

Policy Options For Workers' Compensation Structure and Competition

The following tables address various structure issues and Montana State Fund competition:

- Oversight/regulation related to Montana State Fund
- Reserve/surplus/dividend determinations for Montana State Fund
- Policy premiums - establishing modification factors and job classifications
- State Fund book of business - the guaranteed market
- Level playing field considerations
- State Fund Board - composition, terms
- State Fund operating as a business and as a state agency

Oversight of Montana State Fund

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • Legislative Audit Committee for finances/ operations through annual audit. Legislative Audit also conducts through an outside qualified actuary an annual review of State Fund rates to determine if they are excessive, inadequate, or unfairly discriminatory. Hires an outside qualified actuary who provides high-level reviews of the State Fund's internal audit processes and State Fund's hired outside qualified actuary. • Legislative Finance Committee for budget review as provided in 39-71-2363. • Rate review - done by board and staff with input from an outside qualified actuary. Also - Legislative Audit reviews rates (see above). • Governor and legislature receive annual financial report from State Fund. • The State Administration and Veterans Affairs Committee has formal review responsibilities during the interim. This usually devolves to review of proposed legislation, but could include any matter of interest to the committee. • Two legislative liaisons are assigned to the Board of Directors (by the Economic Affairs Committee) to attend board meetings and receive board information. 	<ul style="list-style-type: none"> • Assign Commissioner of Insurance Office market conduct and financial review authority for reporting to legislature but without regulatory authority • Assign Commissioner of Insurance Office market conduct and financial review authority with regulatory authority. • Assign State Fund to pay for independent market conduct and financial exams every 5 years (or other term considered appropriate) • Assign to Commissioner of Insurance Office the rate review authority <u>without</u> regulatory authority (for informational purposes only). • Assign to Commissioner of Insurance Office rate review <u>with</u> regulatory authority. (see Missouri mixed option below under Complications/Concerns.) <p>(for above see Premium Assessment LFD report)</p> <ul style="list-style-type: none"> • Segregate State Fund from the Department of Administration attached agencies to provide interim oversight to the Economic Affairs Committee rather than the State Administration and Veterans Affairs Committee. (Several changes may be proposed through Legislative Council, but if an overall change is not suggested the Economic Affairs Committee may want to suggest this change, which follows almost a decade of practice.)
Complications/Concerns	
<ul style="list-style-type: none"> • The 2009 Legislative Performance Audit noted that legislative oversight of Montana State Fund is different from regulatory supervision. The audit pointed out, "Although 39-71-2315(2), MCA, grants the MSF board powers and authority equivalent to those of a private mutual insurance carrier, the (continued on next page) 	

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fund is not subject to the same type of regulatory supervision. The other competitive state funds we reviewed are subject to at least some of the same regulatory supervision that applies to private insurance companies operating in their states. (p. 08P-08, Montana State Fund Corporate Governance Practices, February 2009) <http://leg.mt.gov/content/Publications/Audit/Report/08P-08.pdf>

- Other than routine financial review by the Legislative Auditor Financial Compliance unit and review by the Legislative Finance Committee of the budget, the only other oversight is by the Montana State Fund Board (see State Fund Board below), with the possibility of seeking a legislative *performance* audit. Generally, there is no oversight to determine appropriateness of the board's actions.
- Other insurers under the regulatory authority of the Insurance Commissioner's Office can end up in a regulatory takeover if financial solvency becomes an issue. There currently is no regulatory takeover for State Fund. Legislation would be needed to create such a regulatory takeover, with the selected regulator tasked -- depending on the statutory authority -- with devising a rescue plan. Previously, when the Old Fund was created, the predecessor to the State Fund was dissolved and the financial "rescue" involved a legislatively enacted surcharge on employers' and later employees' pay-related taxes. A similar "rescue" would need to happen if State Fund were ever to become at risk of not fulfilling its obligations.
- Missouri law provides for a mixed option - either accept the NCCI loss costs ratio or a ratio determined by the department of insurance. In 2010, www.insurancejournal.com says, the Missouri department recommends loss costs that are 8.1% lower than current loss costs. NCCI recommends 1.9% lower loss costs than last year. (Thrown in to illustrate what other states do -- good or bad.)
- The independent qualified actuary required under 39-71-2330 is "to develop and recommend actuarially sound rates". There is a potential conflict of interest if the contracted agent sees the benefit (of retention) by weighing in favor of what the hiring entity wants to hear, although a qualified actuary uses the same assumptions for all clients. There is a benefit from long-term association in that the learning curve is not continually re-entered. In some cases Montana State Fund has been more conservative than its outside qualified actuary's best recommendation in setting reserves. The outside qualified actuary has been the same at Montana State Fund for about 20 years.

Reserve/Surplus/Dividend Determinations

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • Set by board, with surplus minimum of 25% of annual earned premium required under 39-71-2330(2). • Review by in-house auditor and outside qualified actuary who makes recommendations to the State Fund Board. • Review by legislative auditor to determine if the process used by State Fund internal staff and external actuaries meets standards. • Review by Legislative Finance Committee for budgetary concerns, as provided in 39-71-2363. State Fund is exempt from the Legislative Finance Act, which includes, among other activities, investigation of confidential records with limitations. • Under 39-71-2323, MCA, the board may declare dividends if at the end of a fiscal year there is "an excess of assets over liabilities, including necessary reserves and an appropriate surplus as determined by the board in accordance with 39-71-2330, and if the excess may be refunded safely...". 	<ul style="list-style-type: none"> • Revise regulations of reserves - perhaps by being more specific regarding language in 39-71-2323 about "if the excess may be refunded safely". • Increase the amount of surplus that must be maintained (possibly based on independent actuarial recommendations). • Revise exemption to Legislative Finance Act to include more specifics about what is exempt but still allow for appropriate investigations. • Place triggers or clarifications of what "may be refunded safely" to recognize equity as well as surplus.
<p>Complications/Concerns</p>	
<ul style="list-style-type: none"> • In the past, the cause of the Old Fund problems was said to be political interference that discouraged increases in premiums considered necessary to meet costs and projected losses. A similar occurrence could result if the State Fund considered its need for growth/competition to be more important than maintenance of reserves/surpluses, e.g. the need for dividend distribution and other means used to retain or increase the number of accounts. The question is whether current practices allow for an alert to be raised before an unstable condition becomes acute. • A second question is whether the effort to retain "good" customers through dividends (arguably a good business practice) results in higher premiums for small businesses with no rating or chance to receive the dividends (according to practices set by the board). A report to the Legislative Finance Committee in October 2006 noted: "Reducing equity through dividend payments reduces the amount of investment income available for offsetting the costs of premiums to all employers, including those not eligible for dividends." (p. 6) The State Fund has issued dividends in years when State Fund had net operating losses. 	

Policy Premiums - Establishing Modification Factors and Job Classifications

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • Classifications - board "may" use employment classifications set by NCCI (or whatever rating agency is used by the Commissioner of Insurance) but there's leeway. See 39-71-2316(1)(e). • Multiple rating tiers are allowed under 39-71-2330(3). (Plan 2 can do so under Title 33.) • State Fund does not have a limit on the schedule rate modifier percentages. • The loss costs used in setting rates can deviate for State Fund from the NCCI loss costs. 	<ul style="list-style-type: none"> • Require use of NCCI classifications for all jobs. • Require use of NCCI classifications for most jobs but carve out jobs in agriculture and other areas currently classified differently than NCCI. • Require the scheduled rate modifier to have the same restrictions as for Plan 2 under 33-16-1023(6). • Require the State Fund to use the NCCI loss cost, with the same terms as applied to the private insurers. (See LFD report on premium assessments)
Complications/Concerns	
<ul style="list-style-type: none"> • There are complaints that classifications may vary or be inappropriately determined without any means of recourse. Having a national standard is one way of dealing with that complaint (but applying a national standard locally may be problematic). • The Commissioner of Insurance limits the scheduled rate modifier to plus or minus 40% below base. • Using the same loss costs as Plan 2 insurers might require rate review regulation or some sort of waiver for State Fund under certain conditions. 	

State Fund Book of Business - Guaranteed Market and Provider of State Work Comp

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • State Fund is the insurer of last resort - or guaranteed market - for all companies except those that have a history of not paying premiums. • State Fund has the state "book of business" for the State of Montana workers' compensation, except for the university system. 	<ul style="list-style-type: none"> • Allow State Fund to privatize and establish a high risk pool instead (for example, either by assigning high risks on a rotating basis among insurers or requiring a separate unit to which all insurers contribute). • Keep State Fund as a government agency and guaranteed market, but allow the State to self-insure or to be covered under a Plan 2 or Plan 3 contract (in its entirety). One option for Plan 2 would be to require the State to be retrospectively rated or have a similar advantageous option. The State currently has a retrospective plan with State Fund.
Complications/Concerns	
<ul style="list-style-type: none"> • SB 304 study of high risk pools resulted in a recommendation of no change. • The SB 304 Committee recommended 8-1 that the exclusive state book of business be phased out. • Enabling the State Fund to privatize most likely would require constitutional changes to remove <p style="text-align: center;">(continued on next page)</p>	

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reference to investments by the State Fund in Article VIII, section 13. (Legal opinion from Greg Petesch to Sen. McNutt, dated Oct. 9, 2002. ... "Because the assets of the state fund are constitutionally declared to be public funds, the state fund is of necessity required to be a governmental entity". p. 4)

- There is a concern that private insurance companies could cherry-pick the good risk among State agencies and leave the bad risk for State Fund. That is why the suggestion is to require any alternate option to provide coverage for all state agencies.
- The suggestion for retrospective rating for the State with Plan 2 insurers would require a negotiation between parties and provide a way for the State to avoid paying potentially excess profits.

Level Playing Field Considerations

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • Plan 2 (private) insurers pay a 2.75% tax on their premiums sold as well as a \$1,900 annual fee to renew (or obtain) a certificate of authority from the Insurance Commissioner's Office. Plan 3, the State Fund as a state agency, does not pay a tax on premiums to the state nor is it under the regulation to pay the fee to obtain the certificate of authority. • Plan 2 insurers participate in the Montana Guaranty Association. • Plan 2 insurers may be required to pay punitive damages but the State Fund, as a state agency, does not have that requirement. • Fraud prosecution is done for the State Fund by the Attorney General's office. Plan 2 insurers have to rely on generally overburdened county attorneys to prosecute their fraud cases. 	<ul style="list-style-type: none"> • Provide for a phased-in premium tax for State Fund. • Require State Fund to be regulated by the Insurance Commissioner under Title 33, chapter 2, part 10, including participation in the Montana Insurance Guaranty Association but providing distinct terms for State Fund dissolution proceedings. • Allow Plan 2 insurers to avoid punitive damages under the same conditions that State Fund has. • Allow Plan 1 risk-retention groups and Plan 2 insurers to participate in the fraud investigation/prosecution unit that State Fund currently finances, so that risk-retention groups under Plan 1 and all Plan 2 and Plan 3 prosecutions would be out of that office.

Complications/Concerns

- The SB 304 Committee recommended 6-3 for a phased-in premium tax. In the ensuing session in 2005, HB 189 would have phased in a premium tax. The fiscal note for HB 189 noted that the tax would be passed along as an equivalent increase in premiums. That bill failed in the House. The fiscal note said State Fund is required to be neither more nor less than self-supporting and its revenue is from premium dollars and investment assets. There is the potential for any tax to be passed to the policyholders. A study may be necessary to determine if adding a tax but imposing certain regulations by the Insurance Commissioner's Office would increase the tax for all policyholders. This study could be accompanied by a survey of policyholders to determine their attitudes about the level playing field imposition of a premium tax.
- All Plan 1, Plan 2, and Plan 3 insurers pay into the work comp administrative fund based on their losses, so in that respect there is an even playing field.

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- The Montana Insurance Guaranty Association, described in 33-10-105, MCA, is obligated to pay the full workers' compensation claims of work comp insurers that are insolvent. It is funded by an assessment on its members. If the State Fund were to be part of this association, it would have all the responsibilities but no recourse (as a State agency that currently must be "rescued" by the legislature) to the dissolution proceedings provided by the association. There may be other options, but a study would be needed to clarify what costs and benefits would accrue to the State Fund.
- Allowing Plan 2 insurers to avoid punitive damages in workers' compensation would be a precedent for notwork comp insurers to point to for also avoiding punitive damages. This might be worth a study to determine how often punitive damages have been awarded in workers' compensation cases. Punitive damages are defined in 27-1-221, MCA, and include that a defendant must be found guilty of actual fraud or actual malice. Those terms include "conscious or intentional disregard of the high probability of injury to the plaintiff" (malice) and concealment of "a material fact with the purpose of depriving the plaintiff of property or legal rights or otherwise causing injury" (fraud).
- Private insurers, including self-insurers, have voiced concerns about fraud, fraud investigation, and fraud prosecution. Self-insurers that provide coverage ought to be able to investigate themselves and their employees adequately for fraud because having anyone else investigate would mean more intrusion into their operations. (But if they want to be included, then perhaps there is a way to include their financing of the fraud investigation/prosecution unit, too.)

State Fund Board - Composition, Terms

Current:	Options (other than status quo)
<p>2-15-1010, MCA requires a 7-member board appointed by the governor. The executive director of MSF is an ex officio nonvoting member. The following criteria apply:</p> <ul style="list-style-type: none"> • at least 4 members must be MSF policyholders or policyholders' employees. • at least 4 members must represent private, for-profit enterprises. • one of the 7 may be a licensed insurance producer. • board members may not -- except for the licensed insurance producer -- be an employee or representative of a Plan 2 insurer or be an employee of a self-insured employer under Plan 1. • board members may not serve more than two 4-year terms. 	<ul style="list-style-type: none"> • Revise to be more like the Board of Investments (BOI) by having more constituent board members and no limit on the number of years served. For example, BOI has 9 members, with 1 each from the public employees' retirement board and the teachers' retirement board. The remaining 7 BOI members are to represent the financial community, small business, agriculture, and labor and to represent a balance of professional expertise and public interest and accountability. • Require a "professional" board. • Require at least one member to have financial expertise. (LAD notation - Feb. 09 audit) • Allow board members to elect chair rather than have chair appointee by governor (LAD note) • Elect some board members from among policyholders.
Complications/Concerns	
<ul style="list-style-type: none"> • More board members cost more money. Professional board members cost even more money, but that may be offset by the skill sets and institutional knowledge that a professional board might bring and the money that those skill sets might save. A board may be professional by areas of expertise. • Federal tax exempt status relies on a certain number of board members being appointed by the legislature or the governor. • The SB 304 Committee voted 2-7 against requiring 3 of the 7 board members to be elected by policyholders. 	

State Fund operating as a business and as a state agency

Current:	Options (other than status quo)
<ul style="list-style-type: none"> • Under 39-71-2316(1)(j), the state fund may, "upon approval of the board, contract with licensed resident insurance producers;..." This provision, according to the 2006 Legislative Fiscal analysis of the State Fund Budget, resulted in 66.2% of MSF premiums being handled by the agents. The commissioners paid in that year were at 7.975% of gross premiums. A second provision in 39-71-2316(1)(k) allows agreements with licensed work comp insurers, associations, or producers to provide work comp coverage in other states to Montana employers insured with the State Fund. • Under 39-71-2316(1)(l), the state fund may, "upon approval of the board, expend funds for scholarship, educational, or charitable purposes;" • Under 39-71-2316(1)(n), the state fund may "perform all functions and exercise all powers of a private insurance carrier that are necessary, appropriate, or convenient for the administration of the state fund". • Under 2-18-103, the executive director and employees of the state fund are exempt from the state pay plan for purposes of classification, compensation, and grievances. They are included for terms of group insurance and can participate in cooperative purchasing if the State Fund determines it to be in its interest. • Under 2-18-601 definitions of "agency", State Fund employees are exempted from leave provisions affecting other state employees. Instead, 31-71-2328 allows an alternate leave plan. 	<ul style="list-style-type: none"> • Assign to a regulatory agency the determination of whether agent commissions for in-state workers' compensation policies ought to be regulated if the State Fund market share surpasses a certain percentage. • Set in statute trigger points based on reserves and/or equity at which funds for scholarship, educational, or charitable purposes may be expended. • Repeal this subsection (1)(l). • Designate legislatively what the functions and powers referenced in subsection (1)(n) are. • Set trigger points based on reserves and/or equity at which the state fund may perform all functions and exercise all powers of a private insurance carrier. • Return State Fund employees to the state pay plan for purposes of classification, compensation, and grievances. • Return the executive director of the State Fund to the state pay plan. • Specifically decouple any incentive payments awarded to State Fund employees from increases in premium. • Return State Fund employees to the leave provisions of other state workers.
Complications/Concerns	
<ul style="list-style-type: none"> • State Fund's operations as a private insurance carrier let it compete with private insurers for agents' business and recommendations. It may be difficult or unnecessary for a regulator to interfere in that relationship. However, if independent insurance agents are receiving better commissions for selling State Fund policies and directing more business to State Fund and this results in a less competitive market overall, then policymakers may want to consider options to keep the private insurers more competitive particularly if there is only board oversight of the commission conditions and percentages. Alternatively, the playing field could be termed level for using commissioned agents. <p style="text-align: center;">(continued on next page)</p>	

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- State Fund employees can receive pay incentives by meeting various criteria, which in the past have included increases in premium. In the 2006 analysis by the Legislative Fiscal Division of the State Fund budget, the report noted that \$1.4 million was paid out in employee incentive payments (in FY 2007). An executive incentive plan has been in effect since FY 1995. Employee incentives were offered in FY 2002. See p. 5 of the October 2006 LFD report for the targets and factors assigned to receive incentive payments. Incentives and bonuses may be considered important for morale and retention of experienced employees.

http://leg.mt.gov/content/publications/fiscal/interim/financecmty_oct2006/MSF_Report.pdf

The Legislative Audit Report on Montana State Fund Corporate Governance Practices also reviewed employee and chief executive officer compensation and incentive plans. The report concluded that employee pay plans were on par with comparable agencies with similar needs, recommended that the chief executive officer's compensation be made public, that the board take a greater role in seeking consultation for the executive officer's compensation, and that claw-back provisions be instituted for payments made in error. See the audit report at:

<http://leg.mt.gov/content/Publications/Audit/Report/08P-08.pdf>

- The alternative leave plan allows State Fund employees to try innovative work-and-leave hours, which is said to be one way of boosting or maintaining morale.
- Policymakers must weigh whether too much specification in statute results in micromanagement or whether that type of specification sets clearer boundaries and maintains competition or discourages competition.