 32,926,219              | 11.34         | 10.33  | 11.03  | 11.80  | 14.16  | 18.88  | 3,085,200              |
| 9422 State: All Other Employees NOC & Drivers          | 11,538,239              | 9.49          | 8.65   | 9.23   | 9.88   | 11.85  | 15.80  | 882,164                |
| 9427 Community Service Workers                         | 160,398                 | 7.22          | 6.58   | 7.03   | 7.52   | 9.02   | 12.02  | 9,025                  |
| Total  | 594,019,029             |               |        |        |        |        |        | 17,623,917             |

\* Final premium excludes estimates for regulatory assessments. Includes expense constant and minimum premium increment. Does not include potential general dividend or potential retrospective rating adjustments.

## State Agencies Required to Use MSF

As stated above, state agencies are required to use MSF to provide workers' compensation insurance. The 2003 Legislature passed Senate Bill 304, a bill directing a committee to study the role of the State Compensation Insurance Fund. Included within the recommendations of the study committee was the determination that MSF is not entitled to have state agencies as an exclusive book of business, and that state agency business be available for self-insurance or to private carriers in four years. Eliminating this requirement would allow state agencies to "shop" for lower premiums. Competition between the MSF and the private insurance companies may result in cost savings to Montana similar to cost savings which theoretically occur through the Request for Proposal process used to procure other services for state agencies. Areas where savings MAY be available include:

- Lower manual and standard rates associated with experience modification factors. As discussed earlier, private insurance companies use multiple companies with varying experience modification factors which somewhat mimic the tier rating used by MSF or use tiers similar to the method used by MSF
- Different analysis of the percentage of the scheduled rate modifier factor that should be applied to the premiums as this determination is considered somewhat subjective on the part of the underwriter. As previously discussed, private insurers have the latitude to increase or decrease the premiums by plus or minus 40 percent through the scheduled rate modifier. Any amount beyond the 40 percent must be approved by the State Auditor's Office. MSF ranges for scheduled rate modifiers vary between -100 and 220 percent. Higher volume discounts for the high dollar premiums paid by the State of Montana may be available through private insurers
- A retrospective rating program for state agencies written by a private insurer may also result in premium savings to state agencies along with creating an incentive for a safe work place. State agencies currently participate in retrospective rating with MSF

However, one major legislative consideration is that state agencies with lower experience modification factors and associated lower risks to the insurance company may be able to obtain workers' compensation insurance at a lower cost than that provided by MSF, while agencies with higher experience rating factors may not have the same options available to them. This allows private insurance companies to "cherry pick" state agency business while requiring MSF to insure those state agencies that have a higher risk of incurring claims costs as exhibited by their experience rating factors. This may result in cost increases to businesses insuring through MSF,



including those state agencies with higher risks. Alternatively, a private insurer could be legislative required to write all state agencies, price according to the experience of each state agency and not allowed to “cherry pick”. This alternative may still result in lower overall premiums for the state as a whole.

The Department of Administration Healthcare Benefits Division makes workers’ compensation insurance policy decisions with MSF for state agencies. Insuring through a private insurer would require the State of Montana to issue an RFP for workers’ compensation insurance coverage. Assurances related to the ability of the private insurer to provide the necessary coverage and customer service for claims would need to be included as part of the contract. Another consideration would be that the class codes used by MSF for state agencies were developed by MSF. A conversion from the MSF class codes to NCCI class codes would need to occur and could potential pose some challenges. Private insurers currently working with other states have expressed an interest in working with Montana should the legislature decide to change the policy options available to state agencies. If the legislature wishes to consider eliminating the requirement that state agencies use MSF to obtain their workers’ compensation insurance, a requirement that if a single private insurance company is to provide workers’ compensation insurance to state agencies it must insure all state agencies should be included.

Another option for the state may be to self-insure for workers’ compensation insurance. IF the state were to self-insure, the state could purchase excess insurance from a private insurer to cover losses over a certain amount to limit the liability of the state. In the LFD report, *State Agency Policy Options*, the LFD determined the following:

- In FY 2008, MSF had 69 percent of the workers’ compensation market with state agencies comprising approximately 7.7 percent of earned premium revenues
- Between FY 2000 and FY 2007 state agencies costs for workers’ compensation insurance through MSF increased 194.6 percent
- Between FY 2000 and FY 2007 the costs of the Office of the Commissioner of Higher Education and Montana University System, which are self insured, increased 144.5 percent

Review of this option by the Healthcare Benefits Division to assess potential cost savings, benefits and drawbacks would be needed before the state could adopt this option.

### ***Legislative Option***

The legislature may wish to request the Department of Administration develop information on the potential cost savings, other benefits, and potential drawbacks that may be realized if the department was allowed the flexibility to obtain workers’ compensation insurance for state agencies through any of the three compensation plans.

## **REGULATORY REVIEW**

As discussed previously, private insurers are required to follow the uniform classification system and uniform experience rating plan filed by the designated workers’ compensation advisory organization in Montana. The State Auditor’s Office Insurance Program has a qualified actuary that reviews each private insurers filing to ensure it is in compliance with ratemaking standards. A qualified actuary is an actuary that is qualified to make Statements of Actuarial Opinion. The State Auditor’s Office is the only state agency that has a qualified property and casualty actuary on staff.

Private insurance companies are required to file audited financial statements and actuarial opinions annually with the Insurance Commissioner. During financial examinations, the Insurance Commissioner conducts:

- separate examinations of the loss and loss adjustment expense reserves of insurance companies using qualified actuarial staff to make determinations of the adequacy of the reserves and the premium rates charged
- additional reviews to ensure the financial soundness of the private insurers. This is done to protect the consumer as private insurance companies do not have the additional resources of the State of Montana to offset any unfunded liabilities

The Insurance Commissioner conducts financial examination of insurers domiciled in Montana. For insurers domiciled in other states, the Insurance Commissioner accepts examinations conducted by the insurer's home state when the home state is accredited with the National Association of Insurance Commissioners (NAIC). Currently, all states are accredited with NAIC. SAO completes market conduct examinations on primarily domestic insurers, but has the authority to complete examinations of foreign insurers when considered necessary.

## **Market Conduct Examinations**

The focus of market conduct examinations is to review insurance company actions in regard to sales, advertising, rating, and the handling of claims. Private insurance companies file their proposed rates on SAO forms. The SAO examines the information included in the insurer filings and for some filings approves or disapproves the rates prior to their implementation. Once the companies file their rates with SAO they are required to follow them. The market conduct examination is designed to insure this occurs. In addition, SAO staff follow-up on consumer complaints regarding sales, advertising, rates or handling of claims for private insurance companies.

## **Financial Examinations**

The goals of financial regulation (both examinations and analysis) conducted by the Insurance Commissioner are to:

- 1) Protect consumers;
- 2) Identify companies experiencing financial problems currently, or possessing the greatest potential for developing financial problems in the future;
- 3) Define and evaluate areas of performance in troubled companies negatively affecting results; and
- 4) Verify the correctness of reported financial data.

Private insurance companies file financial information with the National Association of Insurance Commissioners (NAIC). The insurance companies' annual statements are formatted onto a prescribed reporting form. The Insurance Commissioner then analyzes the information using the NAIC financial analysis solvency tools included in the NAIC financial analysis handbook. The NAIC financial analysis handbook addresses three levels of analysis.

The objective of level 1 analysis is to perform sufficient analysis on year-end results to determine the areas and extent for which additional procedures may be warranted. In addition to a detailed review of the insurers annual statutory financial statements, the analysis includes reviews of:

- o Actuarial opinion
- o Management's Discussion and Analysis
- o NAIC Annual Scoring Results
- o Insurance Regulatory Information System (IRIS) Ratios
- o NAIC Company Profile Report

In addition, the insurer's past regulatory history, accuracy of filing, age of insurer, stability of business plan, and knowledge of company's operations may affect the extent to which Level 2 or Level 3 procedures are considered necessary.

IRIS ratios examined include:

- o Gross premiums written to policyholders surplus
- o Net premiums written to policyholders surplus
- o Change in net premiums written
- o Surplus aid to policyholders surplus
- o Two-year overall operating ratio
- o Investment yield
- o Gross changes in policyholder surplus
- o Change in adjusted policyholder surplus
- o Adjusted liabilities to liquid assets

- Gross agents balances (in collection) to policyholders surplus
- One-year reserve development to policyholder surplus
- Two-year reserve development to policyholder surplus
- Estimated current reserve deficiency to policyholder surplus

NAIC Annual Scoring Results focus on financial position, results of operations, cash flow and liquidity, and leverage.

If issues or concerns are noted in the level 1 analysis additional work is completed to determine if the company is at risk of financial problems. The Insurance Commissioner conducts quarterly and annual reviews of private insurance companies' financial information. Every 3 to 5 years, the Insurance Commissioner conducts an in depth examination of the insurance companies and examines the affairs, transactions, accounts, records, and assets of the insurer.

When companies are found to be in hazardous financial condition, the Insurance Commissioner has the statutory authority to require the insurers to take certain actions. These could include supervision conducted by Insurance Commissioner, cessation of new business, infusion of additional capital, and filing of plans of corrective action. If corrective action is ineffective, SAO has the authority to initiate court-ordered rehabilitation or liquidation. Private insurers pay into the Montana Guaranty Fund which is used to pay benefit costs in cases of liquidation.

### **MSF Currently Not Subject to Regulatory Oversight**

According to the Legislative Audit Division (LAD) performance audit - Montana State Fund Corporate Governance Practices, while all 10 of the other workers' compensation state funds reviewed by LAD are subject to some form of regulatory supervision through the state insurance commissioner or a similar office charged with regulation of insurance providers, MSF is not. The report goes on to state that under a system of regulatory supervision, insurers are subject to specialized reviews by organizations with appropriate subject matter expertise. These reviews, as discussed above, are generally based on pre-defined standards or requirements established by the NAIC. The goal of regulatory supervision is promoting adherence to standards and requirements in day-to-day business operations and this generally involves giving the regulatory agency enforcement authority in some form. Legislative oversight of MSF does not meet these parameters.

### ***Legislative Option***

The legislature may wish to consider including MSF as an insurance company for purposes of regulatory oversight provided by the Insurance Commissioner.