

# **Actuarial Report on Montana State Fund**

**REPORT TO MONTANA STATE LEGISLATURE  
ECONOMIC AFFAIRS INTERIM COMMITTEE**

**SEPTEMBER 12, 2014**

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**FINANCIAL RISK ANALYSTS, LLC**

# Agenda

- **Purpose and Scope of Review**
- Uncertainties
- Reserves as of June 30, 2013
- Rates Effective July 1, 2013 and July 1, 2014
- Old Fund Claim Management
- Recommendations
- Questions



# Purpose and Scope

- Financial Risk Analysts was engaged by the Commissioner of Securities and Insurance (“CSI”) to support required annual review of Montana State Fund
- Scope included:
  - Review loss reserving methodologies and estimates
  - Review rates and pricing methodologies
  - Review State Fund case reserving practices and levels
  - Comment on actuarial reports of State Fund’s external actuaries (Towers Watson or “Towers”) and Legislative Audit Division’s actuaries (AMI Risk Consultants, Inc. or “AMI”)
  - Provide independent analysis where necessary



# Purpose and Scope

- Focus on reserve analysis as of June 30, 2013 and rate/pricing analyses for rates effective July 1, 2013 and July 1, 2014
- Separate analysis for New Fund and Old Fund
- Our study did not include analysis of the Towers review of reserves as of June 30, 2014 which will be presented to the State Fund Board in September
- Summary comments and results in this presentation should be considered in context of full written report including all conditions and limitations included therein



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# Uncertainties

- Towers actuaries indentified in their reports factors that create materially more uncertainty than is usual for analyses of this nature, including changes in:
  - Statutory benefits
  - Volume and mix of State Fund business
  - State Fund operations, including claim handling and case reserving
  - Economic environment
- Financial Risk Analysts concurs with Towers view regarding elevated levels of uncertainty
- Necessitates significant adjustments, assumptions, and judgments in application of actuarial methods
- Creates wider range of financial projections than might otherwise be expected



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# Overview Regarding Reserves

- Towers applied multiple actuarial methods and made differing adjustments to deal with the numerous factors causing material uncertainty for State Fund reserves
- While we believe the methods applied and adjustments made by Towers are generally reasonable, we identified certain concerns as detailed in our report
- Financial Risk Analysts completed independent projections of indicated reserve needs as shown in our report





# Summary Regarding Reserves for New Fund

as of June 30, 2013 (\$ millions)

## UNDISCOUNTED

	<u>Low Range</u>	<u>Central Estimate</u>	<u>High Range</u>
Towers Watson	687	762	867
AMI		825	
Financial Risk Analysts	776	847	918

## NEW FUND CARRIED RESERVES

State Fund		816	
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- **Towers central estimate is below the midpoint of its range of indications**
- **FRA and AMI central estimates are in upper end of Towers range**
- **State Fund booked reserves \$54 million above Towers central estimate**
- **Booked reserves are within our range therefore we believe reasonable**

# Summary Regarding Reserves for Old Fund

as of June 30, 2013 (\$ millions)

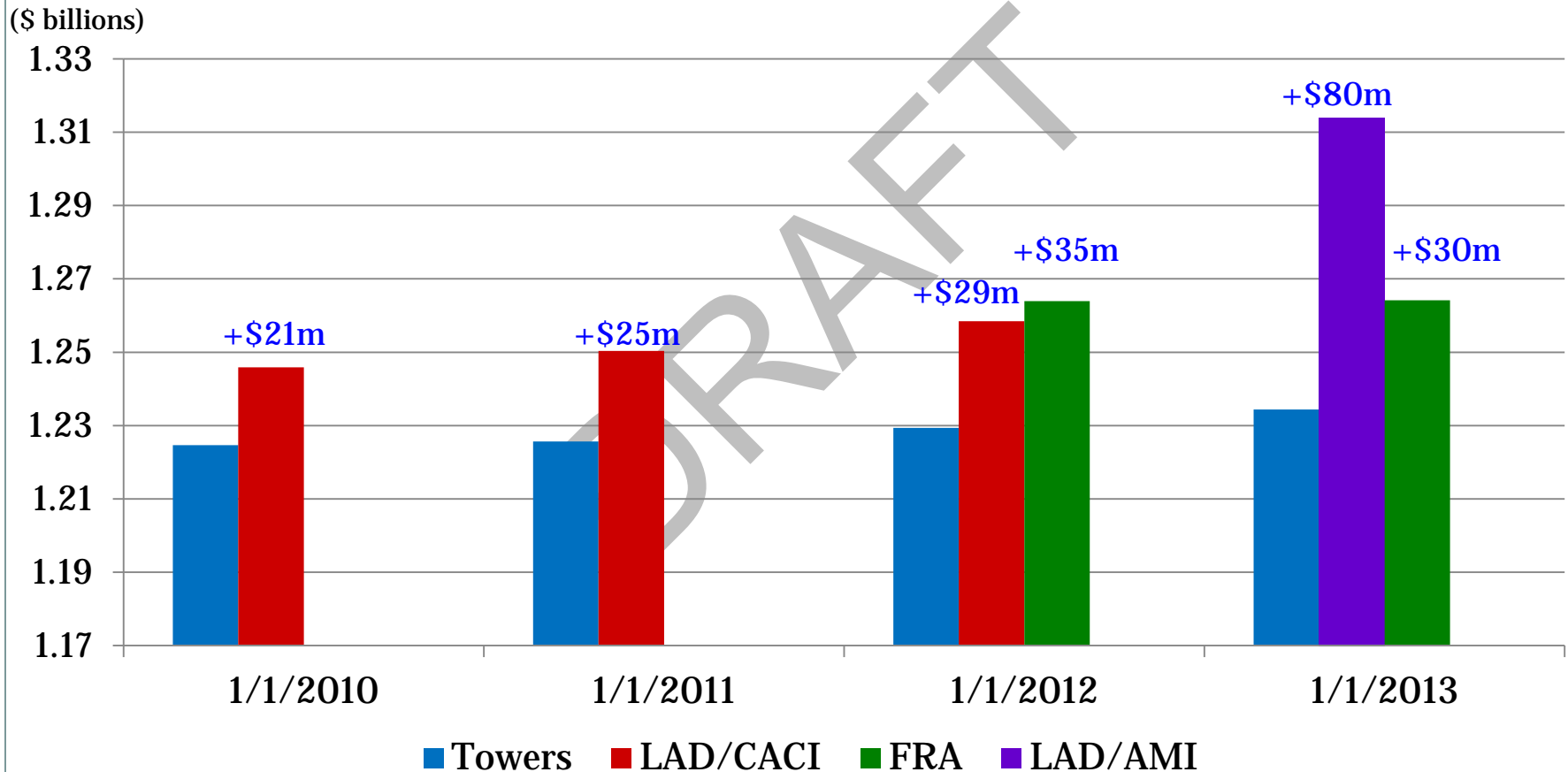
## UNDISCOUNTED

	<u>Low Range</u>	<u>Central Estimate</u>	<u>High Range</u>
Towers Watson	40	44	86
AMI		124	
Financial Risk Analysts	50	74	101

- **Towers central estimate slightly above low end of their range**
- **Previous Towers estimates have persistently developed adversely**
- **FRA and AMI estimates significantly above Towers**
- **We concur with AMI that the Towers central estimate appears low**



# Old Fund Ultimate Losses Comparing Central Estimates Over Time



Note: Numbers above bars are differences to Towers



# Historical Changes in Ultimate Losses – Towers Watson

## CHANGE IN PRIOR YEAR UNDISCOUNTED ESTIMATED ULTIMATES

<u>Fiscal Year</u>	<u>NEW FUND</u>			<u>OLD FUND</u>		
	<u>Indemnity</u>	<u>Medical</u>	<u>Total</u>	<u>Indemnity</u>	<u>Medical</u>	<u>Total</u>
2008-09	\$2.6 m	\$3.4 m	\$6.0 m	-\$0.5 m	\$4.7 m	\$4.2 m
2009-10	1.2 m	12.6 m	13.8 m	-0.6 m	3.0 m	2.4 m
2010-11	-8.7 m	11.0 m	2.3 m	0.0 m	3.1 m	3.1 m
2011-12	-4.2 m	6.2 m	2.0 m	0.1 m	3.6 m	3.7 m
2012-13	-5.5 m	8.5 m	3.0 m	0.4 m	4.6 m	5.0 m
5 Yr Total	\$-14.6 m	\$41.7 m	\$27.1 m	-\$0.6 m	\$19.0 m	\$18.4 m

Note: From prior year for same accident years: + indicates unfavorable, - indicates favorable



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# Observations Regarding Rates – July 1, 2013

- Towers and AMI appear to have used approaches that follow generally accepted actuarial ratemaking principles
- Identified no material flaws with methodologies, assumptions, adjustments, or results of either party
- Towers includes 5% provision for risk of adverse loss deviation
- AMI selected ultimate losses nearer midpoint of Towers range of estimates and does not include provision for adverse deviation
- Based on Towers analysis, the State Fund implemented rate change that varied by class and rating tier and averaged -6.0%
- AMI concluded that the -6.0% average rate change produced rates that were not excessive, inadequate, or unfairly discriminatory
- Based on our review of Towers and AMI analyses we concur



# Observations Regarding Rates – July 1, 2014

- Based on Towers analyses, the State Fund implemented a rate change that averaged 0.0% effective July 1, 2014
- Towers continues to include 5% provision for risk of adverse loss deviation
- Actuaries for the Legislative Audit Division have not yet completed review of the July 1, 2014 rate analysis
- FRA completed an independent analysis of indicated rates
- FRA began with ultimate losses higher than those selected by Towers but we did not include adverse deviation provision
- Based on our analysis, we believe the State Fund rates effective July 1, 2014 are reasonable

# Observations Regarding Class Rates and Tiered Pricing

- Financial Risk Analysts believes that Towers analysis and the State Fund's approach to developing rates by class are reasonable
- Financial Risk Analysts believes that Towers analysis and State Fund's approach to application of rating tiers based on multivariate analysis are reasonable and are an improvement over more qualitative approaches to assigning insureds to rating tiers that are common among commercial insurers



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# Third Party Administrator (TPA) Management of Claims

- State Fund acts as TPA for State with respect to Old Fund claims
- State / Legislature is payer (carrier) and retains all financial risk
- TPA is paid on basis of fee for service with no financial stake in the outcome of claims handling
- To ensure effective TPA performance, the carrier or other payer typically actively engages in oversight of the operation of the TPA

# Claim TPA Oversight Payer Best Practices

- Providing feedback on individual claim actions undertaken by the TPA
- Proposing strategies for future claims handling
- Reviewing case reserve adequacy
- Ensuring appropriate focus on claim disposal
- Setting claims service requirements, defining best practices, and monitoring for consistency against established standards
- Performing periodic compliance and performance audits
- Establishing financial goals and measuring financial performance



# Observations Regarding Claim TPA Oversight Best Practices

- Legislative Audit Division or its designees are performing certain functions required for best practices payer oversight of TPA
- Other functions may not be regularly performed



# Observations Regarding Case Reserves

- In our prior reviews of State Fund on behalf of CSI, we observed that State Fund claim examiners were reserving in aggregate at levels far above Towers indicated reserve needs for most years in the Old Fund and many early years in the New Fund
- CSI asked us to provide additional analysis on case reserves this year

## Medical and Indemnity Losses at June 30, 2013

Years	Case Reserves	Towers Indicated	Difference
All Old Fund	\$127.9m	\$44.0m	(\$83.9m)
New Fund 7/1/90-00	158.5m	118.3m	(40.2m)

# Case Reserves Analysis

- We reviewed updates to the State Fund Claim Guidelines
- We discussed claim reserving policies and practices with State Fund claim management and understand that there have been no material changes since prior review
- We were provided and analyzed claim reserve detail on all open cases in the Old Fund and on all open permanent total and fatality cases in the New Fund
  - For each open claim, we calculated life expectancy of the claimant based on general population mortality statistics
  - We compared life expectancy to current case reserve and recent year loss payments



# Summary Regarding Case Reserves

- We found that aggregate case reserves for the Old Fund and the early years of the New Fund roughly imply general population mortality statistics despite the fact that claimants have injuries and illnesses that reduce life expectancies in many cases
- Our analysis suggests that the likely cost to settle all claims in the Old Fund will be below the total case reserves to some degree

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# Recommendation 1 - Reserves for New Fund

- State Fund management has in recent years reserved well above the levels indicated by the Towers central estimates for the New Fund
- We recommend that management continue to give consideration to both the current elevated level of uncertainty and the position of the Towers selections relative to the range of indications from their actuarial methods when determining New Fund carried reserves

# Recommendation 2 – Reserves for Old Fund

- Based on our methodologies and selected ultimates, the metrics presented in our report, and our review of reports by AMI and CACI on behalf of LAD at recent fiscal year ends, we believe that the Towers central estimates for the Old Fund may be low
- We recommend that the Fund, LAD, and the legislature carefully review the results of the latest Towers, AMI, CACI and Financial Risk Analysts reserve analyses when assessing the magnitude of remaining Old Fund liabilities

# Recommendation 3 – Claim TPA Oversight Role

- We recommend that the legislature identify any gaps that may exist regarding the State fulfilling its oversight role as payer and develop a plan to address any such gaps
- We encourage the legislature to engage a professional claims advisory service to conduct a comprehensive audit of open claim files in the Old Fund with the objectives to include identification of opportunities for potential savings on large, complex cases

# Recommendation 4 - Case Reserve Study

- We believe that a claim reserve study focused specifically on quantifying the level of case reserve redundancy should be considered, particularly if it is important to narrow the range of estimates of Old Fund liabilities for any reason (for example to support decisions about restructuring the financial responsibility for those liabilities moving forward)
- Consideration should be given to combining a case reserve study with the open claim audit in the prior recommendation



# Recommendation 5 – Ratemaking Methodologies

We recommend that the State Fund and its actuaries continue to include a provision for adverse loss deviation in its rate level indications in the short run, particularly in light of continuing uncertainty regarding the actual savings that will inure from HB334 relative to the adjustments made by Towers to reflect the estimated impacts of these savings



# Questions?

DRAFT





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