COMPETITION IN WORKERS' COMPENSATION

AND WHAT OPERATING AS A BUSINESS MEANS

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Introduction

What is the role of competition in Montana's workers' compensation system, a state-required coverage provided by most employers to ensure that their employees who suffer an on-the-job injury or occupational disease are treated and returned to the work force or otherwise compensated for their inability to work? Competition underlies two of Montana's three tiers in the workers' compensation system. Those that self-insure -- known as Plan 1 insurers -- do not need to compete for their workers' compensation coverage if they agree to cover the costs of workers' injuries and occupational disease with their own resources. By doing this, they project that their safety training and attention to detail will keep workers safe and prevent short- or long-term costs to cover recuperation or disability. Because Plan 1 does not compete in the same way that Plans 2 and 3 do, this report primarily will deal with Plan 2, the private insurance companies, and Plan 3, the Montana State Fund.

Plans 2 and 3 operate their workers' compensation insurance as a business. For Plan 2 insurers, the business operation includes offering a service, following regulations required by the state, and making a profit. As with all workers' compensation insurers, the service in terms of benefits offered are identical for Plans 1, 2, and 3 and are specified under Title 39, chapter 71, of the Montana Codes Annotated. Benefits will be addressed in a separate report. This report will detail the differences between Plan 2 and Plan 3 in terms of regulation, the origins of various requirements for Plan 3 to operate as a business, and the perceptions of how those requirements are being implemented. When differences in approach affect Plan 1, those differences will be mentioned.

Regulation and Plan 2 Insurers

Workers' compensation insurance is one of the casualty lines of insurance. In Montana approximately 220 companies offered workers' compensation insurance in 2008, although 652 of 831 property and casualty companies authorized to do business in Montana had the authority that year (the latest year for full-year figures) to offer workers' compensation insurance here. Table 1 provides a list of the top 20 private insurers in Montana by Plan 2 market share. The Insurance Commissioner's Office notes that of the 220 private insurers writing premiums, fewer than 30 write more than $1,000,000 in premiums annually[1].

These insurers receive a certificate of authority to do business here from the Commissioner of Insurance. The Insurance Code requires them to pay $1,900 a year to obtain or renew the certificate of authority and a premium tax of 2.75% on premium written, as provided in 33-2-705(2), MCA. Each agent pays additional fees for an individual license or license renewal, as spelled out in 33-2-708, MCA.

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[1] Email from the Office of the Insurance Commissioner, Jan. 11, 2010.

Table 1: Top 20 Workers' Compensation Plan 2 Insurers in Montana (by market share-2008)

Company	Domicile	Direct Premiums Written	Market Share	Direct Premiums Earned	Direct Loss Incurred*	Pure Direct Loss Ratio
Liberty Northwest Ins. Corp.	Oregon	$37,705,956	33.553%	$37,582,050	$33,707,578	89.6906%
Employers Compensation Insurance Co.	California	$4,683,724	4.1679%	$4,782,319	$2,851,143	59.6184%
American Zurich Ins. Co.	Illinois	$4,154,928	3.6973%	$3,844,791	$1,320,853	34.3544%
National Union Fire Ins. Co. of Pittsburgh	Pennsyl-vania	$3,530,914	3.142%	$1,910,885	$2,616,203	136.9105%
New Hampshire Ins.	Pennsyl-vania	$2,989,646	2.6604%	$2,301,357	$741,716	32.2295%
American Home Assurance Co.	New York	$2,548,385	2.2677%	$5,430,394	$1,986,830	36.5872%
Victory Ins. Co., Inc.	Montana	$2,454,640	2.1843%	$2,039,254	$1,590,653	78.0017%
Insurance Co. of the State of Pennsylvania	Pennsyl-vania	$2,374,993	2.1134%	$2,311,025	$631,126	27.3094%
Liberty Mutual Fire Ins. Co.	Wisconsin	$2,370,076	2.109%	$1,995,870	$989,385	49.5716%
Rochdale Ins. Co. of NY	New York	$2,277,268	2.0264%	$1,2708,274	$1,099,366	64.3554%
Liberty Ins. Corp.	Illinois	$2,165,326	1.9268%	$2,515,358	$4,115,161	163.6014%
Hartford Ins. Co. of the Midwest	Indiana	$2,147,241	1.9107%	$1,871,462	$816,868	43.6487%
Travelers Ind Co. of America	Connecticut	$2,056,414	1.8299%	$1,841,602	$481,468	26.144%
Twin City Fire Ins Co..	Indiana	$2,044,492	1.8193%	$1,347,083	$390,485	28.9874%
Associated Loggers Exchange	Idaho	$1,958,488	1.7428%	$2,027,758	$1,055,233	52.0394%

Workers' Compensation Plan 2 Insurers, Table 1 continued						
Company	**Domicile**	**Direct Premiums Written**	**Market Share**	**Direct Premiums Earned**	**Direct Loss Incurred**	**Pure Direct Loss Ratio**
Liberty Mutual Ins. Co.	Massa - chusetts	$1,817,451	1.6173%	$1,429,864	$227,495	15.9103%
Wausau Underwriters Ins. Co.	Wisconsin	$1,709,495	1.5212%	$1,602,269	$1,114,112	69.5334%
Truck Ins. Exchange	California	$1,607,261	1.4302%	$1,606,463	$957,608	59.6097%
Zurich American Ins. Co.	New York	$1,548,097	1.3776%	$1,970,339	$964,175	43.8592%
First Liberty Ins. Corp.	Iowa	$1,511,525	1.345%	$2,622,560	$1,798,954	68.5953%

*Direct losses incurred includes adjustments to loss reserves established in prior years.

Source: Montana Insurance Commissioner's Office. Copyright Information from the 1990-2010 National Association of Insurance Commissioners.

These Plan 2 insurers account for about 32% of the market share[2] of workers' compensation in this state, based on premiums written by Plan 2 and Plan 3. The biggest among Plan 2 insurers, Liberty Northwest Insurance Co. had about 34% of the Montana Plan 2 market, based on 2008 data from the Commissioner of Insurance. The only currently active Montana-domiciled Plan 2 insurer is Victory Ins. Co. Inc., which has 2.18% of the Plan 2 market here. (Valor Ins. Co., Inc. previously operated in Montana but wrote their last policy in the late 1990s and was put into liquidation proceedings by the Insurance Commissioner in 2009.) In addition, a captive insurer, which means that the insurer serves only members of a defined group, provides workers' compensation insurance for some of its members in the MHA - Montana Association of Health Care Providers. They operate under captive insurance laws.

Regulation of Plan 2 insurers under the Insurance Commissioner's Office includes:

- ***solvency determinations*** both prior to authorization to do business and during operations. As provided in 33-2-109, MCA, an insurer may not receive a certificate of authority without having unimpaired paid-in capital stock or surplus as provided in

[2]Market share for State Fund is estimated at 68.4% of the written premium market. The remainder is held by Plan 2 insurers. Liberty Northwest's share of the total Plan 2 and Plan 3 market is 10.6%. Estimated for all Plans by payroll, State Fund has approximately 50.2% of the market, Plan 1 has 28.8%, and Plan 2 has 21%.

statute, unless longevity or other circumstances described in 33-2-110, MCA, apply. After the initial certificate, an insurer must comply with risk-based capital requirements provided in Title 33, chapter 2, part 19.

- ***rate review*** to determine whether rates are excessive, inadequate, or unfairly discriminatory, as provided in 33-16-201, MCA, and 33-16-1021, MCA, and the ability to prohibit use of a rate determined to be any of the above, under 33-16-211, 33-16-1028, and 33-16-1029, MCA;
- ***review of rate filings*** under 33-16-1026 and 33-16-1027, MCA. Filed rates are allowed to be used 30 days after the date on which the filing or supporting information is received by the commissioner unless the commissioner disapproves within the 30 days or any extension of that period. The commissioner also may set different timeframes for insurers considered in need of closer supervision (under 33-16-1029, MCA) or in cases when a market is considered noncompetitive.
- ***an option for policyholders to challenge rates***, under 33-16-204, MCA, and a ***procedure to review classifications*** through the classification review committee (33-16-1012, MCA);
- required ***reports on maintenance of reserves*** for losses and mandatory rates and rating plans for prospective loss costs from a workers' compensation advisory organization.. Requirements for reporting reserves and loss adjustment expenses are described in 33-2-518, MCA. The rate filing requirements for the advisory organization are in 33-16-1026, MCA.
- the potential for ***supervision, rehabilitation, and liquidation*** of insurers whose actions may imperil their ability to fulfill the contracts with insureds, claimants, creditors, and others described in Title 33, chapter 2, part 13;
- the ability under 33-1-311, MCA, to ***conduct "examinations and investigations*** of insurance matters" and specific duties to examine "not less frequently than every 5 years" insurers' affairs, transactions, accounts, records, and assets, as provided in Title 33, chapter 1, part 4. The company being examined pays the costs of retaining additional personnel, including independent actuaries under 33-1-408(4).
- ***approval of contract forms***, application forms, and related forms. Under 33-1-501, MCA, the forms must be submitted 60 days prior to use. If, after 60 days, the commissioner has not disapproved the forms, they may be used unless the commissioner later disapproves them or notifies the insurer of concerns about them. These are not the same as the rate filings which have a 30-day file option. These contract forms are filed by the rating advisory organization and Plan 2 insurers. See Appendix A for the sample of a form filed by the National Council on Compensation Insurance, Inc. (NCCI) for use by Montana private work comp insurers.
- ***oversight*** regarding the formation ***of reciprocal insurers*** carrying out workers' compensation coverage, under Title 33, chapter 5;
- ***regulation of the Montana Insurance Guaranty Association***, which handles the claims of work comp insurers that are being supervised, rehabilitated, or have been

liquidated. This is under Title 33, chapter 10.

- ***oversight of work comp policies,*** contracts, and agreements to make certain that they contain various requirements, including for the insured employer to implement a safety program, as provided in 39-71-1507 and 33-15-318, MCA;
- ***annual renewal of*** a workers' compensation (rating) ***advisory organization***;
- ***authority to make rules*** regarding the classification review committee (33-16-1012, MCA); and
- ***determination of whether a competitive market exists among Plan 2 insurers***. By leaving Plan 3 outside that determination, the competitive market picture is incomplete, but the insurance commissioner only has authority under 33-16-1030, 33-16-1032, and 33-16-1035, MCA, to handle options related to Plan 2 insurers.

Since 1995 there have been few revisions to the specific part in the Insurance Code (Title 33) that relates to workers' compensation rates and advisory organizations (chapter 16, part 10). Major workers' compensation revisions occurred in 1987, 1989, 1990, 1995, and 2005. The first three attempted particularly to address problems of solvency and high premiums. The 1995 and 2005 changes generally sought to improve conditions for injured workers and provide clarity for insurers. The 1995 changes also sought to increase competition among insurers. See Table 2.

Table 2: Major Revisions for Workers' Compensation in Montana

Year	Revision	Problem
1987 Main changes: chapter 464. (repealed sections not included)	• Established a public policy section. • Established definition of wages. • Established fraud section (39-71-316) • Prohibited employer from terminating an employee because of injury (39-71-317) • Allowed insurers to provide incentives to employers who offer safety programs (39-71-421) • Revised references to attorney fees (39-71-611 through 614) • Revised benefit provisions.(39-71-701 through 703) • Required department to set hospital rates • Revised language regarding termination of benefits on retirement (39-71-710) • Established impairment rating. (39-71-711) • Adjusted date from which compensation paid. (39-71-736) • Revised lump-sum settlement language. (39-71-741) • Disallowed incarcerated persons from receiving benefits. • Established terms for vocational rehabilitation. (part 10) • Established dispute/mediation process (39-71-2401) • Established requirements for petitions to work comp court (39-71-2914)	Faced with unfunded liabilities in a faltering economy -- when Plan 3 insurance was part of the Department of Labor and Industry and rates were set at artificially low levels and payouts were increasing -- the legislature sought to generally revise the workers' compensation system. New and revised statutes sought to address the policy concerns. To help with financial concerns, a 0.3% payroll tax was placed on employers.

1989 Main changes: chapter 613, setting up State Fund	• Established intent and purpose for State Fund. • Created State Fund as a mutual insurance fund, with a 5-member board of directors appointed by the governor. • Included under powers of the State Fund the ability to "adopt classifications and charge premiums for the classifications so that the state fund will be neither more nor less than self-supporting" and to "declare dividends if there is an excess of assets over liabilities". In the 1989 version, no dividends could be paid until the elimination of the unfunded liability of the State Fund and the determination of adequate actuarially determined reserves. The language also allowed the State Fund to "perform all functions and exercise all powers of a domestic mutual insurer that are necessary, appropriate, or convenient for the administration of the state fund". • Applied most of the regulation of domestic mutual insurers (i.e. regulation by the Insurance Commissioner) to the State Fund except for laws regarding formation and bonding requirements in Title 33, chapter 3, and inclusion in the Insurance Guaranty Association of Title 33, chapter 10. This included belonging to the rating organization that Plan 2 insurers belong to. • Replaced references to division with the Department of Labor and Industry where appropriate. • Included state fund membership on the classification committee in Title 33, chapter 16, part 10. • Noted that if the Dept. of Labor and Industry established an assigned risk plan, the State Fund would be subject to the premium tax liability assessed on Plan 2 insurers. Provided that -- if an assigned risk plan were established -- all Plan 2 insurers and the State Fund would participate and that risks be equitably apportioned. Failure to participate could result in suspension or revocation of a certificate of authority. • Exempted executive director and employees of the State Fund from the State pay plan. • Applied notice of coverage and cancellation requirements to State Fund policies. • Established a temporary freeze on medical/hospital fees.	1989 Changes were driven by: 1) the increase in unfunded liabilities by what was then the State Fund operating as an entity within the Department of Labor and Industry; and 2) private carriers threatening to leave the state because they couldn't compete with the artificially low premiums set by State Fund. The result was creation of a State Fund as a separate entity from the bureau within the Department of Labor and Industry. (The unfunded liabilities were set in June 1988 at $157.3 million and later reported by State Fund to reach $499 million.)
1989 Special session - chapter 9	• Continued a freeze on medical and hospital fees and on benefits. • Appropriated $20 million for use in reducing the unfunded liability.	Faced with more bad news on unfunded liabilities, the legislature met in special session ane provided a $20 million appropriation and continued freezes.

1990 (special session) Chapter 4	• Separated State Fund into Old Fund and New Fund, which is to say that the claims arising from injuries before July 1, 1990, were to be paid out of the Old Fund and all new claims as of July 1, 1990, were to be paid out of the New Fund. Accounting of each fund was to be separate. A yearly limit of $3 million was put on State Fund's Old Fund administration. • Assigned temporary payroll taxes and a loan from the Board of Investments for use in paying Old Fund claims. • Revised State Fund's intent and purpose to include caution about predicting future costs but also allowed unnecessary surpluses to be refunded through dividends. • Decreased the employer's payroll tax from 0.3% to 0.28%. • Provided terms for dividends and rate-setting to achieve solvency (including delay in dividend payments until adequate actuarially determined reserves had been set aside for Old Fund claims). • Provided for legislative financial and compliance audits, including audits of reserves. • Specified that the State Fund generally is subject to laws governing state agencies, unless specifically exempted. • Removed regulation by Insurance Commissioner for Plans 1 and 3 (as of July 1, 1990).	The legislature determined that the extent of the unfunded liability could not be determined "at this time" and that the struggling economy meant that substantial increases in premiums were not possible "at this time". The proposed solution was to start fresh with a New Fund for new claims and continue to pay off the unfunded liability for old claims with strict terms for use of taxes for Old Fund. Both were to be administered by State Fund.
1995 Chapter 243 (more on next page)	• Provided for speedier medical treatment for injured workers by allowing payment of medical claims by an insurer without requiring the insurer to accept liability. • Required written explanations of why a claim was denied, how an appeal could be made, and the amount of wage loss benefits to be paid (and how that was calculated). • Provided for objective medical findings in determining an insurer's liability and impairment evaluations. • Included in permanent partial determinations a permanent impairment established by objective medical findings and actual wage loss. • Provided that wage loss benefits for permanent partial disability benefits are to be based on the differences between actual wages at time of injury and wages at time of maximum healing, with provisions for payment during rehabilitation. • Included in the 30-day notice a requirement to notify insurers if the injury is to a sole proprietor or manager who otherwise might be exempt but who has elected coverage. • Provided for a termination of temporary total disability benefits on the date a worker is released to return to work in some capacity. (1995 revisions continued below)	Changes in 1995 featured efforts to improve payments to injured workers and set some clarifications for insurers.

1995 Chapter 243	Continued from previous page • Revised provisions for compromise settlements and lump-sum payment and for rehabilitation benefits.	
2005	• Incorporated occupational disease into overall workers' compensation statutes. • Adopted new independent contractor formula	Sought to resolve inconsistencies raised in court cases.

Regulation and Plan 3

The history of the State Compensation Insurance Fund starts either in 1989 or in 1990, depending on whether one feels that its beginning stems from its creation as a mutual insurance company in 1989 with a board of directors appointed by the governor and regulated by the Insurance Commissioner, or as an entity that in 1990 became subject to legislative oversight but no longer was regulated by the insurance commissioner. Technically, the statute that created the State Fund, 39-71-2313, MCA, began life as Section 4 of Chapter 613, of the Laws of Montana 1989. Similarly, the statute creating the board of directors for the State Fund was part of Chapter 613, of the 1989 Session Laws. Section 39-71-2313 described the new entity as "a nonprofit, independent public corporation established for the purpose of allowing an option for employers to insure their liability for workers' compensation and occupational disease coverage under this chapter [Title 39, chapter 71]". Amended out of that section in 1990 was the reference to the state fund as a domestic mutual insurer (see below). The difference in "start" dates is important from the perspective of the relationship of the Old Fund to the New Fund and the State Fund's interpretation that it is the New Fund, only administratively responsible for the Old Fund.

What is more important for the purposes of this paper is the State Fund's creation out of the chaos of unfunded liabilities, which reportedly was caused by premium rates of the then state-administered workers' compensation Plan 3 being 18-20% lower than they recommended for sound claims payment.[3] The Plan 3 workers' compensation insurance prior to 1989 was operated by the Division of Workers' Compensation in the Department of Labor and Industry.

Among the recommendations to the new State Fund board\ were the following in 39-71-2315(1):

> The board may perform all acts necessary or convenient in the exercise of any power, authority, or jurisdiction over the state fund, either in the administration of the

[3] Testimony at hearings Feb. 14, 1987, on two workers' compensation bills before the Senate Labor and Employment Relations Committee, p. 22 of committee minutes.

> state fund or in connection with the insurance business to be carried on under the provisions of this part, as fully and completely as the governing body of a private mutual insurance carrier, in order to fulfill the objectives and intent of this part.

The importance of acting as a business or as a private mutual insurance carrier would act is, in part, because a business presumably operates to survive. Its actions are intended to maintain and even grow the business. As stated by one proponent of Senate Bill No. 428, the bill creating the State Fund Board and other changes to the Plan 3 structure, "...the new state fund will have the incentive to seek the most efficient, cost effective means to run a successful insurance business." [4]

The origins of Montana State Fund also include its description in 39-71-2313, MCA, as a nonprofit, independent public corporation. When first enacted, 39-71-2313 described the state fund as a mutual insurance fund that exists as a domestic mutual insurer as defined in 33-3-102, MCA. Within six months of the effective date of that statute, the Legislature in special session further amended 39-71-2313 to remove the language of its being a domestic mutual insurer and removed its regulation by the Insurance Commissioner's Office. The creation of the State Fund as a nonprofit, independent public corporation in 1989 was to take away the perceived conflict of interest of the Department of Labor and Industry both regulating workers' compensation insurance and running its own workers' compensation insurance under Plan 3. The decision to remove the Insurance Commissioner's involvement from the State Fund took place in the Free Conference Committee on House Bill 2, the vehicle that separated the Old Fund and the New Fund and provided for ways to resolve unfunded liabilities. Earlier committee discussions in the House and Senate during the 1990 special session cast little light on the reasons for removing the State Fund from the regulation of the Insurance Commissioner except that the sense of the committees was to let the State Fund operate as a business, with minimal micromanagement by state government. Also, concerns were raised about attempts in House Bill 2 to clarify the use of the Montana Administrative Procedure Act (MAPA) for determining the rate-setting process, particularly whether the process would burden the State Fund with excessive oversight.[5] Language regarding MAPA ultimately affected only the process of rate setting but not the setting of individual rates. However, the concerns of the State Fund legal counsel may have aided the decision to remove the Insurance Commissioner from being involved in regulating State Fund. Richard Bach in his testimony to the Senate Labor and Employment Committee on May 23, 1990, said:

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[4]Testimony on Senate Bill No. 428, by Jack Salmond, Western Environmental Trade Association, before the Senate Committee on Business and Industry, Feb. 17, 1989, p. 13 of the committee minutes.

[5]Jim Tutwiler, on behalf of the Montana Chamber of Commerce, said that required use of the Montana Administrative Procedure Act in setting premium rates would be "possibly detrimental to timely and responsive decision making...". Exhibit #3, Testimony before the House Committee on Labor and Employment Relations, May 21, 1990.

> If we are a state agency and MAPA must apply, then strike the application of the Insurance Code from the operations of the State Fund. If, on the other hand, we are to operate as S.B. 428 intended, then give the State Fund the opportunity to operate as 'a domestic mutual insurer', whether a state agency or not, without saddling it with an additional set of procedures that will ultimately serve no purpose other than to add to the problems already faced by this 'insurer of last resort'.[6]

Perhaps another reason for removing the Insurance Commissioner from any regulatory role stemmed from confusion over an initial section in House Bill 2[7] that sought to exempt the State Fund's future business from certain asset and reserve requirements. The Insurance Commissioner's Office sought to clarify this provision but the discussion resulted in confusion over the terms reserves and surplus. Others also raised questions about whether other existing law and proposed oversight already were sufficient. George Wood, representing the Montana Self-Insurers Association, questioned whether State Fund could be both a nonprofit, independent public corporation and a state agency.[8]

Retained in1990 but amended was a reference to State Fund's participation in an assigned risk plan. Although language was stricken from 39-71-2314, MCA, regarding State Fund's regulation by the Insurance Commissioner as a domestic mutual insurance company, the legislators that year left in the provision for State Fund to pay the premium tax if the Department of Labor and Industry created an assigned risk plan. That option was removed in 1997.

Primarily in the 1990 special session, opponents objected to the continuation of payroll taxes to help cure the unfunded liabilities from claims for injuries suffered in prior years. Both the taxes and the proposed use of bonds to help retire the debt (the later removed bond proposal would have required a 2/3 majority in each house to establish a state debt) raised major concerns in the special session as did warnings that the State Fund's rates might need to increase by 24%. In addition to the financial worries, which were not unique to Montana at the time, the legislators discussed a broad range of regulatory concerns.

Eventually, House Bill 2 ended up in a free conference committee where one of the conferees

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[6]Testimony of Richard Bach, Exhibit #7, on House Bill 2 before the Senate Labor and Employment Committee, May 23, 1990, p. 3.

[7]A legislative staff summary of House Bill 2, noted that Section 8 "reflects the fact that the state fund is a state agency and has been monetarily backed by the legislature in the past, is monetarily backed by this bill, and will probably, if necessary, be monetarily backed in the future by the legislature". Exhibit 1 for House Bill 2, presented to the House Committee on Labor and Employment Relations, May 21, 1990.

[8]George Wood, testimony for the Montana Self-Insurers Association, Exhibit #6, before the House Committee on Labor and Employment Relations, May 21, 1990, and before the Senate Labor and Employment Committee, May 23, 1990, Exhibit #2, p. 5.

summed up a letter from then State Auditor and Insurance Commissioner Andrea Bennett by referencing her duty to shut the State Fund down if it was not financially solvent. Among proposals presented by the free conference committee for discussion was the following "The State Auditor will be out of the picture".[9] Reference to the State Fund being a domestic mutual insurer in 39-71-2313, MCA, was struck as were related sections involving Insurance Commissioner (State Auditor) regulation. Discussion continued over the State Fund's role as a business versus its role as a state-created entity. The final language referencing at least one part of that discussion was an amendment to 39-71-2314, MCA, saying " (2) The state fund is subject to laws that generally apply to state agencies... The state fund is not exempt from a law that applies to state agencies unless that law specifically exempts the state fund by name and clearly states that it is exempt from that law".

This lengthy history of the regulatory changes for State Fund, including the early confusion, is intended to help understand some of the issues raised by private insurers, which are subject to regulation by the Insurance Commissioner, and issues raised by various observers of State Fund, including concern about oversight and perceptions that the benefits and responsibilities of state agencies do not jibe with various activities allowed by statute for State Fund's use of premiums and investments.

Plan 3 and operations as a business

Threaded through this review of competition is a question of primary importance to members of the Economic Affairs Interim Committee, studying workers' compensation under Senate Joint Resolution No. 30. And that question is: what policies might be instituted to help lower premiums and bring Montana more in line with other states' workers' compensation costs? With State Fund as the largest single insurer for Montana workers' compensation policies, the question of premiums and competition is germane. What happens when an insurer with roughly a 50% market share for all policies written in the state, including by self-insurers and private insurers, has advantages of a state agency and a somewhat murky regulatory structure? Trust is key, particularly because the state taxpayers (and most likely businesses and employees) would be on the hook if decisions made by State Fund's board of directors turned bad. Statutes require board decisions to be based on actuarial soundness. Sound decisions also rely on independent reviews to better assure Montana taxpayers and businesses that a business geared to appropriately assessing and charging for risk can weather severe economic storms.

Discussions during the Special Session in 1990 clearly emphasized the attitude of many legislators that the State Fund needed to operate as a business. Although created legislatively, the entity was expected to "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",

[9]Minutes from the Free Conference Committee, May 25, 1990, p. 4.

as provided in 39-71-2316(1)(n). Operating as a business usually means competing with other businesses for the same policies. The more policies that an insurer writes at appropriate rates, the better the chances of spreading risk. Among the various ways to attract business, obviously, are competitive pricing of premiums, promises of dividends to companies that have low claims and good safety records, and fair service to the employer, the injured worker, and medical providers.

Operating as a business also has meant that State Fund offers commissions to insurance agents that bring in business. This is one of the larger expenditures in the State Fund's operations budget. A 2006 Legislative Fiscal Division analysis of the State Fund budget noted that 66.2% of State Fund's premiums were handled by agents other than State Fund agents -- indicating that State Fund does not sit idly by waiting to be the "insurer of last resort" but rather aggressively seeks out business. Having a mix of good risks helps to offset any bad risks that may be among those seeking out the "insurer of last resort".

Being a business means maintaining customers, which State Fund and other insurers often seek to do through paying dividends as well as providing services. As an insurer of last resort or guaranteed market, the State Fund also serves a number of employers that are small, which means they are unlikely to have an experience rating (a means of either raising or lowering a premium). An analysis of State Fund's premium-setting process by the Legislative Fiscal Division indicates that for some premium rate payers, the State Fund process has winners and losers. The process does not always award good experience -- in part because a small employer might have only one catastrophic claim in the life of the business, but that claim would cost far more than any premiums the business had paid. So, while larger businesses might benefit from dividends and a few policyholders like the State of Montana are able to participate in retrospective return plans[10] there are few opportunities for small employers to move into the

[10]State Fund's Vice President for operations Dick Root provided the following explanation of retrospective rating via email:

Retrospective rating is an optional rating program that employs a formula for factoring an insured's loss experience into the final premium. It can be used only by mutual agreement between a policyholder and the insurer. Basically, it allows a policyholder to have more control over its insurance costs through control of its own loss experience. Under a "retro plan," a policyholder's premium is adjusted approximately 24 months after the inception of the coverage period based on its loss experience and based on any change in the premium from payroll. Typically, retro plans with MSF are closed out after 24 months from inception of the policy year.

Retrospective rating plans allow policyholders to receive the cost benefits from good loss experience (or to incur the penalty from poor experience) much more quickly than plans based on experience rating alone. Thus, they invoke a high degree of incentive to emphasize loss control efforts. However, retrospective rating is not a substitute for experience rating.

At the inception of a retro plan, the standard premium is developed using guaranteed cost rating procedures without the premium discount. Usually, the insurance premium to be paid up front (or under some form of installment plan) is calculated based on the standard premium. If an insured's actual loss experience is favorable during the rating period, it can earn a return premium. On the other hand, if the insured's loss experience is worse than expected during the rating period, the retro premium adjustment can result in an additional charge.

The factors used in the retro plan are part of the policy contract for the rating plan year so the policy holder knows the minimum and

(continued next page)

less costly rating tiers. Pooling risk and instituting safety plans provides one way. Making sure that State Fund's reserves and surplus are adequately based is another way. See LFD report on Montana State Fund Workers' Compensation Premium Assessment, January 11, 2010. Among past proposals for determining whether those reserves and any surplus are adequate is to require market conduct or financial examinations of State Fund, requirements that Plan 2 insurers face under their regulation by the Insurance Commissioner (for example, see HB 507 in the 2009 session). Other examples of differences and similarities between Plan 2 and State Fund are in the Level Playing Field section below.

Operating as a business from personnel perspectives -- From the beginning, the executive director was expected to be exempt from the state pay plan, and an amendment to HB 613, which created the State Fund in 1989, provided that all employees would be exempt from the state pay classification, compensation, and grievance procedures. The approach was reportedly intended to help hire, retain, and set targeted goals for employees to meet. Similarly, the State Fund provides a bonus or incentive pay plan that incorporates meeting various targets, including achieving higher premiums.

Operating as a business from charitable and educational perspectives -- The statute that sets out the powers of the State Fund, 39-71-2316, MCA, allows the State Fund, with approval of the board, to expend funds for scholarship, educational or charitable purposes. Under the goal of educating football fans, including students, about the need for safety, State Fund has sponsored football games and provided hand-sanitizers or other logo-endowed mementoes for reminding people about safety. In its role as competitor or educator, State Fund has helped to sponsor the Governor's Conference on Workers' Compensation and provided water bottles to participants. Scholarships often go to the children of injured workers covered by a State Fund policy. The question often heard related to the educational or charitable efforts is whether premium dollars are appropriately going to these expenditures if, instead, rates might be lower.

Level Playing Fields and Private Insurers' Concerns

Unlike private insurers that can bundle other types of insurance to give a customer a better rate on perhaps more than one policy, State Fund is limited to writing workers' compensation and employers' liability insurance. But that tends not to assuage the concerns of the private (Plan 2) insurers that have less than 40% of the workers' compensation direct written premium market in Montana. Their concerns include:

Explanation of Retrospective Rating, continued:

maximum ultimate premium to finally be charged. Retro plans are generally for policyholders with annual workers compensation premium in excess of $200,000. Below this level of premium, the results are very volatile and thus not as predictable for the policyholder.

- State Fund, as a state agency, does not pay a 2.75% tax on written premiums, as they do.
- State Fund does not have to pay for market conduct or financial exams, as they do. These costs reportedly can run at least in the six-figures, approximately every five years.
- State Fund can tie into the investigative and prosecutorial antifraud units of the Attorney General, services for which State Fund pays. Private insurers must investigate on their own and refer fraud as a criminal prosecution to a county attorney, usually overburdened with prosecuting crimes against persons.
- State Fund is not subject to punitive damages, as a state agency.
- State Fund is allowed more variation in classifications and loss costs than private insurers that must follow the classifications and loss costs proposed by the National Council on Compensation Insurance, Inc., and adopted by the Insurance Commissioner.
- State Fund has a guaranteed client - the State of Montana (see below).
- State Fund does not have to participate in the Montana Guaranty Association, which private insurers do. This means that if a private insurer becomes insolvent, other insurers must help to pay the insolvent insurer's work comp claims through the Montana Guaranty Association.
- State Fund does not have the rate review requirements that private insurers do. Although the legislative auditor hires an outside actuary to review State Fund rates to determine if they are excessive, inadequate, or unfairly discriminatory, the review reportedly is not as involved as reviews conducted by the Insurance Commissioner's Office.

Under 39-71-403, MCA, all state agencies are required to obtain workers' compensation from the State Fund. However, the Montana University System is excepted from the definition of state agencies for the purpose of this statute. That change occurred in 1999 at the request of the Board of Regents. An introductory "whereas" clause for House Bill 57 stated that the measure was an attempt to introduce "competition into the University System's workers' compensation coverage as a positive step in controlling costs and in continuing the Board of Regents' efforts to operate as a public business". In the 2009 session, House Bill 126 allowed the Department of Administration to manage the state's workers' compensation coverage (with the legislative and judicial branches allowed to opt out of that management) through one or more policies. The State of Montana spends roughly $18 million on workers' compensation coverage. In 2009, that amounted to about 9% of Montana State Fund's accident year written premium, according to information from the Department of Administration. The estimate for 2010 is that the State of Montana's premium will comprise about 10% of the State Fund's written premium. As mentioned earlier, the State of Montana does participate in a retrospective rating plan with State Fund. In FY 2008, that option returned $64,537, contrasted with retention returns of $879,650 in FY 2006 and $1,643,973 in FY 2007.[11]

[11]Letter to Laurence Hubbard at Montana State Fund from Budget Director David Ewer, dated September 1, 2009.

Summary

Major changes have occurred throughout Montana's nearly 100-year old history of workers' compensation[12]. Fears of out-of-control costs to premiums encouraged competition as a way of decreasing costs, but competition is not necessarily thriving in the Montana market, where almost half of all workers' compensation policies are provided by State Fund. That large market share could be either due to a good business plan or an unlevel playing field. An analysis by the Insurance Commissioners Office, required to assess competition among all private insurers, indicates that if State Fund is included in the analysis then Montana's workers' compensation market is not very competitive. See Appendix B. If there is a perception of an uneven playing field, new private insurers are unlikely to seek out new policyholders here. Competition does not necessarily guarantee the lowest rates, as indicated by North Dakota with its monopolistic state fund having some of the nation's lowest rates, according to the Oregon Workers' Compensation Premium Rate Ranking Summary.[13] But competition generally is seen as a way to promote lower rates -- if all things are equal (as economists would likely say).

For a list of statutes that apply to State Fund, excluding those that apply in Title 39, chapter 71, except for part 23, see Appendix C.

[12]A law affecting coal miners and termed the "State Accident Insurance and Total Permanent Disability Fund" was enacted in 1909 but declared unconstitutional in 1911. The 1915 Legislature enacted the Workers' Compensation Act. See Eddye McClure, "The Montana Workers' Compensation Act and the Applicability of the Exclusive Remedy Rule", Montana Legislative Services February 2000, pp. 2-3.

[13]For a copy of the 2006 Oregon study see: http://www4.cbs.state.or.us/ex/imd/reports/rpt/index.cfm?fuseaction=version_view&version_tk=178058&ProgID=FEARA011.