Montana State Fund
Reserves, Equity, Solvency, and Related Oversight

Claims, loss reserves, and equity

- Estimate of cost of claims, set aside a claims or loss reserve for those costs paid in the future
- According to the American Association of Insurance Services Claims (loss) reserves established in two ways:
  - Statistically or actuarially by monitoring past lost experience and projecting future losses
  - Subjectively by the claim person's judgment

Claims, loss reserves, and equity

- If estimates in loss reserves insufficient, additional funding provided from either investment income or equity
- Equity available to offset increased risks – increases in indemnity or medical costs or increases due to court decisions

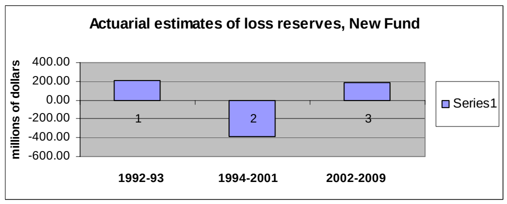
Adverse Development

Increases in loss reserves

Cannot go back to insured and request additional premiums

Reduce income and may affect equity in year recognized

Adverse Development



Uses of Equity – New Fund

- MSF board declared dividend to Old Fund $102.3 million in September 2006
- 1997 Legislature transferred $63.8 dividend to Old Fund
- 1997 Legislature transferred $10 million in FY 1998 and $10 million in FY 1999 to general fund for transfer of general fund in FY 1989

Uses of Equity – Old Fund

- MSF Board transferred $14.1 million to New Fund between FY 2001 and FY 2002
- Legislature transferred $23 million between FY 2004 and FY 2005

Review of Loss Reserves

Statute requires Legislative Audit Division to:

- Evaluate claims reservation process
- Evaluate the amount reserved
- Evaluate the current report of MSF actuary
- Determine if the rates are excessive, inadequate, or unfairly discriminatory

MSF Actuary Estimates Below LAD Actuary Estimates

	New Fund	Old Fund
MSF Actuary	$707,101,978	$65,277,946
LAD Actuary	$794,716,311	$85,654,237
Difference	($ 87,614,333)	($20,376,291)

Actuarial Analysis on Old Fund

- MSF does not currently have assets available to support the discounted reserve
- The investment income assumed to be earned on reserves of $12.3 million unlikely to be earned
- Current deficit of the Old Fund of $45.5 million likely understated

Actuarial Analysis of Old Fund – Legislative Option

The legislature may wish to consider eliminating the requirement that MSF discount the loss reserves of the Old Fund to clarify the total cost of the unfunded liability to the general fund. The change would increase the unfunded liability by approximately $12.3 million over the period claims are paid by the general fund.

MSF Adjuster's Case Reserve Estimates Exceed Actuarial Estimates

- Claims examiners or adjusters subjectively determine the cost of the claims – referred to as case reserve estimates
- LAD actuary noted the claims adjusters reserve estimates significantly exceed MSF actuarial estimates.
- LAD actuary recommends MSF determine the source of these significant differences and reconcile them.

MSF Board Action on Loss Reserves

- For FY 2009, board adopted a loss reserve for loss reserves and loss adjustment expenses of $813.3 million, $32.7 million above the "best" estimate of the MSF actuary
- FY 2009 board set aside an additional $4.0 million of operational results for "reserve strengthening". Total for reserve strengthening is $32 million

Equity Targets

- Importance of equity highlighted by:
  - MSF serves as the guaranteed market for workers' compensation insurance
  - Long-term liabilities associated with workers' compensation claims that may cause greater volatility
  - MSF writes one line of highly regulated insurance
  - MSF writes business only in Montana
  - MSF has no access to capital markets to finance adverse financial results or to finance growth objectives

Equity Targets

- MSF actuary recommends a reserve to equity target of 2.0 to 2.50 to 1.0
- This target indicates equity between $325 million and $407 million at FY 2009
- Actual equity for FY 2009 $201 million

Equity targets

Fiscal Year	Loss reserve to Equity ratio	Equity
2002	2.19	$158,498,995
2003	3.40	121,599,417
2004	3.55	127,492,000
2005	3.45	148,353,871
2006	3.62	163,101,495
2007	3.41	199,168,517
2008	3.47	216,564,182
2009	4.05	$201,031,900

Equity Targets

Figure 5

Loss Reserve to Equity Target

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
FY 2003 Strategic Plan	2.09	2.07	2.05							
Actual	3.40	3.55	3.45							
FY 2004 Strategic Plan		2.64	2.60	2.56						
Actual		3.55	3.45	3.62						
FY 2005 Strategic Plan			3.23	3.70	2.88					
Actual			3.45	3.62	3.41					
FY 2006 Strategic Plan				3.75	3.78	3.75				
Actual				3.62	3.41	3.47				
FY 2007 Strategic Plan					3.42	3.24	3.00			
Actual					3.41	3.47	4.05			
FY 2008 Strategic Plan						3.52	3.20	2.91		
Actual						3.47	4.05			
FY 2009 Strategic Plan							3.17	2.98	2.77	
Actual							4.05			
FY 2010 Strategic Plan								4.24	3.88	3.55

Equity Targets

- MSF premium rates include contribution to equity as part of the loss cost multiplier
- If MSF able to achieve $186.5 million in premiums, maintain or reduce budgeted costs, does not have significant adverse loss development, and does not have significant unbudgeted costs such as dividends or performance incentives, approximately $10.1 million could be used to move MSF’s equity closer to the recommended target

Other Factors Influencing Equity

- If investment income not sufficient to cover operating losses and dividends, MSF reduces equity to pay for the additional costs
- Statute allows MSF to pay dividends if there is an excess of assets over liabilities, including necessary reserves and an appropriate surplus. Statutorily required to set aside 25 percent of annual earned premium as surplus (equity). FY 2009 - $50.99 million

Other factors influencing Equity

Year	Net Operating Income/Loss- in millions	Dividends – in millions
1998	$42.65	$7.00
1999	24.50	6.95
2000	5.30	4.99
2001	6.50	2.80
2002	7.80	1.90
2003	(37.50)	5.00
2004	(8.30)	5.00
2005	18.78	7.00
2006	10.12	3.99
2007	18.90	2.00
2008	32.09	N/A
2009	$ 8.63	N/A

Other Factors Influencing Equity

- Dividends declared two years after the policy year ends
- $7 million dividend for FY 1998 declared in FY 2000
- Board declared $10 million in dividends in years suffered net operating losses
- MSF equity used to cover net operating losses and dividends in FY 2003 and FY 2004
- Result is to extend time MSF to achieve recommended strong equity position

Other Factors Influencing Equity – Legislative Option

Due to the significance of the need for equity and the inclusion of the contribution to equity component in the premium rates as part of the loss cost multiplier, the legislature may wish to further clarify under what conditions dividends can be declared.