

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 53rd LEGISLATURE - REGULAR SESSION

SELECT COMMITTEE ON WORKERS' COMPENSATION

Call to Order: By CHAIRMAN CHASE HIBBARD, on January 11, 1993,
at 3:00 p.m.

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: Susan Fox, Legislative Council
Evy Hendrickson, Committee Secretary

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

Committee Business Summary:

Hearing: None
Executive Action: None

CHAIRMAN HIBBARD said the committee would hear a presentation from Jacqueline Lenmark about Plan 2 under Workers' Compensation coverage and the Zurich proposal. Also, Gary Uhlemeyer, president of Uhlemeyer Services, the broker/facilitator who brought Zurich in to give the presentation to the Joint Select Committee, will say a few words about that proposal as well.

Jacqueline Lenmark, representing the American Insurance Association (AIA), said her first comments would be on behalf of the American Insurance Association.

She had prepared informational comments on Plan 2 carriers' concerns and the work that has been done with the Joint Select Interim Committee and the Governor's task force.

AIA was involved with the task force during the interim. There were lengthy presentations from people representing the self insurers and also from the State Fund, on beneficial system changes. They discussed legislation that would have an impact

not only on the State Fund, but on all plans.

The primary concern for AIA is rate adequacy which is absolutely crucial in the private market. Private carriers are regulated by the insurance commissioner. It is also important that the State Fund operates accurately so there is competition available between the State Fund and the private market to encourage the private markets to come in. It is AIA's view that for the past ten or so years there has been an artificial suppression of rates in Montana which has created a rate disparity in the State Fund and has impacted successful competition in Montana. Whenever legislation is considered that might solidify the process and ensure consistent regulation of rates being set for all players, AIA will probably support that legislation.

When rates are artificially suppressed, it leads directly to the kind of problem being faced right now with regard to the unfunded liability of the State Fund.

Another general point that AIA would like to stress in all legislation is objectivity. Every time more objectivity can be gained, the system will probably improve. Objectivity allows the system to be self-administering, as it was originally intended. Workers' compensation was never intended to be an adversary system involving lawyers, and it is AIA's position that every time legislation is passed that allows room for argument, we have the intervention of the legal system which adds to the cost. In every instance where the legislature can carefully set out an objective way of determining entitlement benefits, it will improve the system.

AIA has supported the Oregon plan but there is one caution: Montana is not Oregon, and the two systems are not identical. When considering the benefits of the Oregon plan -- and there are many -- it must be remembered that Montana is not Oregon. We must look to Montana's system to see if any suggested changes based on the Oregon plan relate to Montana.

The AIA strongly opposes the creation of an assigned risk pool. That topic comes and goes, but AIA has been consistent in its opposition. They support the three-way system found in Montana. They support a strong, competitive, properly managed State Fund. They support strong participation by the self insurers.

One other area of concern to the private carriers has been what is perceived as a very liberal court system, referring to the Supreme Court. It's an issue that has not come up a lot but perhaps the Stratemeyer case might be a good example. It is very important to any legislation that is passed out of this committee, that you have well-prepared and documented legislative history. That does not necessarily ensure that your intent will be followed if it should be contested in court. But, it certainly gives the court guidance, and it better ensures that your intent will be followed should there be a legal challenge

later down the line.

At this point Ms. Lenmark advised she was switching clients. For the record she will be representing Centre Re Insurance, Alexsis, Inc., The Zurich Co. and Uhlemeyer Services, and briefed the committee a bit about the Zurich proposal. EXHIBITS 1, 2 and 3

CHAIRMAN HIBBARD asked Ms. Lenmark to elaborate a little on the Oregon system because many people tout the "Oregon miracle" as the answer to workers' compensation. He asked Ms. Lenmark if she would give her impressions about the Oregon plan and how it may or may not be comparable to Montana, some of the pitfalls in looking at the Oregon plan and try to draw conclusions about Montana.

Ms. Lenmark said what the beauty of the Oregon miracle seems to have been is that, for practical purposes, a representative from labor and a representative from employment were locked in a room together with the instruction that they come up with something that would satisfy both parties. And they did that. They came up with some reforms that would apply to those particular areas.

She said the Montana system may not be bleeding in the same given areas but didn't have specific examples. One example is that Oregon has a simple administrative system over their workers' compensation -- they have one person or one agency administering workers' compensation, commerce and insurance regulation. In Montana those duties are combined among several different agencies. So, if there were administrative changes involved in the Oregon plan, they may not be pertinent to Montana. She noted that she was not attempting in any way to cast a shadow on the State Fund. This worked for Oregon, and Montana may benefit from looking at different aspects.

REP. BENEDICT asked Ms. Lenmark if the Oregon system has an assigned risk pool, to which she replied that was correct.

REP. BENEDICT said it was his understanding the Oregon plan has a surplus approaching a billion dollars. They lost about \$54 million last year, but still paid a dividend last year and took it out of their surplus to make it look like it was still a miracle. He asked if that was Ms. Lenmark's understanding. that

Ms. Lenmark said that was her understanding.

REP. DRISCOLL said during the first two years of operation of the Oregon miracle they were denying 50% of the claims. Are they still doing that?

Ms. Lenmark responded that she did not know. It is an example of the type of thing this committee should be cautious about.

REP. BENEDICT said he also understood when they first got started they dumped about 4000-5000 small businesses and told them that

they couldn't obtain coverage through the system anymore because they were too small. And then they came back and they let them back in. Is that your understanding?

Ms. Lenmark said that was her understanding. She asked not to be quoted on exact numbers, but there was very strong medicine for everyone involved in the system in Oregon when the miracle was enacted.

CHAIRMAN HIBBARD asked if there were further questions by the committee before moving on.

Ms. Lenmark, making one last follow-up comment from AIA, stated that AIA has significant resources available to provide information on how various proposals may work in one state or another. They would make that information available to this committee at any juncture.

REP. COCCHIARELLA asked Ms. Lenmark what the situation would have to be to encourage private insurance to come back to the state. She sensed that private insurance companies don't like Montana because there is no competition.

Ms. Lenmark responded to REP. COCCHIARELLA stating she may have sounded too simplistic. The Joint Select Interim Committee requested of her early on in some of their meetings, suggestions for ways to encourage the private sector. She said when she speaks about the Zurich proposal she is saying that that is another place to start the private market looking at Montana. One of the deterrents for the private market has been the constant attempt to correct the system by amending the laws. Pricing a risk into the future and the uncertainty of what laws will be amended every two years makes it difficult, coupled with the rate inadequacy, to rush back into our market place. Montana is too small to have that kind of clout in the insurance market.

Ms. Lenmark then moved on to the Zurich proposal. She began with some identification of names and terms to which she would be referring. This has been referred to in the press as the Zurich proposal. Zurich is the parent of a group of companies. Centre Re Insurance is the subsidiary company within the Zurich Groups that will be issuing the reinsurance should this committee and the state of Montana choose to go forward with the proposal. IRISC is the company that assisted in the work in developing the proposal. It is the entity that issued confidence to the Joint Select Interim Committee about the claims management of the Fund. Alexander & Alexander is one of the largest retail insurance brokers in the world. It is the parent of Alexsis, and Alexsis was one of the participants in bringing the proposal to this committee. Alexsis is a national claims management services company. Seventy percent of its business is in workers' compensation and it is already in Montana. They were in Montana when REP. DRISCOLL suggested that the insurance industry respond to this problem. Uhlemeyer Services is the specialist in the

to this problem. Uhlemeyer Services is the specialist in the development of marketing as a placement of financially insured suppliers.

When the proposal began in the Joint Select Interim Committee almost a year ago, REP. DRISCOLL and the Joint Select Interim Committee asked about insurance companies that could solve this problem with the State Fund. As a result of that, four insurance companies responded: The Travelers, The Zurich Group, AIG and Bergsheir & Hathaway. Those four companies spent a great deal of time analyzing every performance audit that came from the legislative auditor's office - the financial and annual reports for the State Fund, pounds and pounds of paper, to give a perspective on what the problems were. Of those four companies, three presented proposals during the special session: AIG, Bergsheir & Hathaway and the Zurich Companies.

After hearing those proposals, the Joint Select Committee selected the Zurich Company and directed Uhlemeyer Services to proceed in arranging for what is called "a due diligence." As a result of that, the Zurich Company sent a number of people from Zurich and Alexsis to look at the operation of the Fund and the financial information with respect to the Fund, so they could price a proposal.

From the very beginning Zurich looked at their proposal as a partnership with the State of Montana, so the initial presentation carried with it the feature of a profit sharing component for Montana, a financing assistance component in Montana and a risk transfer component. Those elements were all in the original presentation.

Zurich sent in a team of approximately 15 people to look at the information and, as a result of that, redefined its proposal. They came back in October to work with a small number of the interim committee to seek direction in that they had now a more comprehensive financial proposal to present to the committee. In November they came back with a more finalized proposal. That proposal was presented to the Joint Select Interim Committee, and the committee voted to proceed.

Zurich Companies was the only group of insurance companies that had a complete response. They were willing to provide assistance in any area requested, but their proposal was directed only to the old fund because that's the direction they received from the Joint Select Committee.

The proposal, as it will be presented today by Mr. Uhlemeyer, is still in negotiations. It is still a transaction that can be adjusted to suit Montana's particular situation. If Montana chooses to go ahead, what needs to be done is a negotiating body designated to give Centre Re direction on what changes need to be made so that a final financial proposal can be presented.

She said all of this is still flexible. Centre Re is committed to the profit sharing components, the risk transfer components and the assistance in financing.

The first and most important aspect of the proposal is risk transfer. That would be accomplished through the insurance mechanism. Presently, it has been structured with limits of \$490 with the ability to continue to purchase additional coverage. Presently, the premium for that is \$490 million. Those limits were dictated to Centre Re by the working session of the Joint Select Committee. Those limits can be adjusted accordingly. With the risk transfer comes the transferred payment of claims. It transfers the risk of not having enough cash on hand to pay claims as they come due -- it also transfers the expense risk.

The next major component of the proposal is claims management. Centre Re will take over with the IRISC Companies and Alexis the claims management involved. This is an area where there can be a substantial savings for Montana. IRISC believes that with proper management of the claims from the beginning, it is possible to save up to 20% in expenses. She wanted to make it very clear to the committee that except for the rare instance, they will not be able to save 20% -- they most likely will not be able to save 20% on old fund claims because Centre Re will not be assuming them from day one. When she says day one, she means the day that the claim comes into the office. Under proper management it may be possible to save about 20%, but there is some savings available there for efficient claims management.

Ms. Lenmark said another major component is profit sharing. Centre Re is a unique company in that it does not believe the state should buy insurance for a risk that it doesn't have or won't use. Centre Re is willing to give back the profit, less a small amount for claims expense, for premiums not needed to pay claims.

She said Centre Re is willing to assist the state of Montana in financing. That is a typical problem for this committee. Center Re is willing to participate with the state in financing. They are also willing to invest to the extent allowed under their investment guidelines. It also means that the proposal would bring more private, good paying jobs to Montana -- not just in the Helena area, but potentially around the state with the various entrepreneurs associated with the claims management administration.

Ms. Lenmark clarified a couple of points of her presentation. The \$400 million does not go to Centre Re's pocket. The bulk of the \$400 million will go to Montanans who are injured workers. That's to pay off the liability the state will have to pay one way or another.

She distributed handouts so that committee would have all the information which has been presented to the various committees.

She cautioned that the numbers in the proposal in terms of premium and limits, for example, still need to be finalized.

She noted that, concerning the work performed by IRISC and the Zurich Companies on the claims management function of the Fund, it is unusual for them to have this sort of a report. Typically in this kind of a situation no formal report would be issued. The committee asked for IRISC to make a final report to them and because of the unusual nature of this transaction, they were unable to comply with the request.

Ms. Lenmark again stressed to the committee the flexibility of this proposal. She then introduced Gary Uhlemeyer, President of Uhlemeyer Services, who has been Montana's advocate to the various insurance markets to obtain and develop a proposal.

Mr. Uhlemeyer said that the Montana proposal from the Zurich Group covers all the bases and is flexible enough to provide a very meaningful solution to the old fund problem. It also provides a stepping stone and a strong foundation for increased private market participation in the state. The program is flexible and could be designed to meet the state's needs.

Just two years ago, the old fund deficit was \$222 million. This has now more than doubled and is approximately \$500 million. He said the key is to recognize that two decisions must be made. First, the state must raise cash because injured workers need to be paid -- so there will be a decision made on raising cash to pay these workers. The second part of the decision is going to be whether the state will make something or buy it. The question is how to invest the cash to get the best benefit for the workers.

The question is: With the resources and expertise available, does it make more sense to go outside and buy a professional competent claims management and private market services to achieve the goal of paying these injured workers in the most efficient and fair way possible; at the same time being fair to the state in trying to get a handle on this half a billion dollar problem? The state will have to look at cash needed, whether the solution comes internally or externally. A decision has to be made as to what resources will be used and who is best suited to administer and manage claims to pay injured workers and, hopefully, effectively reduce or control this ballooning deficit.

He said the first place the state is falling short is risk transfer. From an underwriting and an accountant/CPA perspective, there are usually four different types of risk transfer: underwriting risk transfer, cash flow risk transfer, investment risk transfer and expense risk. Basically, all those are risks; what is Montana going to do with those risks -- transfer them or keep them? The Zurich program has been designed, and will be further designed, to transfer those various risks to the Zurich group of companies. He said it's important

to note that being an insurance entity, the state has already accepted all these risks. It currently has underwriting risk: you know what's happened there; there's half a billion dollars vested in the old fund. There are cash flow risks: around \$142 million bond issue and a cash estimated flow risk. Investment risk: where the state is going to yield as far as the timing of the payment; two things were considered there -- the timing and the interest rate that can be earned on the money available to pay injured workers. And expense risks: an example is the risk you've assumed in the expense risk category in the 1991 annual report where \$3 million was authorized to pay for the administration of the old fund and the actual amount came in at about 50% greater than that before and after the adoption.

Mr. Uhlemeyer said that, hopefully, through those examples the committee can see what the various risks are and what's happened to the state in assuming those risks. The state has brought the private market to the table but it was a very hard sell. He said he specialized in these programs; however, saying to somebody "How'd you like to work with a bankrupt entity whose deficit went from \$250 million to \$500 million in two years?", it's not likely they'll think it's a good deal. As noted by Ms. Lenmark, one company responded and then backed off.

Tape 1, Side 2

Mr. Uhlemeyer said what's happened is that the actuaries' estimate of what the liability is, or was, has been grossly inadequate -- and this has been done by various actuaries over the last number of years. The most recent actuarial report received by the state was a 1992 report from Tillinghast, the State Fund's actuaries. Basically that '92 report, although the liability might have stayed about the same, can be deceiving one doesn't take into account that approximately \$75 million more paid losses have occurred from '91 to '92. Even in the last year from report to report, another \$75 million of adverse underwriting loss developed.

The Tillinghast report says that, based upon the current best estimate, it can be \$1 million plus, but it has the potential for being an additional \$31 million more. He said the Zurich Groups' estimate of liability is on the plus side from that, not on the down side.

He said the '92 report also excluded certain items that were in the '91 report which made it difficult to analyze. Just making the reports consistent, forgetting about who's right or who's wrong, requires adding another \$20 million onto the liability. These numbers are huge, terrible numbers we're talking about, but just to make it consistent from one year to another -- an extra \$20 million in liability.

He said this is an important part of the Zurich program in the details of its operation. Any two actuaries and accountants will

give two different numbers. An actuary does not have a crystal ball. They do certain methodologies, mathematical applications, to try to develop a number. That's a big part of the risk that Zurich will accept from the state. The state will give up the problem of what's going to happen in the future to Zurich -- a very, very important benefit of the program, especially with that type of growth in losses.

Another risk that's going to be transferred to Zurich is protecting cash flow and budget problems. You know that one of the greater risks in workers' compensation can be the acceleration of losses -- when they are due and how they will be paid. That's a risk that will have to be faced by Zurich when they accept the program, and which is currently being absorbed by the state. A \$122 million bond issue initially was thought to be sufficient to pay all old fund liabilities.

He said he had received a high risk report on expense risk. IRISC did not come in to do a due diligence and performance review of the State Fund management of the old claims. They came in to basically work with Centre Re and Zurich to answer this question. He said there is about a half billion dollar deficit in the old fund and a lot of injured workers.

IRISC's call was under what type of structural program Zurich would work with the state of Montana. They went in to look at that, but not to do a performance audit and not to do a review of operations, etc. Their review was based upon "will we work with the state?" and, if so, "how bad is it?" and "what will we have to do to manage it?" For Centre Re to accept this risk and this obligation from the state, they will require that they manage and administer the claims. That's a requirement of the program, but also a great benefit of the program. As Ms. Lenmark mentioned earlier, claims savings and proper management and administration can be a potential savings for the state.

How does the state benefit from claims savings and costs if this portion is transferred to Zurich? How that's going to happen is through the profit sharing provision. This isn't an easy program to understand; there's a lot of misunderstanding about profit sharing. If there are some favorable claims developing, the state, under different scenarios, has an opportunity to get back up to or more than \$300 million of the \$400 million initial payments.

How does that happen? Basically, the premium is paid to Zurich and is called an experience account or profit sharing. What will be deducted from that account is what Zurich needs to participate in a program and assume the risks. The margin is deducted from those premiums and goes into an account. Those are substantial losses paid to workers. Basically, it is losses and loss adjustment expenses, expenses to handle the claims, and to the account is added interest.

If, for some reason, losses develop because of claims management, etc., for example, the losses are only \$300 million instead of the estimated current \$426 million, the state will get almost all of that money back with interest -- a very, very key component of the program. The state only has upside potential in that incidence with a very minimal downside. And the downside is the good news: the state gets all the money back. The bad news is Zurich experiences the losses continuing to go out of control, and Zurich loses a lot of money. What's good about the transaction is the state gets its money back. Zurich is losing, not the state. They took that risk.

In profit sharing, the maximum cost features of this program are very important elements, and they really present a different type of program -- it's a partnership type of program. This program realizes that this is a huge amount of money, responsibility and premium. Zurich is fixing its interest to be the same as the state's; so if the program is managed properly, the state has the opportunity to have most of the money returned. The profit sharing can result in a huge return to the state based upon the development and management of the losses.

Mr. Uhlemeyer said Zurich was the only company willing to work with the state, but the program also provides the foundation and basis for them to move into more private market involvement working with the state in solving the new fund problems as well as the old fund problems. He said the opportunity is here now to work with companies such as Zurich to design a program; he was not sure when chance would happen again.

He suggested that the committee work to put together a preliminary framework to present to the Governor and the legislature. In order to do that, the committee will need to decide the state's priorities regarding limits, what the state needs to best suit its needs, and then discuss these definitions and priorities to hammer out this particular framework.

He said the state has the ability, based upon feedback that Centre Re got from the interim committee, to buy an unlimited amount of insurance coverage at a certain price in the future. He stressed that, in order to move forward from here, discussions need to take place with Centre Re to determine priorities and then have Centre Re respond to them and be part of the process with a more focused and defined program structure. Right now the program is quoted at \$490 million of limits.

Even though the state doesn't even have \$100 million currently required up front for the first year's deposit, they are willing to work with you and finance the receipt of the premium. That is a huge benefit, and nobody else was willing to take on that type of credit risk.

In addition to these are the quantitative benefits and terms that we have to talk about. When Zurich comes in, they are going to

be the managers. They will bring in a management team, and they plan on taking a three-pronged approach to the management and administration of the old fund claims. They're going to bring in their own management team. It would only make sense to work with people who are currently involved in the administration of Montana claims. The only thing that will be new will be the proper allocation of cost and resources.

In addition to these quantitative benefits, some qualitative benefits will enure to the state from this process. One, it will receive the benefit of the best and brightest of management skills in the insurance industry from the claims side, asset management, etc. Private industry will be working with the state on the workers' compensation problem, trying to solve a half billion dollar problem. For Centre Re to win, the state has to win. It truly is a stepping stone and foundation for increased private market participation in the workers' comp arena here in Montana.

With all these benefits, there's also a cost. The maximum cost here is limited to the market and in it there are savings generated by the management of the claims. Basically, this program can go from a loss to a benefit and the whole program will end up being on the plus side - a cost benefit to the state, not a cost expenditure to the state.

Mr. Uhlemeyer said he respected the courage that the committee would need to face these problems, but he believed a decision would have to be made. They are offering an opportunity for private industry to be part of those decisions and part of developing workable solutions.

CHAIRMAN HIBBARD asked for questions from the committee.

REP. BENEDICT said, using round numbers, but let's say the state has an unfunded liability somewhere in the neighborhood of \$400 million, plus or minus between \$10 or \$20 million, and for some reason Centre Re can bring it in for \$300 million. Center Re is going to charge the state 9% for administration on \$300 million, which would make it roughly \$327 million?

Mr. Uhlemeyer said right now the margin is a percentage of the premium, not the losses. It's not an add-on to the premium. It's part of it. It's embedded within the premium, so it's not an additional cost.

REP. BENEDICT said if the state knew it was going to pay out \$400 million in liabilities over the course of the next 10 or 15 years, how much could be saved by going with a private company if they could do it for somewhere around \$300 million?

Mr. Uhlemeyer said that Ms. Lenmark had quoted the insurance industry stats earlier. Proper and complete claims management and administrative practices can save up to 20%, but that 20%

number is more applied to a claim that happens today.

REP. BENEDICT stated that he is aware the state is not going to save 20% on \$400 million or \$80 million; but using a figure that's easy to work with, say \$300 million, if we could settle those claims for \$300 million, how much will it cost the state? Is it going to be just that \$300 million and we save 100 million bucks less \$9 million?

Mr. Uhlemeyer said yes, it will save \$100 million, and that \$100 million less the margin will be returned.

REP. BENEDICT said, in effect then, the state will save \$100 million, but just for round numbers -- then we would save \$90 million here to the state as opposed to doing it the old way. So, if we divide that into 350, we'd still have some kind of savings versus just leaving it and doing it the way we're doing it right now.

Mr. Uhlemeyer said the committee should analyze what would happen with and without the program; then members could see what the difference would be.

REP. BENEDICT said we'd probably save in the neighborhood of \$45½ million doing it this way as opposed to doing it as it is now.

REP. EWER said he had heard Ms. Lenmark say that the Fund may be able to save up to 20% in expenses, but she made a big point of clarifying that probably would not be on claims for the old fund. Now when we say expenses -- I heard you talking about initial expenses, or do you use expenses in the way of meaning the total benefit?

Mr. Uhlemeyer responded that when Ms. Lenmark said expenses she meant all costs, including losses, which are medical payments, indemnity payments, allocated loss adjustment and expense payments.

REP. EWER said that in 1991 the legislature heard that the old fund liability was something on the order of \$220 million. It's up there in the neighborhood of \$400 million now. Is that based on actuaries or is it because people have reviewed the data and that's what the numbers turned out to be?

Mr. Uhlemeyer said the answer would be it's mixture of both. The numbers come from an actuarial analysis of the actual results based upon the report of old fund data. The key is what's embedded within those numbers. Underwriting does not mean underwriting risk.

REP. EWER said as he understood the proposal on November 13, but he wanted to focus on the basics. The state gives Zurich a big lump sum today and you pay \$490 million. Is that right?

REP. EWER said he didn't see this "upside" that was talked about. If the unfunded liability goes to \$590, the state doesn't reap the benefit of \$100 million windfall. It's a top loss of \$490 million. Right? Mr. Uhlemeyer responded that was correct.

Mr. Uhlemeyer suggested that what needs to be done to find out whether it's cost efficient for the state or not is to take various scenarios: loss scenarios, rates of return, payment patterns, etc., when you make that type of analysis. When that analysis is done, and models can be built to do that type of analysis, this program has to be cost efficient for the state for want it. The value of this program is built into that analysis.

REP. BENEDICT offered to shed a little light on the problem. The \$220 million that talked about in 1991 has grown so phenomenally fast in just two years. The \$400 million is where Centre Re figures the true liability could get higher because of the spiking from year to year, but as close as they can come from the actuary figures, that's about where it's at. And if they could all of a sudden come in and say "We're going to insure you for \$490 million, but we're going to try to stop it right there at that \$400 million and started trying to bring it back down through some constructive management changes into the way that you administer claims. If we can do that, we can bring you back some money. But even if we can't bring you back some money, we can at least stop your losses where they're at."

Mr. Uhlemeyer responded that was fair to say.

CHAIRMAN HIBBARD asked Mr. Uhlemeyer to go back over the profit sharing concept.

Mr. Uhlemeyer said it's hard without the advantage of using numbers. Under the current scenario there is a \$400 million premium. From the \$400 million premium, the current margin Centre Re is assigning to provide all the benefits is a 9½% margin; 9½ times \$400 million is \$38 million. From \$400 million you subtract \$38 million. You have a separate bank account of \$362 million; out of that bank account losses are paid, meaning indemnity, medical, unallocated loss adjustment expenses. Assuming that number is \$50 million, subtract \$50 million from the current balance of \$362 million, which was the \$400 million minus \$38 million; and now it's \$312 million. What got added back in will be credited back to that account as interest starting with the \$362 million that was in that account. That goes on in perpetuity every year that calculation is made. And that's a simple calculation.

What happens is the state will have a unilateral right, a very important element that I failed to mention earlier. This is where you get more than 20-20 hindsight. As the state looks at liabilities down the road, it compares what it believes those liabilities would be with what money is now in that bank account. At any time, and this also must be discussed and negotiated, when

you decide it's your unilateral right to say I want the cash in that account because let's say there's not \$250 million, now it looks like losses are only \$200 million, you say give me the \$250 million back and I'll reassume, or I'll begin paying for these losses that are now only \$200 million, and I'll pay for them over time. So, what happens in that account is this -- if losses develop negatively, not positively, they go bad or they keep on going the way they've been going, you can see your liabilities will never exceed what the cash is in that expense account balance, and at the end of the day Centre Re will end up paying for all the losses up to a certain limit.

Now, if money is returned to you, the most that they kept is that 9½%. If they go bad, they not only spent the 9½%, they spent a lot more. This program should be analyzed, and I fully support an analysis being done on a present value comparison of the benefit of the state doing it or not doing it. There's a cost benefit analysis that must be done.

REP. BENEDICT clarified that he believes there's a balance point to cost benefit and that's the \$400 million. If things go right, it's going to swing one way, our way, and we get us some money back from that balance point of \$400 million. If it goes the other way, it's not our bad luck up to \$490 million, we're still insured.

Mr. Uhlemeyer responded that was correct. If it goes good for the state, the maximum cost of the program is defined. It's not \$400 million anymore; it's the margin. The state knows going in the maximum it will pay for this if things go right, which is a tremendous benefit. It's a different type of philosophy and most insurance carriers are willing to work with the insurer on that type of basis.

REP. COCCHIARELLA said basically, what I heard is that the risk on that guarantee is \$490 million. Center Re is basically assuming that the fund will have \$362 million in claims. You would assume the cost of this would be about \$362 million.

Mr. Uhlemeyer said the analysis is not that simple. Even if things go favorably, they are allocating a tremendous amount of capital to come here. Not many companies have the ability to walk in and offer up to a half a million dollars of capital. There's a cost associated with that. There's a lot more involved and we shouldn't focus on whose profit is what. It's a win/win situation. The state has to make a decision: it has to raise cash because it has to pay injured workers. The state has to decide what course it will take to manage and administer claims; what benefits and what protection it wants; whether it wants additional protection to stop the continued growth of deficits and losses. The program provides all three. Is there a cost involved? Yes there is.

TAPE CHANGE HERE

REP. COCCHIARELLA said there must be an assumption that they'll have to pay out about \$362 million and that they will make \$38 million, or they wouldn't do this.

Mr. Uhlemeyer said their hope is to make a profit. There is more than a reasonable chance they won't make any money, but that's why they're in the insurance business. Whoever your insurance carrier is, when you pay them your premium they're not planning on paying you, or some third party, a million dollar loss. That's not their intent. Their intent is to make money on the premium you pay them. They are in the insurance business, and their business is taking a premium for a risk. But, they also have the risk and that's the business. If it goes badly, they don't get their \$38 million, and they lose the \$38 million plus another hundred.

Ms. Lenmark clarified that the \$38 million is not all profit; there are expenses involved too, so it's just not a gross profit number. It's not a net income number for Centre Re.

REP. BENEDICT said regardless of who administers those claims in the old fund over the next 10 or 15 years, there's going to be some administration costs. Is there any idea what that administration cost will be?

Mr. Uhlemeyer said he believed it was somewhere around \$30 million.

Scott Seacat, Legislative Auditor, said the administrative run out is closer to \$20 million.

John Fine, Legislative Auditor's Office, said that's been fairly constant for the last couple of valuations.

REP. BENEDICT said what he has been hearing is that it will still cost the old fund about \$38 million to accept this proposal from Zurich. If the state did not accept the proposal for the old fund, it would still cost the old fund around \$20 million. Is that right?

Mr. Uhlemeyer: You're going to have to pay that cost to somebody.

Mr. Fine said the costs involved with administering claims are in the stream of claims adjustment costs which may vary depending on who is administering the claims. They're not included in this \$38 million. It's not administrative cost.

REP. BENEDICT restated the question: if we told Zurich to go home and we administered the State Fund under the present administration, it would probably cost us somewhere around \$20 million to run those claims off. Mr. Fine replied that was correct.

REP. BENEDICT said the question to Mr. Uhlemeyer is: If it costs \$20 million to run those off ourselves over the next 10 or 15 years and it costs us \$38 million to bring Zurich in to run those claims off for us -- for the extra \$18 million, or whatever, we've got the probable assurance that maybe we have stopped the hemorrhaging.

Mr. Uhlemeyer said the first part's true, as Mr. Fine told you, that it's going to cost an estimated \$20 million outside, but the way the program is structured is that those are called un-allocated loss adjustment expenses and those will be coming out of the experience account similar to a loss payment, so we can't make that specific comparison.

REP. EWER said it would seem logical that your best estimate would be, at this point, that you hope you could realize losses of under approximately \$362 million, and you'd like to keep as much of that \$38 million as possible. In addition to that, Centre Re will have some initial expenses which will come out as a percentage of paying claims. He said that's what he would expect as well, because you've heard already that the projected cash payout does include some of the percentages for costs.

REP. EWER asked Mr. Uhlemeyer to address the issue of cash flow. Do you feel that you can save money because you think you can more appropriately cash out claims? Do you think that it would be more appropriate for claims to be delayed so there would be a savings there? Do you think the Fund is paying out too fast?

Mr. Uhlemeyer said, from workers' comp experience and experience as manager of an insurance company, workers' comp claims should be settled as quickly as possible. If that hasn't been done, there would be a potential for additional claim savings. You don't want to try to play a cash flow game on a workers' comp claim because it's going to turn around and kill you in the costs of medical, etc. The answer is there should be or could be savings for proper settlement of claims. The intent would not be for them to cash flow the claims.

REP. EWER asked if they see some potential advantage for settling claims quickly.

Mr. Uhlemeyer said he understands that a blue light special could be part of the other negotiations -- the ability to analyze claims and properly settle them with claimants. His job as the state's advocate is to bring the two parties together. The state should talk with Centre Re about priorities are and develop a program to meet those needs. In their bidding and model analysis, they are planning an acceleration factor unpaid in the first year because they definitely plan on doing that -- going out and settling as many claims as possible.

REP. EWER said to be able to do that it would be presumed that you'd be using that \$400 million cash from the state to

accelerate payments and try to close cases.

Mr. Uhlemeyer responded that was correct.

REP. EWER asked if he was asserting that Zurich could do that in a more efficient manner than the State Fund?

Mr. Uhlemeyer suggested that he read the report by Mr. Johnson regarding management and the claims management practices. They will not put up their money and take the risk with their capital unless they have the responsibility to settle claims. There is a reason for that, and the reason is they want to protect their investment. They are not willing to work with the state unless they can have claims management and administration authority on the old fund.

REP. EWER asked then if Zurich planned to save money on administration and the whole processing of claims. Of those four areas: underwriting, investment, cash flow and expenses, is that last category sort of active management of the claims? Is that the potential for savings that you see as the greatest potential value added that Zurich brings to this?

Mr. Uhlemeyer responded yes, but asked whether Rep. Ewer meant do they see the expense savings on unallocated loss adjustment being the greatest potential?

REP. EWER said he wants to know how they are going to actively manage this so they can swing what the actuaries are saying -- this is \$490 million worth of problems.

REP. BENEDICT said when the president of Centre Re made the proposal and talked about investing in Montana, he wasn't talking about dropping some money into a tractor company, or whatever. He was talking about buying state investment paper of some kind. For example, if we gave a lump sum to Centre Re of \$400 million, they would probably invest the total back somehow but less their administrative reserve or holdback. However, if we did decide to do it over a five to ten year period, for every dollar we paid in, say \$60 million or \$75 million the first year, whatever that amount is, then they would invest the lion's share of that back into some instrument issued by the state of Montana. Mr. Uhlemeyer responded that the answer is yes.

CHAIRMAN HIBBARD asked if there were any further questions of Mr. Uhlemeyer or Ms. Lenmark or if either one of them would like to make any concluding comments.

Mr. Uhlemeyer thanked the committee for their time and offered to do anything he could to help in answering further questions.

Ms. Lenmark made a few brief comments. She stressed that, throughout the process, Centre Re and the company involved have been willing to send their top people here to consult and to

answer questions. She also stated the commitment of AIA. Centre Re wants to be sure that the proposal is structured fairly for Montana and for Centre Re. They are very willing to work with Mr. Seacat's office to provide whatever financial information is necessary to produce an appropriate financial analysis of the proposal. The numbers are difficult; depending on how the program is structured, different figures will be produced, different profits, different premium analysis, different types of coverage. They are very willing to provide to Mr. Seacat's office whatever information might be needed to help with the analysis of the proposal.

Centre Re will bring what they feel to be superior claims management abilities to the state of Montana with this proposal. They are not willing to enter into the proposal unless they have the ability to manage the claims. They believe they can bring about major changes for Montana.

Once the terms of the proposal are finalized and submitted, the only person or entity with the ability to back out is the state of Montana. That option will be available at any point along the way if Montana decides they want to take back the responsibility for claims administration. Montana can cancel the contract at any time. Centre Re cannot.

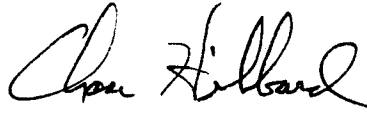
She said when the bill contemplating this Zurich proposal is heard, she anticipates the CEO of Centre Re and the company presidents will again be here to discuss details.

CHAIRMAN HIBBARD thanked Ms. Lenmark and Mr. Uhlemeyer and said there would be some top management people from Centre Re here the 27th to the 29th of January if that coincides with when the bill is introduced. If it does not coincide, they will be here anyway, so there will be another opportunity to ask questions.

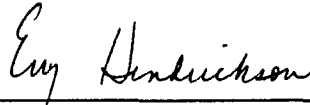
CHAIRMAN HIBBARD noted that the committee would meet on Wednesday to hear from the Department of Labor on their role in the Workers' Compensation system and from Workers' Compensation Judge Tim Reardon. On Friday, committee member REP. EWER will talk about the bonding program. On Monday the committee will hear House Bill 13. The committee is also trying to have a presentation by people from Oregon about the Oregon miracle.

ADJOURNMENT

Adjournment: 5:00 p.m.



REP. CHASE HIBBARD, Chairman



EVY HENDRICKSON, Secretary

by *Pringle Neilsen*

Select - Workers Compensation COMMITTEE

DATE _____

1-11-92

[illegible]

November 23, 1992

JACQUELINE T. LENMARK

Keller, Reynolds, Drake, Johnson and Gillespie, P.C.
38 South Last Chance Gulch
Helena, Montana 59601

Re: Montana Workers Compensation Fund

IRISC

Dear Jackie:

Following my November 14th presentation to the Select Committee on Workers Compensation, you asked me to consider submitting a copy of my presentation text to the Committee. The purpose is to help simplify the transcription. To that end, the text is enclosed.

There were a number of issues related to the Fund's response which I would have liked to be able to rebut, the following three being the most notable:

1. Whereas the Fund complained as to the general and anecdotal nature of our observations, they completely ignored responding to substantive issues including the massive backlogs, reason for overstatement of workloads, and significant divergence between case reserves and needed reserves.
2. The Fund's response was largely based on their assumption that, by reviewing only Old Fund cases, we overlooked improvements that have been made since inception of the New Fund (the example used was that we may have looked only at 1984 cases). In reality, regardless of the age of the cases, we based our findings on the quality of handling in the past two years.
3. The Fund relied heavily in their response on what they believe to be refutation of our observation that early return-to-work techniques were not evidence. In fact, their answer proved our point, although I am sure it was not evident to the

Peter Johnson
President

Integrated
Runoff
Insurance
Services
Corporation

8

Centre Drive
Jamesburg,
New Jersey
08831

609-395-7287

FAX:
609-655-0503

committee members. You see, they quoted expenses paid for outside rehabilitation services as their proof, and produced outside testimony to the same effect. However, early return-to-work techniques are those involving the claim adjuster simply calling an employer to see if temporary light duty work is available shortly after the outset of a claim, and other such efforts practiced on less serious cases not ultimately requiring rehabilitation. Interestingly, Jerry Driscoll came up with just such an example during question period which followed, and further pointed out that it was done by a private industry company rather than the fund. We saw no evidence of the Fund attempting this.

Please let me know whether these points could be submitted as additional testimony, as well as your thoughts about whether it would be appropriate to do so.

Best Regards.

Sincerely,

Peter Johnson

cc: Robin Hamill
Gary Uhlemeyer

MONTANA STATE COMPENSATION FUND

"OLD FUND" DUE DILIGENCE RESULTS

PRESENTATION TO THE SELECT COMMITTEE ON WORKERS' COMPENSATION

MONTANA STATE LEGISLATURE

NOVEMBER 14, 1992

THE FOLLOWING COMMENTS ARE BASED ON THE RESULTS OF A DUE DILIGENCE ON THE OPERATIONS OF THE STATE FUND THAT WE CONDUCTED DURING THE WEEK OF AUGUST 10. THE SOLE PURPOSE OF THE DUE DILIGENCE WAS TO HELP ZURICH/CENTRE RE FORMULATE A REINSURANCE SOLUTION WHICH WOULD BEST ALLOW THE STATE TO MITIGATE ITS OLD FUND EXPOSURE. NORMALLY, WE DO NOT PUBLICIZE THE RESULTS OF OUR INVESTIGATIONS, SINCE THEY ARE USED EXCLUSIVELY FOR OUR OWN INTERNAL EVALUATIONS. THE ONLY REASON THAT WE HAVE ALTERED OUR CUSTOMARY PRACTICE HERE IS IN RESPONSE TO THE COMMITTEE'S SPECIFIC REQUEST FOR A CANDID DISCUSSION OF OUR OBSERVATIONS.

OUR DUE DILIGENCE PROCESS CONSISTED OF: (A) INTERVIEWS OF FUND MANAGEMENT AND OTHER PERSONNEL; (B) REVIEW OF FILES, RECORDS, PROCEDURES, CONTROLS AND WORK FLOWS; AND (C) EVALUATION OF DATA PROCESSING REPORTS, WORKLOADS, AND BACKLOGS. FOLLOWING AN INITIAL MEETING WITH THE FUND'S PRESIDENT, WE INTERVIEWED

THE CLAIMS VICE PRESIDENT AND MANAGERS, CASE RESERVE ANALYST, AND OTHER CLAIMS SUPERVISORY, TECHNICAL AND SUPPORT PERSONNEL. WE ALSO MET WITH PERSONNEL IN THE ACCOUNTING, LEGAL AND DATA PROCESSING DEPARTMENTS. ANCILLARY MEETINGS WERE HELD WITH THE LEGISLATIVE AUDITOR AND A WORKERS COMPENSATION JUDGE.

THE DUE DILIGENCE TEAM WAS COMPRISED OF NINE CLAIM SPECIALISTS FROM FOUR DIFFERENT ORGANIZATIONS, PLUS A TEAM MEMBER WITH ACTUARIAL AND FINANCIAL EXPERTISE:

PETER JOHNSON	PRESIDENT & CEO	IRISC
MARK LYONS	SENIOR VICE PRESIDENT	ZURICH AMERICAN
STEPHEN EISENMANN	VICE PRESIDENT	IRISC
LUCRETIA MARCUS	PRESIDENT	L.A. MARCUS CO.
BETTY JOHNSON	CLAIM MANAGER	ZURICH AMERICAN
HELEN DEWALD	SENIOR CLAIM SUPERVISOR	ZURICH AMERICAN
DAN BURKLAND	SENIOR VP CLAIMS	ALEXIS
OWEN VOIGT	CLAIMS MANAGER	ALEXIS
PAULA VIDRINE	CLAIMS REPRESENTATIVE	ALEXIS
KAREN WILES	CLAIMS REPRESENTATIVE	ALEXIS

OUR QUALIFICATIONS TO MAKE THIS EVALUATION ARE BRIEFLY AS FOLLOW:

I (PETER JOHNSON) HAVE MORE THAN 20 YEARS OF DIVERSE CLAIMS EXPERIENCE. PRIOR TO FOUNDING IRISC -- A CENTRE RE AFFILIATE OF WHICH I AM PRESIDENT AND CHIEF EXECUTIVE OFFICER -- I HAVE SERVED AS CLAIMS VICE PRESIDENT WITH COMPANIES AT BOTH THE PRIMARY AND REINSURANCE LEVELS, INCLUDING CENTRE RE, BERKSHIRE HATHAWAY AND LINCOLN INSURANCE GROUP. IRISC, WHICH EMPLOYS MORE THAN ONE HUNDRED PROFESSIONALS, SPECIALIZES IN MANAGEMENT AND AUDITS OF CASUALTY INSURANCE BOOKS OF ALL TYPES. MY ASSOCIATES AND I HAVE CONDUCTED AUDITS AND DUE DILIGENCE EVALUATIONS ON HUNDREDS OF COMPANIES AND OPERATIONS, FROM MAJOR STOCK INSURANCE COMPANIES TO SMALL SPECIALTY INSURANCE PROGRAMS TO PRIVATE AND PUBLIC INSURANCE FUNDS. THESE ACTIVITIES ARE GENERALLY PERFORMED IN CONNECTION WITH REINSURANCE TRANSACTIONS, MERGERS AND ACQUISITIONS.

MARK LYONS, SENIOR VICE PRESIDENT OF ZURICH AMERICAN SPECIALTIES, HAS HELD SENIOR ACTUARIAL POSITIONS WITH MAJOR STOCK COMPANIES INCLUDING BERKSHIRE HATHAWAY AND AIG, AND HAS SUBSTANTIAL LOSS RESERVING, FINANCIAL, EDP AND OPERATIONAL EXPERIENCE.

STEPHEN EISENMANN, VICE PRESIDENT AND CHIEF CLAIMS OFFICER OF IRISC, HAS MORE THAN FIFTEEN YEARS CLAIMS

EXPERIENCE INCLUDING SENIOR MANAGEMENT EXPERIENCE AT BOTH THE INSURANCE COMPANY AND SELF INSURED LEVELS, AS WELL AS SUBSTANTIAL AUDIT EXPERIENCE. MR. EISENMANN HAS WORKED PREVIOUSLY AT UNIVERSAL HEALTH SERVICES, LINCOLN INSURANCE GROUP AND RELIANCE INSURANCE COMPANY.

LUCRETIA MARCUS, THE OWNER AND PRESIDENT OF L.A. MARCUS COMPANY, IS A CERTIFIED WORKERS COMPENSATION SPECIALIST WHO HAS MORE THAN TWENTY YEARS EXPERIENCE, INCLUDING POSITIONS AS WESTERN REGIONAL VICE PRESIDENT AND DIRECTOR OF TRAINING FOR A NATIONWIDE WORKERS COMPENSATION CLAIMS MANAGEMENT COMPANY. AMONG OTHER THINGS, SHE PERIODICALLY EVALUATES THE PERFORMANCE OF THE CLAIMS ADMINISTRATOR FOR ANOTHER MONTANA COMPENSATION ACCOUNT AND CONSEQUENTLY IS FAMILIAR WITH THE SPECIFICS OF MONTANA'S BENEFITS APPLICATIONS;

BETTY JOHNSON AND HELEN DEWALD ARE, RESPECTIVELY, A CLAIM MANAGER AND SENIOR HOME OFFICE CLAIMS SUPERVISOR - MAJOR CASE UNIT - FROM ZURICH AMERICAN INSURANCE COMPANY, A LARGE WRITER OF WORKERS COMPENSATION BUSINESS (APPROXIMATELY \$500 MILLION PER YEAR); AND

DAN BURKLAND IS SENIOR VICE PRESIDENT AND CHIEF CLAIM

OFFICER FROM THE NATIONAL HEADQUARTERS OF ALEXIS, THE THIRD LARGEST PROPERTY/CASUALTY TPA IN THE COUNTRY WITH APPROXIMATELY SEVEN HUNDRED MILLION DOLLARS OF WORKERS COMPENSATION CLAIMS PAID ANNUALLY ON BEHALF OF OVER THREE THOUSAND CLIENTS. MR. BURKLAND, WHO HAS EIGHTEEN YEARS EXPERIENCE IN WORKERS COMPENSATION CLAIMS, WAS PREVIOUSLY EMPLOYED AND TRAINED AT LIBERTY MUTUAL, A MAJOR WORKERS COMPENSATION INSURER. OWEN VOIGT IS ALEXIS' LOCAL CLAIM MANAGER; PAULA VIDRINE AND KAREN WILES ARE LOCAL CLAIMS REPRESENTATIVES.

AS SHOULD BE APPARENT FROM THE FOREGOING, THE COMBINED EXPERIENCE OF OUR TEAM IN MANAGEMENT, CLAIMS MANAGEMENT, WORKERS' COMPENSATION, RESERVING, AUDITING, TRAINING, AS WELL AS SPECIFICS OF MONTANA BENEFITS IS SUBSTANTIAL.

IT IS THE UNANIMOUS OPINION OF THE DUE DILIGENCE TEAM THAT THERE ARE SERIOUS OPERATIONAL DEFICIENCIES IN VIRTUALLY ALL ASPECTS OF THE FUND'S CLAIMS ADMINISTRATION. THE FOLLOWING ARE MAJOR AREAS OF CONCERN:

1. MANAGEMENT CONTROLS ARE SERIOUSLY INADEQUATE:

A. THERE WAS LITTLE EVIDENCE OF MANAGEMENT INVOLVEMENT

OR OVERRIDE IN FILES. ALTHOUGH WE WERE INFORMED BY SENIOR MANAGEMENT THAT EACH FILE HANDLER IS SUBJECT TO AUTHORITY LEVELS BEYOND WHICH THEY MUST OBTAIN THE APPROVAL OF THEIR SUPERVISOR OR MANAGER, THE FILES CONTAINED NO EVIDENCE THAT SUCH APPROVALS WERE BEING OBTAINED. IN VIRTUALLY EVERY FILE REVIEWED, THERE WAS NO INDICATION THAT THE FILE WAS SEEN PERIODICALLY BY THE SUPERVISOR OR MANAGER, OR THAT THE FILE HANDLER'S ACTIVITIES WERE SUBJECT TO OVERSIGHT AND APPROVAL.

B. KNOWLEDGE OF ORGANIZATION, WORK FLOWS AND PROCEDURES WAS WEAK. WE ASKED FOR AND RECEIVED VERBAL DESCRIPTIONS OF THE ORGANIZATION (THE ORGANIZATIONAL CHART WE WERE GIVEN WAS MORE THAN TWO AND ONE HALF YEARS OLD), FIRST REPORTS AND MAIL FLOWS, DIARY PROCEDURES, ETC. FROM SENIOR MANAGEMENT. SUBSEQUENT TRACING OF THE ACTUAL WORK FLOWS AND PROCEDURES REVEALED THEY WERE FREQUENTLY DIFFERENT.

C. CLAIM COUNTS AND OTHER STATISTICS NEEDED FOR GOOD MANAGEMENT CONTROL ARE MISUSED OR MISUNDERSTOOD, UNUSED OR UNAVAILABLE.

EXHIBIT 1
1-11-93

WHEREAS WE WERE INFORMED, FOR EXAMPLE, THAT AVERAGE EXAMINER WORKLOADS WERE 340 PENDING CASES (COMPARED TO INDUSTRY STANDARDS IN THE 200 RANGE), ACTUAL PENDING ON ASSIGNMENT TO ADJUSTERS AVERAGED 215 CASES -- WITHIN ACCEPTABLE NORMS. THE DIFFERENCE REPRESENTS CASES ASSIGNED TO CLAIMS ASSISTANTS IN WHICH THE INDEMNITY ACTIVITY IS DORMANT AND WHERE THE ASSISTANTS ARE FOLLOWING FOR MEDICAL ONLY, PLUS OTHER INACTIVE CASES. THESE CASES ARE NOT ON THE EXAMINERS ASSIGNMENT AND OUGHT NOT TO BE ADDED TO EXAMINER NUMBERS FOR THE PURPOSE OF CALCULATING AVERAGE EXAMINER WORKLOADS.

IT IS OUR BELIEF THAT EXCESSIVE WORKLOADS CANNOT BE BLAMED FOR THE EXTENT OF THESE DEFICIENCIES OR TARDINESS WITH RESPECT TO CORRECTIVE ACTIONS. CURRENTLY, AVERAGE EXAMINER CASE LOADS ARE MANAGEABLE. MOREOVER, ONE DATA PROCESSING REPORT REVIEWED INDICATES THAT AS MANY AS 38% OF OLD FUND OPEN INDEMNITY CLAIMS AT AUGUST 1, 1992 CARRY ZERO BALANCE INDEMNITY RESERVES, WHICH IS INDICATIVE THAT THOSE CASES DO NOT REQUIRE SIGNIFICANT WORK, ARE INADEQUATELY RESERVED, OR BOTH.

FURTHERMORE, GIVEN THE ABSENCE IN THE PAST OF A DIARY SYSTEM TO FOLLOW UP ON CLAIMS REMAINING OPEN AFTER THE CLAIMANT HAS RETURNED TO WORK, MANY OF THE CLAIMS REFLECTED IN THE PENDING COUNT WERE MOST PROBABLY INACTIVE AND SHOULD NOT HAVE BEEN INCLUDED IN THE MEASURE OF ADJUSTER WORKLOADS. WHILE DIFFICULT TO QUANTIFY, MUCH OF THE REDUCTION IN CLAIM PENDING COUNTS SINCE THE FIRST OF THE YEAR HAS SIMPLY BEEN THE CLEANING UP OF THESE DANGLING AND ZERO BALANCE RESERVES ON OPEN CASES THAT HAD NOT REQUIRED ADJUSTER ACTIVITY FOR SOME TIME. THE NUMBER OF OLD FUND ZERO BALANCE OPEN INDEMNITY CLAIMS, FOR EXAMPLE, HAS BEEN REDUCED BY OVER TWO THOUSAND SINCE FEBRUARY.

OTHER AREAS INCLUDE MAIL COUNTS AND FILING BACKLOGS, WHICH ARE ESTIMATED BASED ON THICKNESS OR WEIGHT RATHER THAN DETERMINED BY NUMBER OF ITEMS AND AGES. INCOMING MAIL COUNTS THAT MANAGEMENT ADVISED TOTALED 70,000 ITEMS PER MONTH ACTUALLY REPRESENT THE ESTIMATED NUMBER OF PAGES RECEIVED BASED ON WEIGHT (I.E. ONE THIRTY PAGE HOSPITAL REPORT RECEIVED IN ONE ENVELOPE WOULD BE COUNTED AS THIRTY ITEMS) RATHER THAN NUMBER OF MAILINGS

RECEIVED. NO ACTUAL ITEM COUNTS OR AGES ARE MAINTAINED FOR FILING BACKLOGS, WHICH BY OUR ESTIMATES AMOUNT TO THE THOUSANDS (THE UNFILED NUMBER OF PAGES, ESTIMATED BY THE FUND BASED ON THICKNESS, WAS 21,000 -- THE EQUIVALENT, BY FUND MEASURES, OF A STACK EIGHT FEET HIGH). INCLUDED IN THE BACKLOGS WERE ITEMS IN EXCESS OF A YEAR OLD. THESE ARE THE TYPES OF THINGS THAT MANAGEMENT SHOULD MONITOR AND CONTROL.

A REPORT RECENTLY MADE TO THE BOARD OF DIRECTORS REGARDING RESERVE STRENGTHENING ACTUALLY USED INCURRED NUMBERS RATHER THAN CASE RESERVES, A SIGNIFICANT DIFFERENCE.

2. CASE RESERVING CONTINUES TO BE SERIOUSLY DEFICIENT:

- A. THE RESERVING DEFICIENCIES PERSIST DESPITE A RECENT REPORT TO THE BOARD THAT RESERVING HAD BEEN EXPANDED IN FEBRUARY FROM ONE SPECIALIST TO MORE THAN 35 TECHNICIANS AT THE EXAMINER LEVEL AND HIGHER. A RESERVE TRAINING PROGRAM CHARACTERIZED AS EXTENSIVE WAS ONLY VAGUELY RECALLED BY STAFF MEMBERS WITH WHOM WE SPOKE AND IS NOT EVIDENT FROM

REVIEW OF FILE RESERVES.

- B. A FORM WHICH WAS DEVELOPED TO HELP DETERMINE THE PROPER RESERVE IS NOT MANDATORY AND IS USED INFREQUENTLY. IN ADDITION, ANSWERS TO QUESTIONS CONCERNING RESERVING METHODOLOGY WERE UNRESPONSIVE. BASED ON THE FILE REVIEWS, ADJUSTERS DO NOT APPEAR TO BE HELD ACCOUNTABLE. WITHIN A THREE MONTH TIME FRAME, THE CASE RESERVE ANALYST HAD PUT UP OVER TEN MILLION DOLLARS IN ADDITIONAL MEDICAL RESERVES -- AN AMOUNT READILY APPARENT TO THE ACTUARY MEMBER OF OUR TEAM FROM REVIEW OF DATA PROCESSING REPORTS -- WITHOUT ANY PRIOR APPROVAL OR CONTROL BY MANAGEMENT. EVEN CASES WITH AWARDS ALREADY MADE AND PAYMENTS PENDING DID NOT HAVE SUFFICIENT RESERVES.
- C. CONTRARY TO THE RECENT REPORT TO THE FUND'S BOARD THAT THE EXAMINERS AND SUPERVISORS HAVE SUFFICIENT TRAINING IN RESERVING AND THAT THE FUND IS RAPIDLY APPROACHING RESERVE ADEQUACY, ALMOST EVERY FILE REVIEWED WAS INADEQUATELY RESERVED. HOWEVER, THIS SHOULD ALSO BE APPARENT SIMPLY BY LOOKING AT THE TILLINGHAST ACTUARIAL ESTIMATE OF ULTIMATE

ADDITIONAL COST OF OLD FUND UNPAID CLAIMS COMPARED TO TOTAL CASE RESERVES --A DIFFERENCE OF OVER \$200 MILLION -- VIRTUALLY ALL OF WHICH CAN BE ATTRIBUTED TO KNOWN CASE DEVELOPMENT (TRUE INCURRED BUT NOT REPORTED NUMBERS ARE SMALL ON WORKERS' COMPENSATION BUSINESS WITH ACCIDENT DATES MORE THAN TWO YEARS OLD) .

3. AMONG A NUMBER OF FACTORS, INADEQUATE CASE RESERVING IS REFLECTIVE OF A TECHNICIAN'S LACK OF AWARENESS OF THE SEVERITY AND COMPLEXITY OF A CLAIM. THE CLAIM FILES REVIEWED SHOWED LITTLE IN THE WAY OF PROBLEM RECOGNITION, FOCUS OR DIRECTION. A DIARY SYSTEM ALSO INSTITUTED EARLIER THIS YEAR IS NOT BEING MAINTAINED. FILE MANAGEMENT IS POOR.
4. COMPENSABILITY WAS ACCEPTED ON SEVERAL OF THE FILES REVIEWED WHERE LIABILITY SHOULD HAVE BEEN QUESTIONED. EXAMPLES INCLUDE CASES WHERE NEW MEDICAL BILLS WERE RECEIVED AFTER A LAPSE OF SEVERAL YEARS FROM THE LAST TREATMENT, OFTEN WITH INDICATIONS OF A NEW INTERVENING CAUSE, THAT WERE SIMPLY ACCEPTED AND PAID AS PART OF THE HISTORIC CLAIM; A CASE WHERE CUSTODIAL CARE WAS ACCEPTED ON A CLAIMANT INCAPACITATED DUE TO DEMENTIA SEVERAL YEARS

AFTER A HEAD TRAUMA; AND CASES WHERE THERE WAS NO INDICATION OF SPECIFIC JOB RELATED TRAUMA.

5. USE OF INDUSTRY "BEST" PRACTICES TO PROMOTE EARLY RETURN TO WORK AND TO IDENTIFY ABUSE AND FRAUD ARE NOT EVIDENT. NO EVIDENCE WAS SEEN IN ANY OF THE FILES REVIEWED OF EFFORTS TO CONTACT THE EMPLOYER AND DETERMINE WHETHER LIGHT DUTY WORK WAS AVAILABLE. NO REQUESTS FOR ACTIVITY CHECKS WERE NOTED WITHIN THE LAST SEVERAL YEARS TO VERIFY WHETHER CLAIMANTS WERE CAPABLE OF WORKING -- THIS INVOLVES CASES WHERE THE CLAIMANT HAS REMAINED OUT OF WORK FOR MORE THAN TWO YEARS.
6. WHILE MEDICAL BILLS ARE CHECKED AGAINST FEE SCHEDULES, THERE WAS NO EVIDENCE THAT OTHER MEDICAL COST CONTAINMENT TECHNIQUES ARE PRACTICED, SUCH AS UTILIZATION REVIEWS FOR UNRELATED OR EXCESSIVE TREATMENTS (EXCEPT WE WERE INFORMED THAT HOSPITAL BILLS GREATER THAN \$15,000 ARE AUDITED). WE SAW VARIOUS EXAMPLES OF CASES WHERE TREATMENTS THAT MAY HAVE BEEN UNRELATED WERE PAID WITHOUT QUESTION, AS IN THE CASE OF CHEST X-RAYS FOR A CLAIMANT RECEIVING A WRIST INJURY.
7. PROCEDURES AND WORK FLOWS REMAIN UNDULY CUMBERSOME. A

NEW REPORT OF ACCIDENT, FOR EXAMPLE, MAKES AN EXCESSIVE NUMBER OF STOPS AND PASSES THROUGH SEVERAL DEPARTMENTS BEFORE IT FINALLY GETS TO THE CLAIM TECHNICIAN WHO WILL BE HANDLING IT, A PROCESS THAT CAN TAKE FIVE TO SEVEN DAYS OR MORE. FOR ANOTHER EXAMPLE, CONSIDER THE MASSIVE FILING BACKLOGS PREVIOUSLY MENTIONED.

8. SUBROGATION IS NOT ADEQUATELY PURSUED. IN RESPONSE TO OUR PRE-VISIT REQUEST FOR INFORMATION ON SUBROGATION CLAIMS, WE RECEIVED THE FOLLOWING RESPONSE:

"ALTHOUGH THE NEW ACT PROVIDES FOR SUBROGATION, THE MONTANA SUPREME COURT HAS RULED THE STATUTE TO BE UNCONSTITUTIONAL. ANOTHER SUPREME COURT DECISION ALSO RULED THAT THE OLD ACT PROVISION FOR SUBROGATION IS UNLAWFUL. THUS, THERE ARE NO SUBROGATION CLAIMS."

WE SPOKE WITH THE LEGAL DEPARTMENT AND REVIEWED THE SUPREME COURT DECISION. WE DO NOT CONCUR THAT SUBROGATION CAN NOT BE PURSUED. WE SAW NO EVIDENCE IN ANY OF THE FILES REVIEWED OF EFFORTS TO DEVELOP SUBROGATION POTENTIAL, EXCEPT TO NOTICE LIENS IN SITUATIONS WHERE THE CLAIMANT ON HIS/HER OWN WAS PURSUING

A THIRD PARTY ACTION.

PLEASE NOTE THAT, DESPITE OUR OBSERVATIONS OUTLINED ABOVE, WE FOUND THE STAFF OF THE FUND TO BE HIGHLY COOPERATIVE, AND POSSESSING BOTH A GOOD WORK ETHIC AND ESPRIT DE CORPS. WE SIMPLY BELIEVE THAT THEY HAVE NOT BEEN PROVIDED ADEQUATE TRAINING OR DIRECTION.

IN CLOSING, I WOULD LIKE TO STATE THAT WE TAKE NO PLEASURE IN CRITICIZING FUND OPERATIONS. I WOULD HAVE BEEN CONTENT SIMPLY TO REPORT OUR FINDINGS TO MY CLIENT - CENTRE RE - RECOMMENDING THAT CLAIMS MANAGEMENT BE TRANSFERRED TO SOME OTHER ENTITY -- AND LEAVE IT AT THAT. THE ONLY REASON THAT WE HAVE PRESENTED OUR FINDINGS TO THE COMMITTEE IS AT THE REQUEST OF ITS MEMBERS.

I WOULD ALSO LIKE TO REEMPHASIZE THAT THIS WAS A DUE DILIGENCE AUDIT FOR CENTRE RE, NOT A PERFORMANCE AUDIT ON BEHALF OF THE FUND. A PERFORMANCE AUDIT WOULD HAVE ENTAILED A HIGHER LEVEL OF EFFORT IN TERMS OF DOCUMENTATION AND REPORTING OF MINUTE DETAILS ON A FILE-BY-FILE BASIS, PREPARING RECOMMENDATIONS AND A TIMETABLE FOR IMPLEMENTATION, FEEDBACK TO THE OPERATIONAL STAFF, AND THE LIKE. THE COST FOR SUCH AN AUDIT WOULD EASILY BE MORE THAN TWICE THE AMOUNT ALLOCATED BY THE COMMITTEE FOR

ZURICH/CENTRE RE'S FORMULATION OF ITS PROPOSAL. WE DO PERFORM SUCH AUDITS FOR FEE. CENTRE RE, HOWEVER, KNOWS OUR CAPABILITIES AND TRUSTS OUR JUDGEMENTS ON DUE DILIGENCE EVALUATIONS -- THE LEVEL OF REPORTING, PREPARATION OF RECOMMENDATIONS AND TIMETABLES, ETC., IS NOT REQUIRED.

WE ARE AWARE THE THAT FUND'S MANAGEMENT WILL BE FOLLOWING WITH A RESPONSE, BASED ON A LETTER THEY HAVE BEEN GIVEN THAT ESSENTIALLY CONTAINS THE SAME INFORMATION I HAVE DISCUSSED TODAY. I CAN GUESS THAT THEIR RESPONSE WILL FOCUS TO SOME EXTENT ON OUR CREDIBILITY, OUR MOTIVATION, OUR METHODOLOGY, AND THE LEVEL OF DETAIL WE REPORTED.

I ATTEMPTED TO ADDRESS THE CREDIBILITY ISSUE AT THE OUTSET OF THIS PRESENTATION. OUR TEAM CONSISTED ON NINE PEOPLE FROM FOUR DIFFERENT ORGANIZATIONS -- OUR OPINIONS WERE UNANIMOUS. WE DO A SIGNIFICANT AMOUNT OF AUDIT WORK AND HAVE A HIGH LEVEL OF EXPERIENCE. THE LOCAL ALEXIS REPRESENTATIVES, WHILE NOT HAVING SUCH EXTENSIVE AUDIT EXPERIENCE, PROVIDED VALUABLE KNOWLEDGE ON MONTANA BENEFITS APPLICATIONS.

OUR MOTIVATION WAS SIMPLY TO REPORT OUR OBJECTIVE FINDINGS TO OUR CLIENT. WE HAD NO PRE-CONCEIVED NOTIONS. HAD OUR FINDINGS BEEN POSITIVE, WE WOULD NOT NECESSARILY HAVE

RECOMMENDED COMPLETE ASSUMPTION OF THE CLAIMS MANAGEMENT. CENTRE RE, FOR EXAMPLE, HAS ASSUMED OTHER PORTFOLIOS IN THE PAST WHERE WE RECOMMENDED THAT THE CLAIMS MANAGEMENT COULD AND SHOULD BE LEFT WITH THE COMPANY.

I HAVE ALREADY TOUCHED ON OUR METHODOLOGY. AGAIN, THIS WAS A DUE DILIGENCE FOR CENTRE RE, NOT A PERFORMANCE AUDIT FOR THE FUND. WE ASKED MANAGEMENT IN DETAIL HOW THE OPERATION WORKED, THEN REVIEWED FILES AND TRACED WORK FLOWS TO DETERMINE WHETHER THEY WERE CONSISTENT WITH MANAGEMENT'S DESCRIPTIONS. IN THE PROCESS OF TRACING WORK FLOWS, WE TALKED TO STAFF PERSONNEL ALONG THE CHAIN. WE DID NOT INTERVIEW ALL OF THE SUPERVISORS AND ADJUSTERS -- JUST A FEW -- BUT IT WAS UNNECESSARY TO INTERVIEW MORE. WE ASKED FOR AND ANALYZED COMPUTER DATA. WE VERIFIED COUNTS AND BACKLOGS.

FINALLY, WE RECOGNIZE THAT WE HAVE NOT PROVIDED MINUTE, FILE-BY-FILE DETAIL. AGAIN, THIS WAS NOT A PERFORMANCE AUDIT. WE REVIEWED AROUND TWO HUNDRED FILES, REPRESENTING APPROXIMATELY FIVE PERCENT OF OLD FUND OUTSTANDING CLAIMS. TO REPORT ON A FILE-BY-FILE, ISSUE-BY-ISSUE BASIS WOULD HAVE BEEN VERY TIME CONSUMING, AND WOULD HAVE RESULTED IN A LENGTHY DELAYING RESPONSE WITH EFFORTS TO DEBATE EVERY MINUTE ISSUE AND LEAVE THE COMMITTEE MEMBERS IN A POSITION OF HAVING THE JUDGE

EXHIBIT 1
DATE 1-11-93

CREDIBILITY ON EACH MINUTE ISSUE. MOREOVER, DEBATES ON MANY ISSUES WOULD BE FRUITLESS INASMUCH A SPECULATION WOULD BE REQUIRED ON QUESTIONS SUCH AS WHETHER LIGHT DUTY WORK WOULD HAVE BEEN AVAILABLE, SUBROGATION PURSUED, OR POSSIBLY UNRELATED BILLS PAID. THE POINT IS, THE QUESTIONS WERE NEVER ASKED.

I SHOULD ALSO STATE THAT OUR REPORT DOES CONTAIN A SUBSTANTIAL AMOUNT OF DETAIL ON ISSUES THAT CAN BE RESPONDED TO, SUCH AS OVERSTATEMENT OF WORKLOADS, MASSIVE BACKLOGS, AND SIGNIFICANT CASE UNDER-RESERVING.

OUR MAIN CONCERNS ARE THAT THERE ARE PERVASIVE PATTERNS OF DEFICIENCY, THAT WORKLOADS OUGHT TO BE MANAGEABLE, AND THAT CORRECTIVE ACTIONS COULD AND SHOULD HAVE BEEN TAKEN YEARS AGO. THE OPERATIONS OF THE FUND COULD AND SHOULD BE A LOT BETTER THAN THEY ARE.

Alexsis

EXHIBIT 2
DATE 1-11-93
HB

**A Presentation on the
State Compensation Mutual Insurance Fund
to the**

**SELECT COMMITTEE ON WORKERS' COMPENSATION
A Joint Committee of the 52nd Montana Legislature**

July 1992

Prepared By:

**Alexsis, Inc.
4099 McEwen Road, Suite 850
Dallas, Texas 75244-5044
(214) 458-3702**

and

**Uhlemeyer Services, Inc.
7710 Carondelet
St. Louis, Missouri 63105-3343
(314) 725-4317**

This document is stored at the Historical Society at 225 North
Roberts Street, Helena, MT 59620-1201. The phone number is

EXHIBIT 3
DATE 1-11-93

Montana State Compensation Mutual Insurance Fund

THE OLD FUND REINSURANCE PROPOSAL

Centre Reinsurance/Zurich Insurance Company
Presentation
November 13, 1992

This document is stored at the Historical Society at 225 North
Roberts Street, Helena, MT 59620-1201. The phone number is

444-2694

1011335

HOUSE OF REPRESENTATIVES
VISITOR'S REGISTER

W. J. Camp COMMITTEE _____ BILL NO. _____
DATE 1-11-93 SPONSOR(S) _____

PLEASE PRINT

PLEASE PRINT

PLEASE PRINT

NAME AND ADDRESS	REPRESENTING	SUPPORT	OPPOSE
Lorna Frank	Montana Farm Bureau		H/B-48
Jacqueline Denmark	American Ins. Assoc.; Centre Re; Alusia; Ulmeny	Select WC Committee	
Don MacMillan	State Fund		
Gary Ulmeny	Ulmeny Service - State	Select WC Comm	

PLEASE LEAVE PREPARED TESTIMONY WITH SECRETARY. WITNESS STATEMENT FORMS
ARE AVAILABLE IF YOU CARE TO SUBMIT WRITTEN TESTIMONY.