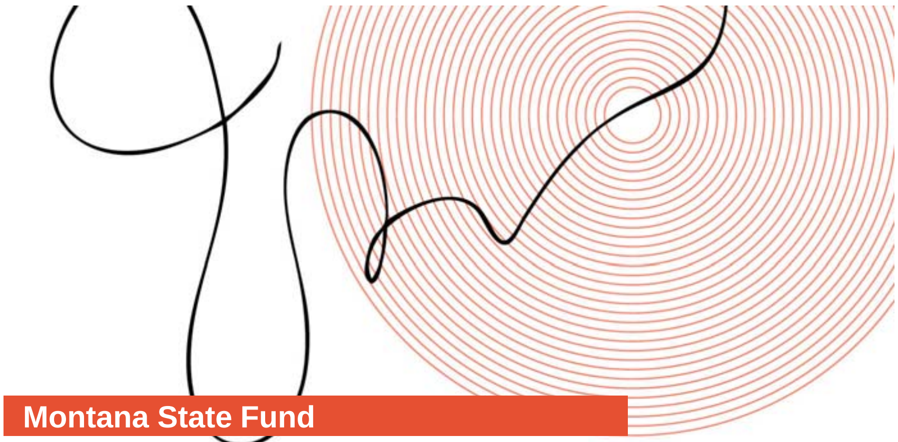

Montana State Fund

Old Fund Funding Options

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Discussion Topics

- A short history of the issue at hand – Legacy Liabilities
- Initial Financing Considerations
- Current Funding Options
  - Loss Portfolio Transfer
  - Adverse Development Cover
  - Pay as You Go

Sections 39-71-2351 and 2352, MCA

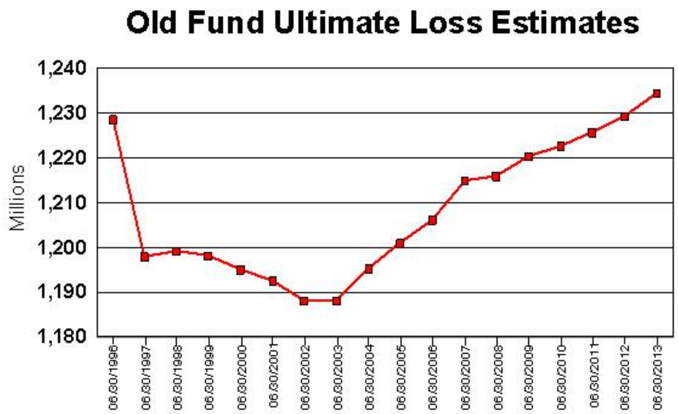
- The enabling legislation took an historically correct and complete view of legacy liability funding:
  - Identify and evaluate the value of all known liabilities
  - Evaluate the potential of such liabilities to change over time
  - Establish a funding mechanism that provided for available assets to meet both known and potential liabilities
  - Monitor results over time, allowing for a moderate surplus to be maintained to assure no further assessment potential

It is important to clearly define terminology

- **Old Fund Ultimate Loss Estimates**: The actuarially determined value of all cases, open and closed, paid and unpaid, including claims handling expense of all claims with injury dates prior to July 1, 1990
- **Old Fund Unpaid Losses**: The difference between the ultimate loss estimates and paid losses to date
- **Loss Adjustment Expense**: The expense both paid and unpaid of handling all aspects of the above referenced claims

Old Fund Ultimate Incurred Loss Estimates

- Actuarial assessments will change over time as additional information is received, as legislative and judicial actions occur, and as individual claims change course.



5

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While Ultimate loss estimates are proving to be quite accurate, the make-up of currently open cases is dramatically different than originally anticipated

- The Montana WC law provides for various coordinating benefit features that tend to reduce indemnity benefits over time, while medical benefits continue for the life of the claim;
  - Of the ultimate Old Fund claims valuation, medical loss makes up **36%** of the total
  - As of June 30, 2013, unpaid medical losses make up **76%** of the total outstanding claims payments of $44MM
  - Of the **782** Old Fund Claims currently open, only **186** of those have some sort of indemnity payments being made, with the remainder being open for medical payments only
  - Of the **186** claims where indemnity payments are being made, **74** are open for benefits payable to surviving dependents

6

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The inability to accurately assess the future cost of catastrophic claims, makes funding decisions quite difficult

- The "outstanding" reserve value of currently open Old Fund Claims is $44MM. Six claims account for $20.7MM or 47% of that amount.
- In only 4 of these cases are indemnity payments continuing
- In each case, the cost of lifetime domicillary care, and prescription drugs are the principal driver of outstanding claims costs
- Given the advanced age of the injured workers involved in Old Fund claims, (Average age = 64 years of age), the potential for individual claims to have a disproportionate affect on estimated liabilities grows each year, both positively and negatively

Various Funding Options Have Been Evaluated Over Time

- In an attempt to add some sense of "certainty" to the cost of Old Fund claims, various alternatives have been assessed over the years:
  - **Loss Portfolio Transfer:** A mechanism that for a cost to the transferring party, would move an agreed upon amount of future liabilities from their balance sheet to that of an assuming party (reinsurer)
  - **Adverse Development Cover**: A mechanism that for a cost to the liable party, would limit the amount of adverse (upward) development of currently held reserves, and transfer such development (limited) to an assuming party (reinsurer)

Loss Portfolio Transfer

Utilized when one party wishes to eliminate both the balance sheet and income statement impact of legacy liabilities into the future

- Montana Legislature would transfer all liabilities resulting from injuries occurring prior to June 30, 1990 to a reinsuring party
- Both claims costs and related expenses would be transferred up to an "agreed amount", or on an "unlimited" basis
- The consideration (payment) would be a function of the amount of liability transferred (underwriting risk), and the amount of discount applied for the time value of money (credit risk)
- Agreement required on the handling of claims into the future

Adverse Development Cover

Utilized when a party wishes to reduce or eliminate the impact on its balance sheet and income statement of adverse development on legacy claims

- Montana State Legislature would maintain all current liabilities related to the Old Fund, and procure protection from an (re)insurer for a stated amount above that current estimate of liabilities
- Consideration would be a function of the limit secured, and the interest rate assumptions applied in evaluating cash flows on claims payments into the future
- The benefit of the transaction is recognized if claims values exceed current valuations (program retention)

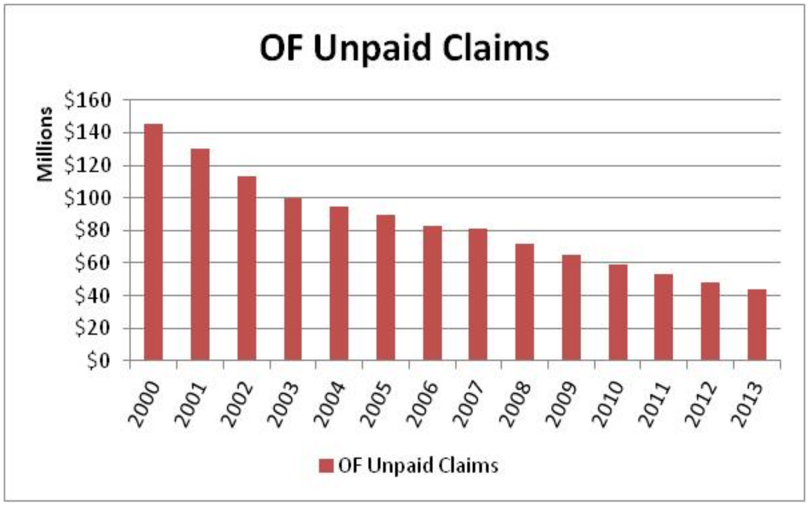
Transaction Valuations are Actuarial Sensitive

- While intuitively, one would think that there is great "certainty" in a book of claims that are over 20 years old, that is very far from the case, which makes such transactions highly sensitive to actuarial assumptions (aka: the "fear factor")
- The average time frame in which to structure and place such a program in the open market is from 6 to 12 months from original request
- Much can happen during that gestation period, given the dynamic nature of workers compensation claims, leading to even greater uncertainty and increased costs to the transferring party

The Pay As You Go Option

- Several years ago, the Montana Legislature chose to move from prospective funding of Old Fund liabilities to a "pay as you go" approach
- Such a process eliminated the vagaries of funding for loss cost uncertainties that were tied to expanded medical costs over indefinite life expectancies
- With each passing year, those uncertainties, while not eliminated, have narrowed considerably, reducing the annual budgetary impact. Undiscounted unpaid loss has fallen from nearly **$100MM in 2003 to $44MM in 2013**

Old Fund Unpaid Losses have Decreased Over Time



Note: Current Estimate of Unpaid Losses are $44MM

13

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Current Cash Outflow Estimates Indicate a Decreasing Funding need for the Old Fund in the Near Future

FY	Beginning Balance	Total Loss & Expense	General Fund Transfer
FY2014	5,133	$9,156,318	$9,151,185
FY2015	0	7,585,617	7,585,617
FY2016	0	6,205,555	6,205,555
FY2017	0	5,194,118	5,194,118
FY2018	0	3,830,540	3,830,540
FY2019	0	3,112,828	3,112,828
FY2020	0	2,496,369	2,496,369
FY2021	0	1,231,128	1,231,128
FY2022	0	812,429	812,429
FY2023	0	689,824	689,824
FY2024	0	550,954	550,954
FY2025	0	509,232	509,232

Current estimates are that payments would continue to 2052 and another $9.65MM beyond what is shown here

14

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The Pay As You Go Option (continued)

- In all cases, there is a "cost" to securing "certainty" and the transfer of risk.
- Maintaining that risk eliminates the frictional cost of securing that certainty

Give me three Actuaries, and I will give you nine answers!

Comparison of Latest Five Years of Ultimate Losses at June 30, 2012 (Central Estimates)

Accident Year	Selected Ultimate Losses TW	CACI	FRA
7/1/07-08	166,410,000	166,806,507	171,552,044
7/1/08-09	145,280,000	143,917,734	147,695,538
7/1/09-10	130,195,000	129,539,427	133,541,033
7/1/10-11	140,075,000	139,751,842	141,963,731
7/1/11-12	113,175,000	125,095,094	123,827,045
Total	695,135,000	705,110,604	718,579,391

Questions?

17

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