

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 53rd LEGISLATURE - REGULAR SESSION

SELECT COMMITTEE ON WORKERS' COMPENSATION

Call to Order: By CHAIRMAN CHASE HIBBARD, on January 8, 1993, at

ROLL CALL

Members Present:

Rep. Chase Hibbard, Chairman (R)
Rep. Jerry Driscoll, Vice Chairman (D)
Rep. Steve Benedict (R)
Rep. Ernest Bergsagel (R)
Rep. Vicki Cocchiarella (D)
Rep. David Ewer (D)

Members Excused: None

Members Absent: None

Staff Present: Paul Verdon, Legislative Council
Evy Hendrickson, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing:
Executive Action: None

CHAIRMAN HIBBARD opened the meeting with a short discussion of the goals and objective statement he sent to all committee members. He explained that it was a draft and asked for comments. It came about from a compilation of the charge that was given the committee from Speaker Mercer, talking with other folks, and a few thoughts of his own.

He asked the members for any suggestions for deletions or additions and said he was basically trying to put together a format to guide the committee in its deliberations and to recognize the areas which the committee might want to consider during the course of its work. He said if there were any areas that he hadn't included but should have, or if there were some that shouldn't be included, he would like to be informed.

If legislation is not proposed to deal with some of the areas in this basic outline and objective statement, then the committee has the power to see that legislation is initiated. The committee has the power to introduce committee bills as well, so they could come up with their own legislation in areas that do

not come from someplace else.

CHAIRMAN HIBBARD said the committee had one bill scheduled for hearing, House Bill 13, which would be heard on Monday, January 18th. He said he also had an inventory of proposed legislation which went out to the committee members with the draft statement.

REP. BERGSAGEL asked CHAIRMAN HIBBARD if it was his intention to hold the bills, hear and consider them, and then hold executive action when they had all been heard.

CHAIRMAN HIBBARD said that was a suggestion. He was not sure how he would handle that. He said that Speaker Mercer, however, would like to see the bills come out of committee just as quickly as possible. He stated they must be careful not to do something one week that would preclude or modify something that might be done a week later, and said there should be some sort of a method to the process.

REP. BENEDICT said he didn't see attorney involvement included in the draft but he didn't know exactly where it would fit in.

CHAIRMAN HIBBARD said when he had talked to REP. BENEDICT earlier he thought there were about nine different areas the committee would be addressing during the informational process. He arbitrarily pared that down to the providers, thinking that if a line wasn't drawn, there would be no end to it. He said at this point, until the first committee hearing, he was planning to utilize the time with informational presentations. The Department of Labor would present an overview from their perspective and he had talked to the Workers' Comp judge, who would also speak to the committee. He said REP. EWER, a member of this committee, had offered to give a presentation on bonding.

REP. BENEDICT said he wasn't referring to a presentation so much as the fact that attorney involvement in workers' compensation claims should probably be examined during the course of the committee's deliberations.

There being no further comments, CHAIRMAN HIBBARD introduced Scott Seacat, Legislative Auditor, who presented informational testimony.

Informational Testimony

Mr. Seacat said he had two brief presentations on the status of the old fund and the new fund, and began by covering the old fund. He also distributed two spreadsheets for the committee's use. EXHIBIT 1A

He referred to the page titled 92-30 EMP. There are several numbers used for the old fund's unfunded liability. His office uses the number supported with the work of the State Fund's

actuary, and that number was the total of the left hand column under total objective liability maintenance, \$406 million. He said these would be the figures upon which they would base their analysis. The \$426 million figure came about during the interim with the Interim Committee on Work Comp.

He also mentioned that left hand column numbers are not discounted numbers. This was a cash flow statement, and therefore he didn't think it was appropriate to use discounted numbers.

The other reason they didn't use discounting with respect to the old fund is because the concept of discounting assumes there is money in the bank which would be earning interest. Obviously, the old fund didn't have a lot of money in the bank.

The second column, bond debt payments, is the existing debt service schedule and was established by an indenture. This was the bond series that REP. EWER worked on and is set already. The total expense was merely a sum of those. The employer payroll tax is the projected payroll tax at the present. There was one major assumption associated with the payroll tax, and that was that the covered payroll would inflate in Montana by about 5% per year. It's a projection that has held pretty constant for the last four years in Montana, but the covered payroll increase has been in excess of 5% so they were not entirely uncomfortable with that projection.

He said the projected end-of-year cash was the significant figure and the reason they did the spreadsheet was to tell the members where they were with respect to the old fund. The bottom line, based upon what was known at that time, was that the old fund was out of money, would borrow money, and that the cash balance at year end would be a negative \$26 million. He said that wouldn't happen because the Fund already had an adjudicated agreement through the Board of Investments, and there would be some borrowing so there would not be negative cash at year end. But, if they were to do nothing with respect to the old fund workers' comp, that is what the scenario would be.

Mr. Seacat said the actuary's projections on the spreadsheet for fiscal '93 show projected liability payments of about \$62.5 million. They had done an analysis to track the expenditures on a year-to-date basis, extrapolated those in the future, and it appeared the old fund liability payments would not be that high in fiscal year '93. They were projecting that the payments actually would be somewhere in the neighborhood of \$52-56 million as opposed to \$62 million.

If the trend continued, ultimately the unfunded liability would be reduced. If it continued in the same positive way, then ultimately the unfunded liability could be reduced somewhere between \$38 and \$57 million.

CHAIRMAN HIBBARD questioned Mr. Seacat if, in fact, that first year liability was more like \$52-56 million instead of \$62.5 million; and since his understanding was that that more or less compounds throughout the life, wouldn't that mean a proportionately larger reduction in the total amount of the unfunded liability? Also, if the same assumptions were true, they could cause the \$10 million decrease here to continue the projections for future years that might be lower as well?

Scott Seacat said the answer to CHAIRMAN HIBBARD'S question was "maybe," and certainly hopeful. These are the early beginnings of this trend, and he assumed the trend would continue but not increase. So he answered "maybe" and hoped that was true, but he couldn't predict that.

Mr. Seacat closed his presentation.

REP. EWER asked Mr. Seacat if the total projected liability payment considered whether stress was going to be covered and would that issue be covered under the old fund?

Scott Seacat said he was not sure what the answer was in respect to new fund stress, and as far as he knew, the assumptions on the old fund liability did not include stress adjustments.

Mr. Sweeney agreed that was absolutely correct.

REP. EWER asked for a clarification from Mr. Sweeney as to old fund liabilities. Was this just a moving target based on numbers, or was it also a moving target based on what the law may be interpreted to be?

Mr. Sweeney told the committee these numbers did not reflect anything to do with stress. Stress was not compensable at that time - no stress claims were reflected in these numbers. However, if the Supreme Court declares that stress is compensable, there would be three years, in effect '87 through '90 covered.

REP. EWER asked if he understood correctly that under current law, if there was a new benefit or the benefit was expanded or increased, that the effect of that is three years back?

Mr. Sweeney said what he tried to point out was that the benefit change made in 1987 was what was challenged in the stress decision; so if stress is found to be compensable, it could go back as far as 1987 when the benefits were changed.

CHAIRMAN HIBBARD asked Mr. Seacat to give some indication of how much of the projected old fund liability might be indemnity and wage loss, in contrast to medical payments.

Mr. Seacat responded the old fund numbers for those were undiscounted numbers. They did not include the allocated loss

expense adjustment of about \$12 million, \$117.6 million for medical, and \$276 million for indemnity.

Medical was \$117.6. This was a greater percentage than 60-40 indemnity to medical, but the medical portion of claims was usually paid out sooner, so this would be expected on the old claims that were at least two years old at the time the assessment was done.

CHAIRMAN HIBBARD asked if it would be possible to discount some of the ongoing flow of liability indemnity payments and perhaps even medical payments that go on through 2009, to discount those and settle them within a short period in the future ... one, two, three years, so claims that might last until 2008 or 2009 could be settled now at a lesser amount if the cash was available.

Mr. Sweeney responded to CHAIRMAN HIBBARD that a couple of years back the legislature passed a bill termed "the blue light special" which gave the opportunity to the State Fund to settle claims on a discounted basis regardless of the law in effect at the time of the injury. The State Fund settled a number of claims under the blue light special. Those claims remaining in the inventory deal with a lot of fatalities, permanent totals, major medical needs, etc.

REP. DRISCOLL asked about the 4200 cases still open in the old fund. Mr. Sweeney responded that approximately 4000 claims had been made on the old fund. He said he could break them down as to the number of permanent and partial permanent, total and temporary total, if the committee desired.

REP. DRISCOLL asked if there was a greater chance of settling with those people still on temporary total on Maximum Medical Improvement (MMI) than with the rest of the cases. Mr. Sweeney said that was absolutely correct.

REP. EWER asked, for the benefit of the newcomers, whether they could define the term a little better. Mr. Sweeney said MMI was the point in a claim where the physician is able to say to the claimant that he is not going to get any better, probably not any worse, but he could provide and determine a disability rating.

REP. DRISCOLL said he would like that information to be provided to him. He said he understood there were still quite a few people on temporary total. He said someone had stated at another committee meeting there were 1200 out of the 4200 still on temporary total. He asked how many were on temporary total and had not received MMI. Mr. Sweeney said he would provide that information to the committee.

REP. BENEDICT asked for a point of verification from Mr. Seacat - the total projected liability payments were undiscounted and asked if this included any claims administration. Mr. Seacat said it was included.

Mr. Seacat pointed out, in regard to the blue light special claims settlement procedure, that they had done some work for SEN. HARP in the 1991 session which showed that the blue light special saved a substantial amount of money. He said the committee also have to consider the fact that this requires a great deal of cash up front, which is the key to settling these claims. The Fund is not in a position to settle a bunch of claims because they don't have the cash in pocket.

CHAIRMAN HIBBARD thanked Mr. Seacat for his comment and said that, if there was a possibility to further discount and reduce the amount of this projected liability and cash flow drain when the committee considers things like the Zurich proposal for the great amount of money up front, one alternative might be raising a similar amount of money and discounting those claims in some way. CHAIRMAN HIBBARD didn't think the members should restrain themselves necessarily to the current situation or the reason they hadn't been able to do things in the past.

He believed it was incumbent on the committee to exercise a little imagination and originality to see if they couldn't come up with something new that might work.

Mr. Seacat then proceeded to the second spreadsheet and referred to the heading 92-30CFD. EXHIBIT 1B The purpose of the spreadsheet was to get a feel for where the interim committee was coming from on the prospective payroll tax and the significance of that tax.

He said they tried to use the same projected liability payments for any bond payments, except an estimated payroll tax for both the employee and the employer as requested by the interim committee. That would essentially get the state out of the business in short order. Using the assumption that this should be done before the year 2000, they identified the payroll tax for both the employee and the employer for 1994 which would be .9. Then for '95 through '99 it would be .72. That would put the Fund in a cash position to where it could not only pay the claims, but also pay off the bonds.

Under "total expense" or under bond debt payments in '99 they would make a significant payment of \$149 million. That would be through a bond call or decrease or something on that order.

REP. BENEDICT asked Mr. Seacat to could clear up a question in regard to the spreadsheet and asked if it was basically a bonding program as opposed to the Zurich proposal; the payroll tax wouldn't be the same with the Zurich proposal because of the different cash requirements the Zurich proposal has.

Mr. Seacat responded that the spreadsheet was not on the proposal. This spreadsheet was what they recommended the payroll tax be for both an employee and employer if the legislature chooses to cash flow the entire Fund; not sell bonds, but pay off

the existing bonds and have enough cash to pay existing claims also. If the state went to a bonding program and that bonding program was over a longer period of time, or a 15-year bonding program, then the annual payroll tax could certainly be a lot less than the .72.

CHAIRMAN HIBBARD asked Mr. Seacat if they were to put this out for ten years rather than two, four, or six as they had done here. He wanted to know the prediction as to what the payroll tax would need to be.

Mr. Seacat said he didn't have those figures on hand but he could give them to the members at a future meeting.

REP. BERGSAGEL asked why 1999 was used.

Mr. Seacat replied that the direction they received from the interim committee was, "Let's get this done before the turn of the century."

REP. BENEDICT asked Mr. Seacat to further clarify that: by 1999 we ought to have a lot better handle on this than we do in 1993? Mr. Seacat responded that was absolutely true.

CHAIRMAN HIBBARD said he was assuming that the unfunded liability would at least remain constant and asked Mr. Seacat how confident he was that those numbers wouldn't inflate similar to medical costs, etc.

Mr. Seacat said he did not have a good answer to that and was not confident of any of the numbers. He said to answer the question specifically, all of these projections have to include the actuaries' assumptions and their best guess.

CHAIRMAN HIBBARD said he was glad Mr. Seacat felt comfortable with the numbers as he was in a position to watch them very closely.

Mr. Seacat stated that at a previous meeting the committee was told incorrectly that the state agencies did not pay payroll taxes and he did have those figures available. In fiscal '91 state agencies spent \$696,000 in payroll tax. In fiscal '92 state agencies paid \$756,000 in payroll tax.

REP. BENEDICT asked Mr. Seacat if he had any assumptions based on the first or second spreadsheet that showed the big jump in payroll taxes from .9 and then to .72. What kind of an impact would that have on state agencies? Mr. Seacat said he guessed it would be about three times what it was right now.

CHAIRMAN HIBBARD introduced Mr. John Fine, who gave his informational testimony.

John Fine, Legislative Audit Committee, referred to the bluebook

handout which included a balance sheet statement with columns for both the new and the old fund. EXHIBIT 1C As shown on this balance sheet statement, the new fund had a deficit of \$42.2 million. This was a deterioration in their fund equity of about \$44 million over the 1991 results.

Using numbers generated by the actuary, he was able to give an idea of which year's experience eroded in modes, 68% of that difference came from a change in the projected liability and ultimate liability for fiscal year '91, and 32% came with the change from all those changes that projected all the liability for the year '92.

He said the key numbers on this balance sheet were the estimated insurance claims and these were based on work done by the State Fund's actuary. The other key was the deficit. These were discounted insurance claims at the new fund, and were discounted at the rate of 7%. The actuary used the 7% based on the investment experience during this one year period.

As mentioned in the latest old fund claims, there was a risk in discounting claims which were not covered by liabilities, so when the question was asked, "Is the deficit more or less than is shown on the financial records?", they would say they were not sure, but they could tell the factors that could take it either way. One factor here was, if they were discounting claims for which there were no assets, it might tend to mean that there was a potential for a larger deficit down the road.

He said another factor that might move the Fund in that direction would be the stress case. The experience in California was, and this information was received by the State Fund, they've calculated about 7% of their liabilities go in on stress cases. What the experience would be here in Montana they didn't know because this hadn't happened yet. That would tend to make the new fund position weaker than it is. Medical inflation would continue to do the same thing.

On the positive side, the estimated insurance claims here were based on paid claims analysis, and that is the incidence of claims from given and current years, how this developed from year to year to year. This paid claim analysis rested fairly heavily on previous years but did not account for changes that may have taken place in the last year or two. Those changes did not get much weight in that analysis. Some changes that could put this new fund situation in a more positive light would be blue light specials and the discounting of claims under the 1991 law. If they assume that the payment of claims in 1991 or 1992 follow the same pattern as previous years, but the fact that they discounted moves more of the incurred claims off the books, it may in fact be in better shape than a paid claims analysis would indicate.

In previous years, the State Fund's reserve policy had been erratic and, therefore, the actuaries were probably using their

best judgment not to put any weight on the book reserves of the insured. In fiscal year '92 the State Fund instituted some new reserving policies. They had not audited these policies because they hadn't been in effect long enough for them to test the results of the application of them, but they had been implemented and should enable the State Fund to maintain closer control of what the reserve position is and how it is developing. To the extent that's happening, the reserve position as reflected in paid claims analysis may, in fact, show higher than has yet occurred.

He said his second handout had to do with premium revenue increases by the State Fund. **EXHIBIT 1D** The Board of Directors had implemented four premium revenue increases since July 1, 1991, which meant four increases in 18 months. These increases accumulated to approximately a 62% increase in projected premium revenue, and an increase of that amount assumes that the insured base is going to be somewhat constant.

He pointed out if, at some point, the premium is high enough that it drives a significant number of the insurers out, the state would not necessarily achieve that premium revenue increase, but also wouldn't have the risks to go with those who are no longer insuring there.

Premium revenue increases are what the bids show. It didn't show what the premium rate increase was in a given class. And that isn't what a so-called rate increase keys on. It would key on how much revenue would be needed to cover the losses that would be incurred in a year. That's the first thing: setting rates for a given loss year and covering losses in previous years that were not fully covered by the rates that were in effect at that time.

Mr. Fine said there were two components to any analysis of what would be the right premium revenue total to have for a particular year. One: what are the losses going to be in a year and what would the actuary's projection say losses would be in this year - how much of the loss from previous years that wasn't covered by the premium would need to be made up. Given the deficit situation, the fund is trying to remedy premium revenue deficits from previous years.

He said a problem with the new fund is having insurers who don't have any surplus reserves in amounts where assets exceed liabilities. They can't account for normal fluctuations in their loss experience. Some years are worse than others, and the actuary cautioned the board against trying to get it all back in one year.

CHAIRMAN HIBBARD asked if by covering deficits, or at least approaching deficits of previous years in the current rate-setting process, that meant they were going back prior to July 1 of 1990, when the new fund originated?

Mr. Fine said they were talking about deficits in the new fund only. The State Fund's accounting system and the management was well aware of the need to segregate the old and the new fund.

REP. BENEDICT asked Mr. Fine if he could give a rough percentage of what they were trying to build in to offset previous deficiencies in the new fund.

Mr. Fine told REP. BENEDICT the premium revenue increase for January 1, 1993 was solely aimed at covering previous deficits. The actuary thought the premium for 1993 fiscal year was on target so this was an example of a 5% increment and Mr. Fine believed the same was true of the 1992 interim increase.

Mr. Fine concluded his presentation.

REP EWER read a letter sent to the Board of Directors of the State Compensation Mutual Insurance Fund dated November 5, 1992 from Tellinghast, the Towers' parent company. EXHIBIT 1E

REP. EWER said he understood the letter to mean that the new fund had premiums set that basically were on an even keel, that it was supposed to be doing what it's doing on an actuarially sound basis, but it was also his understanding that one of the biggest problems is that the Fund was undercapitalized, which he suggested is a much different type of problem than having rates set artificially low and asked Mr. Sweeney to comment on this.

REP. EWER referred to the last page of the letter where it stated that the new fund was planning to increase premiums by 5%. The actuary said, "It is our opinion that aggressive rate level action that would completely raise the estimated deficit on January 1 is not the best way to attain the goal of the Fund being self-supporting and not having unnecessary surplus."

Mr. Sweeney said according to the actuary, the Fund was initially "severely undercapitalized." At one point in his discussion with the Board he also indicated that the new fund had a \$40 million deficit and in order to make that up in one fell swoop, the actuary believed it would be extremely disadvantageous to the policy holders of the Fund. He thought it would be better for the Board of Directors to develop a plan to erase that deficit over a period of time, while at the same time keeping an eye on building service in the future. His recommendation as adopted by the Board was to take a 5% increase strictly for erasing the deficit on January 1, and to keep that 5% in place for all rate increases into the future until the deficit was erased.

CHAIRMAN HIBBARD asked Mr. Sweeney why, in his opinion, the \$42 million deficit occurred.

Mr. Sweeney said in conversations with the actuary, he indicated that the first year of the new fund was obviously underpriced. They went with the information they had at that time. They go

with what the trends were in the past. They found that the first year the new fund was under-priced, maybe by as much as 10%. He saw a deterioration in the second year. In the third year, he felt extremely comfortable with the rates that were established as John Fine indicated, for FY93. He believed those rates were sufficient for this fiscal year.

REP. COCCHIARELLA asked Mr. Sweeney if he anticipated another rate increase in July of '93. Mr. Sweeney responded affirmatively and said it would be a rate increase based upon the experience of the Fund and would be 5% as well.

REP. BENEDICT asked Mr. Sweeney if the actuaries had given any indication as to when this would level off and we would be able to hold rates where they are presently. Mr. Sweeney responded that the actuaries didn't give any indication. The only indication with regard to rates was the comment made in a report given last July to the Board of Directors that in the foreseeable future they were going to be looking at double digit rate increases.

Mr. Sweeney, responding to a question from REP. COCCHIARELLA, said there is double digit medical inflation every year, and when rates are calculated for any given year that has to be taken into consideration. There is also the average weekly wage annual increase which also has to be considered.

The only way that he could see the State Fund reaching some point where they would not have to take a rate increase, or a rate increase would be very minimal, would be if there was a sufficient surplus to take care of peaks and valleys that occur.

He referred to the "Oregon miracle" which had been recording underwriting losses as a result of their legislative changes, but at the same time they had in excess of \$1 billion in surplus that made up for those peaks and valleys that enabled them to keep the rates down and also they didn't issue dividends.

CHAIRMAN HIBBARD asked if there were further questions for any of the three gentlemen appearing before the committee. There being none, he said the committee would be hearing from Jacqueline Lenmark on Plan 2 insurance and the Zurich proposal at a future meeting. The first bill would be heard on Monday, January 18.

There being no further business to come before the committee, CHAIRMAN HIBBARD adjourned the meeting.

HOUSE SELECT WORKERS COMPENSATION COMMITTEE

January 8, 1993

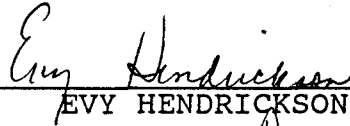
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ADJOURNMENT

Adjournment: 6:00 p.m.



REP. CHASE HIBBARD, Chairman



EVY HENDRICKSON, Secretary

by *Naigra Miller*

CH/ev

HOUSE OF REPRESENTATIVES
53RD LEGISLATURE - 1993
SELECT COMMITTEE ON WORKERS COMPENSATION

ROLL CALL

DATE

1-8-93

[illegible]

HR:1993

wp.rollcall.man

OFFICE OF THE LEGISLATIVE AUDITOR
 SCHEDULE OF PROJECTED LIABILITY PAYMENTS AND CASH NEEDS
 ATTACHMENT 1- PRE JULY 1, 1990 CLAIMS FINANCED WITH .28% EMPLOYEE
 92-30EMP
 12:10 PM
 01/04/93

6.75% BONDS-NEW FUND PAYBACK IN 1992
 PAYROLL TAX SUNSETS 2ND QUARTER FY 2009

FISCAL YEAR	TOTAL PROJECTED LIABILITY PAYMENTS	BOND DEBT PAYMENTS	TOTAL EXPENSE	EMPLOYER PAYROLL TAX	PROJECTED END OF YEAR CASH	PROJECTED INTEREST EARNINGS	PAYROLL INFLATOR OF 5% USED AS REQUESTED BY LEGISLATORS	THIS SPREADSHEET PREPARED WITH THE FOLLOWING ASSUMPTIONS:
1993	\$62,546,121	\$11,320,241	\$73,866,362	\$14,351,617	(\$26,367,966)	\$214,318		PAYROLL TAX OF--> 0.2800%
1994	\$51,269,234	\$11,319,361	\$62,588,595	\$15,069,198	(\$76,415,788)	(\$2,528,424)		
1995	\$43,147,042	\$11,318,181	\$54,465,223	\$15,822,658	(\$119,093,875)	(\$4,035,523)		
1996	\$37,847,457	\$11,320,631	\$49,168,088	\$16,613,791	(\$156,991,164)	(\$5,342,991)		
1997	\$33,959,999	\$11,317,544	\$45,277,543	\$17,444,481	(\$191,350,676)	(\$6,526,450)		
1998	\$30,193,073	\$11,318,244	\$41,511,317	\$18,316,705	(\$222,132,368)	(\$7,587,078)		\$4,881,502,500
1999	\$27,544,827	\$11,317,694	\$38,862,521	\$19,232,540	(\$250,319,904)	(\$8,557,555)		COST OF CAPITAL--> 6.7500%
2000	\$25,034,783	\$11,319,984	\$36,354,767	\$20,194,167	(\$275,919,681)	(\$9,439,177)		PAYROLL INFLATION RATE--> 5.0000%
2001	\$22,838,388	\$11,318,859	\$34,157,247	\$21,203,875	(\$299,110,989)	(\$10,237,936)		BEGINNING CASH BALANCE--> \$32,932,460
2002	\$20,062,816	\$11,321,394	\$31,384,210	\$22,264,069	(\$319,160,839)	(\$10,929,709)		
2003	\$16,175,201	\$11,318,394	\$27,493,595	\$23,377,272	(\$334,746,985)	(\$11,469,823)		
2004	\$12,658,910	\$11,318,819	\$23,977,729	\$24,546,136	(\$346,041,069)	(\$11,862,491)		THIS SPREADSHEET CALCULATED THE FOLLOWING FINANCIAL RELATED DATA:
2005	\$9,483,823	\$11,320,939	\$20,804,762	\$25,773,443	(\$353,184,947)	(\$12,112,560)		TOTAL EXPENSE \$678,953,443
2006	\$6,653,346	\$11,317,964	\$17,971,310	\$27,062,115	(\$356,318,990)	(\$12,224,847)		2009
2007	\$4,277,273	\$11,322,569	\$15,599,842	\$28,415,221	(\$355,712,045)	(\$12,208,434)		YEAR PAYROLL TAX ENDS
2008	\$2,454,046	\$11,320,844	\$13,774,890	\$29,835,982	(\$351,726,602)	(\$12,075,649)		
2009	\$572,213	\$91,123,229	\$91,695,442	\$7,831,945	(\$450,953,777)	(\$15,363,679)		
						(\$152,288,009)		

EXHIBIT 18
 DATE 1-8-93
 HB

OFFICE OF THE LEGISLATIVE AUDITOR
 SCHEDULE OF PROJECTED LIABILITY PAYMENTS AND CASH NEEDS

92-30CFD
 07:54 AM
 01/08/93

PAYROLL INFLATOR OF 5% USED
 AS REQUESTED BY LEGISLATORS

THIS SPREADSHEET PREPARED WITH THE FOLLOWING ASSUMPTIONS:

FISCAL YEAR	TOTAL PROJECTED LIABILITY PAYMENTS	BOND DEBT PAYMENTS	TOTAL EXPENSE	EMPLOYEE PAYROLL TAX	EMPLOYER PAYROLL TAX	PROJECTED END OF YEAR CASH	PROJECTED INTEREST EARNINGS	PAYROLL TAX OF-->	1994	1995
1994	\$51,269,234	\$11,319,361	\$62,588,595	\$48,436,709	\$48,436,709	\$33,834,258	\$867,835		0.9000%	0.7200%
1995	\$43,147,042	\$11,318,181	\$54,465,223	\$40,686,835	\$40,686,835	\$60,917,904	\$1,559,517	COVERED PAYROLL-->	\$4,881,502,500	
1996	\$37,847,457	\$11,320,631	\$49,168,088	\$42,721,177	\$42,721,177	\$98,238,288	\$2,499,652	COST OF CAPITAL-->	5.0000%	
1997	\$33,959,999	\$11,317,544	\$45,277,543	\$44,857,236	\$44,857,236	\$144,823,744	\$3,674,739	PAYROLL INFLATION RATE-->	5.0000%	
1998	\$30,193,073	\$11,318,244	\$41,511,317	\$47,100,098	\$47,100,098	\$201,002,656	\$5,092,555	BEGINNING CASH BALANCE-->	(\$26,367,966)	
1999	\$123,136,331	\$149,003,626	\$272,139,957	\$49,455,102	\$49,455,102	\$554,197	\$831,907			

THIS SPREADSHEET CALCULATED THE FOLLOWING FINANCIAL RELATED DATA:

TOTAL EXPENSE	\$525,150,724
YEAR PAYROLL TAX ENDS	1999

LOANS FROM NEW FUND OTHER SOURCES

1993 26367966

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1-8-93

STATE COMPENSATION MUTUAL INSURANCE FUND
BALANCE SHEET - ENTERPRISE FUND
JUNE 30, 1992
(in thousands)

	<u>New Fund</u>	<u>Old Fund</u>
ASSETS:		
Cash/Cash Equivalents	\$ 85,120	\$ 8,361
Receivables (Net)	32,654	475
Due from Other Funds	2,108	2,129
Inventories	59	
Long Term Loans/Notes Receivable		2
Investments	58,415	33,706
Equipment	1,237	
Accumulated Depreciation	(326)	
Intangible Assets	37	
Deferred Charges		3,861
Other Assets	<u>10,514</u>	
TOTAL ASSETS	<u>\$189,818</u>	<u>\$ 48,534</u>
LIABILITIES/FUND EQUITY:		
Liabilities:		
Accounts Payable	165	843
Due to Other Funds	753	1,813
Bonds/Notes Payable (Net)		138,244
Property Held in Trust	18,710	
Compensated Absences Payable	433	
Estimated Insurance Claims	<u>211,995</u>	<u>406,719</u>
Total Liabilities	<u>232,056</u>	<u>547,619</u>
Fund Equity:		
Contributed Capital	12,011	
Retained Earnings:		
Unreserved	<u>(54,249)</u>	<u>(499,085)</u>
Total Fund Equity	<u>(42,238)</u>	<u>(499,085)</u>
TOTAL LIABILITIES/FUND EQUITY	<u>\$189,818</u>	<u>\$ 48,534</u>

Premium Revenue Increase

<u>Effective Date</u>	<u>Percentage Increase</u>
July 1, 1991	15.7
January 1, 1992	11.0
July 1, 1992	20.0
January 1, 1993	5.0

Source: Compiled by the Office of the Legislative Auditor

EXECUTIVE SUMMARY

PURPOSE

Tillinghast, a Towers Perrin company, was engaged by the Montana State Compensation Mutual Insurance Fund (the Fund) to estimate the unpaid loss and allocated loss adjustment expenses (ALAE) as of 6/30/92 for the Fund's workers compensation exposure. We examined both the New Fund and the Old Fund, using data as of 9/1/92.

DISTRIBUTION AND USE

This report is being provided to Fund management to assist in estimating the indicated reserves as of 6/30/92. We understand that copies of this report may be provided to the Fund's Board of Directors and its auditors, and that the report is considered public information in Montana. We request that the Fund inform us of any distribution beyond management, Board of Directors, and the Fund's auditors.

Tillinghast has prepared this report in conformity with its intended utilization by persons technically competent in the areas addressed and for the stated purposes only. Judgments as to the conclusions, recommendations, methods and data contained in this report should be made only after studying the report in its entirety. Furthermore, members of the Tillinghast

staff are available to explain any matter presented herein, and it is assumed that the user of this report will seek such explanation as to any matter in question.

RELIANCES AND LIMITATIONS

In performing our analysis, we have relied on:

- Historical paid and reported loss data, as provided by the Fund.
- Historical premium and payroll data, as provided by the Fund.
- Historical ALAE payments, as provided by the Fund.
- Asset information as provided by the Fund.
- National Council on Compensation Insurance (NCCI) information regarding the effect of benefit changes in Montana.
- Tillinghast analysis of industry loss reporting and payment patterns. | *used in develop. of the test*

Throughout our analysis we have relied, without audit or verification, on historical data and qualitative information supplied by the Fund. Our reliance is based on oral and/or written confirmation, by responsible representatives of the Fund, of the quality, accuracy, and completeness of the data and information supplied to us. We did, however, review this information for reasonableness and internal consistency. The accuracy of our results is dependent upon the accuracy and completeness of this underlying data; therefore, any material discrepancies discovered in this data by the Fund should be reported to us and this report amended accordingly, if warranted.

3.

Our projection of future claim payment and emergence is based on the Fund's historical patterns. It is possible that this data will not be predictive of future loss emergence for the Fund. We have not anticipated any extraordinary changes to the legal, social and economic environment which might affect the cost and frequency of claims.

Loss and ALAE reserve estimates are subject to potential errors of estimation due to the fact that the ultimate liability for claims is subject to the outcome of events yet to occur, e.g., jury decisions and attitudes of claimants with respect to settlements. Thus no assurance can be given as to the adequacy of the indicated reserve level.

Another source of uncertainty is introduced in estimating unpaid loss and ALAE on a present value basis. That is, besides the risk of underestimating or overestimating the overall amount of the loss and ALAE liabilities, there is the additional risk that the timing of the future payment of those liabilities will differ from the estimated payout, or that the future yield on the underlying assets will differ from the assumed interest rate. Actual loss and ALAE payments could occur materially more rapidly or more slowly than projected, due to random variations and the timing of large claim payments. The yield on assets supporting the liabilities may be affected by capital gains or losses, or significant changes in economic conditions.

We have employed techniques and assumptions that we believe are appropriate, and we believe the conclusions presented herein are reasonable, given the information currently

4.

available. However, it should be recognized that future loss emergence will likely deviate, perhaps substantially, from our estimates.

Throughout this report, the term incurred but not reported (IBNR) includes all indicated additions to case loss and ALAE reserves as of 6/30/92, i.e.,

- future revisions of case reserves for known losses,
- closed cases that will be reopened, and
- claims incurred but not yet reported ("pure" IBNR).

It should be noted that the indicated reserves on Exhibits I through V include a provision only for loss and allocated loss adjustment expense. No provision is included for unallocated loss adjustment expense.

Finally, the exhibits attached in support of our recommendations should be considered an integral part of this report. These exhibits have been prepared so that actuarial judgments and assumptions are documented.

SUMMARY OF INDICATIONS

Exhibits I through V contain the summary of estimated unpaid loss and ALAE as of 6/30/92 for each Fund year. At the request of Fund management, we have provided indications on both an undiscounted and discounted basis. The discounted indications are given at 4%, 5%,

5.

6%, and 7% annual rates of return. We have displayed indications for both the Old Fund (77/78-89/90) and the New Fund (90/91 - 91/92) exposure periods.

A summary of the indications on Exhibits I through V for medical and indemnity combined are as follows:

Occurrence Period	Undiscounted (\$000's)	Discounted (\$000's)			
		4%	5%	6%	7%
OLD 77/78 - 89/90	(\$393,636)	\$325,818	\$312,129	\$299,488	\$287,790
NEW 90/91 - 91/92	285,499	234,865	224,988	215,966	207,702*
Total	\$679,135	\$560,683	\$537,117	\$515,454	\$495,492

* - In response to review comments, the actuary adjusted these numbers upward to include unallocated loss adjustment expense and, for the Old Fund, the projected payout on cases prior to fiscal year 1976-77.

These estimates contain a relatively high degree of uncertainty. This high degree of uncertainty results from the following:

A. The adjusted amounts appear on the balance sheet distributed to the audit committee.

- There is a high degree of uncertainty involved in projecting workers compensation losses;
- Workers compensation loss experience is inherently volatile;
- Limited Fund data was available to analyze development beyond 134 months;
- According to Fund management, the Fund has recently implemented programs to close certain types of claims more quickly than in the past;
- According to Fund management, the Fund has recently strengthened case reserves; and
- The effect of the 7/1/89 and 7/1/91 benefit changes on tail development is unknown.

In particular, we were unable to rely on the incurred loss development technique for the medical projections to a great degree due to the Fund's recent case reserve strengthening. This case reserve strengthening, although viewed as positive since it is the opinion of Fund management that the reserves are being set at a more realistic case reserve adequacy level, causes distortions in the historical incurred development triangles. This case reserve strengthening is evident in several exhibits, including the incurred loss development exhibit and the paid-to-reported exhibit. (Theoretically, these exhibits could also be illustrating a uniform serious deterioration in loss experience for all years during the last 12 months. Fund management believes that there is little evidence to indicate this has happened).

Thus, due to this case reserve strengthening, we have relied primarily on the paid development techniques in selecting ultimate losses for medical. Unfortunately, the paid development technique, although not affected by case reserve strengthening, usually gives volatile results due to the highly leveraged loss development factors.

Fund management believes the 7/1/87 and 7/1/91 benefit changes will have a significant favorable impact on both incurred and paid development patterns in the tail. Unfortunately, it is too early for evidence of this improvement to appear in the 9/1/92 data. Additionally, development data for older accident years, which are now in this tail period, are not available. Thus, we relied on industry data and have assumed that both the Old and New Funds will exhibit significant development in the tail.

7.

We understand that the cash assets available to pay losses as of 6/30/92 are \$169.7 million. Thus, on a discounted basis at 7%, this would indicate a reserve deficiency of approximately \$37.3 million. (We have adjusted for loss payments made on June 29 and 30, which were not reflected in the loss runs.)

This number may prove to be pessimistic. It may turn out that recent benefit changes will significantly affect tail development. At the request of Fund management, we have performed some sensitivity testing regarding the tail development issue. If there is no significant development beyond 8 or 10 years, then the indicated deficit on a discounted basis at a 7% rate of return would be significantly lower than the indicated deficit of \$37.3 million.

These facts, coupled with the recent 20% rate increase which presumably has a reasonable probability of generating some surplus funds for the 92/93 loss period, indicates that the deficit may decrease over the next 12 to 24 months. This situation bears close monitoring by the State Fund management staff.

There is also no guarantee that the deficit will not prove to be significantly greater than \$37.3 million. Apparent case reserve strengthening may be partly reflecting rapid deterioration in loss experience. Also, it is our understanding that the Fund is now exposed to stress-related claims due to a recent judicial decision.