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MONTANA STATE FUND
BOARD MEETING
December 16, 2016

The Montana State Fund (MSF) Board meeting was held December 16, 2016 at Montana State Fund, 855 Front Street, Helena, Montana.

Directors Attending

Lance Zanto, Helena
Richard Miltenberger, Helena
Jan VanRiper, Helena- telephonically
Jack Owens, Missoula
Bruce Mihelish, Lolo
Lynda Moss, Billings – telephonically
Matt Mohr, Big Sky

MSF Staff Attending

Laurence Hubbard, President/CEO
Verna Boucher, Spec Asst to Pres/CEO
Kevin Braun, General Counsel
Mark Barry, Corporate Support VP
Julie Jenkinson, Insurance Operations VP
Sam Heigh, Operations Support VP
Al Parisian, Chief Information Officer
Rick Duane, Human Resources VP
Mike Worden, Senior HR Generalist
Sandy Leyva, Director, IT Enterprise Apps
Erika Ayers, Business Unit Director
Rene Martello, Controller
Christy Weikart, Underwriting Services Dir
Patti Grosfield, Internal Auditor
Shannon Copps, Director, ESPM
Mary Boyle, Communications Specialist
Dan Gengler, Internal Actuary
Curtis Larsen, Assistant General Counsel
Peter Strauss, Compliance Officer
Nick Hopkins, Business Unit Director
Tammy Lynn, Safety Services Team Leader

Others Attending

Mari Kindberg, SAO/CSI
Russell Greig, Willis Towers Watson
Eric Strauss, DOLI
Bill Wheeler, DOLI
Dave Glennon, Eide Bailly
Bob Biskupiak, IIAC
Leslie Vernon, Willis Towers Watson
Pat Murdo, Legislative Services Division
Jason Lindstrom, Eide Bailly
Sonia Powell, OBPP

I. Meeting Preliminaries

A. *Call to Order*

Chair Lance Zanto called the meeting to order at 8:34 a.m. He explained that Board Members Jan VanRiper and Lynda Moss were participating telephonically which meant all Board members were present. Chair Zanto noted that neither of the two Legislative Liaisons, Senator Gordon Vance and Representative Ryan Lynch, from the Economic Affairs Interim Committee (EAIC) were able to attend this Board meeting.

B. *Approval of September 16, 2016 Minutes*

Chair Zanto said the first order of business was approval of the Board meeting minutes from September 16, 2016 and called for a motion.

Mr. Richard Miltenberger made a motion to approve the September 16, 2016 minutes. The motion was seconded by Mr. Bruce Mihelish. Chair Zanto called for discussion from the Board, MSF staff and members of the public. There being none, he called for the vote and the motion passed unanimously.

II. Miscellaneous – Laurence Hubbard, President/CEO

A. Miscellaneous

President Hubbard welcomed the attendees and thanked the Board and staff for making it through the snow storm to attend. He thanked the Board members participating telephonically for using appropriate caution and choosing safety first when determining their travel plans in the inclement weather.

Mr. Hubbard provided a short overview of the upcoming legislative session. He noted that there were 35 workers' compensation bill draft requests for possible proposed legislation already submitted yet said that not all of those requests would result in an actual bill draft. He said that once the legislative session begins, the pace at which bills are introduced, heard and voted on is quite brisk, making it difficult for staff to keep the Board apprised of all legislative actions. For that reason, he recommended that Board Members follow the proceedings through the Legislative Website as much as possible and stated that staff will provide updates on key pieces of legislation. He reminded the Board that MSF's policy, historically supported by the Board, has been to not take positions on injured worker benefit legislation. He said those decisions should be made by the policymakers; however, if a particular bill is problematic in terms of implementation or constitutionality, MSF will and must weigh in appropriately. He noted that MSF is typically called upon to provide educational and fiscal impact information regarding specific proposed legislation. MSF carries approximately 60 percent of the workers' compensation insurance market in Montana which means MSF's policyholders and injured workers are impacted significantly. For those reasons, MSF's General Counsel, Kevin Braun and Director of Government and Community Relations, Ethan Heverly, spend a great deal of time and energy networking with and educating policymakers on issues of importance to MSF.

President Hubbard covered items of interest for MSF since the November election: Matt Rosendale was elected State Auditor and MSF's former General Counsel, Nancy Butler has been appointed Deputy State Auditor by Mr. Rosendale. Bob Biskupiak, CEO of the Independent Insurance Agents Association (IIAA) has been appointed as Deputy Insurance Commissioner. Mr. Biskupiak and Ms. Butler are well known to MSF. MSF has been working with the staff of SAO for several years on the implementation of SB123 and MSF views these appointments as a continuation of a strong relationship between MSF and SAO.

He provided an internal MSF update on the State Employees Charitable Giving Campaign (SECGC), a state agency fund raising campaign. He noted that of the 287 MSF employees, 145 participate in the "click and give" campaign which is an increase of 30 employees over last year. MSF also hosts a variety of internal fundraising events such as the Executive Breakfast, sponsored by and funded by MSF's executive team. MSF employees raised $38,000 for the SECGC campaign. President Hubbard said he was very proud of the MSF employees for their support and participation in this campaign each year.

B. Report of Internal Auditor – Patti Grosfield, Internal Auditor

Ms. Grosfield provided an update on the status of the distribution of the dividend declaration that the Board made at the September 16, 2016 Board meeting. She said 23,072 policies will receive $35,000,685, after rounding, in January 2017, of that, state agencies account for roughly $948,000.

She said internally, in coming months, she will audit agent incentives, employee leave balances, merit pay and any other necessary audits that arise.

Externally, there are several sets of auditors currently reviewing MSF; the Legislative Audit Division (LAD) and Eide Bailly. LAD will be preparing for the calendar year 2016 audit and Ms. Grosfield and Shannon Copps have been working with the Information System (IS) auditors from LAD who will be reviewing the claim system and policyholder system and how those systems interface. The IS auditor's goal is to provide assurance to the LAD financial auditors regarding the correctness of information feeding into the financial reports correctly. She said Eide Bailly also has information system auditors completing similar work on the statutory financial statement side.

She said MSF's pharmacy benefit manager, ESI is undergoing a controls audit over the services ESI provides to MSF. The audit is nearing the final stages and the report is expected by the end of February.

Ms. Grosfield said on the insurance basis side (Statutory Financial Statements), Eide Bailly auditors were working off-site last week and are on-site this week, performing tests of controls, and reviewing compliance and processes. MSF staff has been responsive and professional in responding to information requests.

Chair Zanto called for questions or comments from the Board and the public; there were none.

C. *Introduction of Dave Glennon, Lead Audit Partner – Eide Bailly*

Ms. Grosfield introduced Dave Glennon, Lead Audit Partner from Eide Bailly who is leading the team working on the statutory financial statement audit. She reminded the Board about their recently approved Request For Proposal (RFP) selection process which resulted in Eide Bailly being awarded the contract to provide audit services to MSF. She provided Mr. Glennon's professional background information and noted that he has 17 years in auditing and accounting services including experience in workers' compensation.

Mr. Glennon took a moment to introduce Jason Lindstrom, Project Manager, Eide Bailly and said Mr. Lindstrom has worked on the project on MSF's audits for a number of years. Mr. Glennon leads the team as the Engagement Partner; however, Marlys Rulon who has worked with MSF for many years in a variety of capacities is the Senior Manager. Kevin Smith is the second engagement partner and he completes a cold review of the file once completed which offers a quality check once the report is done and before it is presented to the client. He said the Eide Bailly team that is assembled for these audits has remained consistent for a number of years, providing MSF with a continuity of knowledge from Eide Bailly. His presentation included the contact information for the Eide Bailly team members so that the Board would have a direct contact line throughout the year.

He provided an overview of Eide Bally's audit objectives and noted that ultimately, they will strive to provide a reasonable, not absolute, assurance that the financial statements are free of material misstatement. The audit procedures include examining evidence supporting amounts and disclosures, obtaining an understanding of the internal controls and assessing the quality of accounting principles and significant estimates.

Mr. Miltenberger asked that since Eide Bailey does not provide an opinion on the adequacy of MSF's internal controls, what do similarly situated organizations to MSF do to get that assurance?

Mr. Glennon recommended Board members be diligent and ask questions as well as communicate with MSF's Internal Auditor regarding audit findings. He also recommended conversing with the external auditors because they will report matters that rise to a certain level of significance to the Board members.

Mr. Miltenberger commented that he has a high level of confidence in MSF's financial team; however, from a due diligence standpoint, it could be beneficial to have someone review the controls every two to three years.

Chair Zanto said he agreed with Mr. Miltenberger and then called for additional questions. There were none.

Mr. Glennon explained the timeline of this audit process and noted the final audit opinion and deliverables will be presented to the Board in June, 2017. He also noted that the Board has year round access to the Eide Bailly auditors and they welcome any contact and input from Board members.

President Hubbard clarified that the auditors conduct interviews of executive management and the Chair of the Board of Directors. During those interviews, the auditors ask if there are concerns about fraud and/or the potentials for fraud in the financial statements or in the organization. The auditors also ask if there is anything that management or the Chair would like the auditors to look into or investigate further. He said if Board members have items they would like investigated, the President or the Chair can take that message to the auditors initially. He also mentioned that MSF's Enterprise Risk Management (ERM) committee evaluates the controls of MSF's currently-identified risks with mitigation plans and controls that are being developed for the risk areas. Periodically, the Board is updated on the list of top ten risks and the activities that are being conducted to plan for those.

Chair Zanto called for additional questions or comments. There were none.

D. *Pharmacy Program Update and LMAC Formulary Development – Sam Heigh, VP Operations Support*

Ms. Heigh said MSF's current pharmacy benefit program manager is Express Scripts (ESI) and they have been providing services to MSF since 2011. Their contract will end December 2017. An RFP must now be issued to establish a new contract or find another program manager. MSF will begin this process in January 2017 and hopes to have the selection process completed by mid- 2017.

In November 2016, David Donn Consulting completed an audit of the services that ESI provides to MSF; though the final report has not yet been issued, early indications are positive with no major concerns identified.

She said through December 14, 2016 MSF has paid slightly over $80 million in medical expenses; of that number a little less than $6 million or seven percent is dedicated to pharmacy. Despite that being a fairly low percentage of the overall spend, MSF would like to further decrease the pharmacy costs, particularly with narcotic medications and will continue to work with ESI in development of further programs. MSF currently has a wholesale pricing program through ESI that offers pricing 11.5 percent below average wholesale cost for brand name and 45 percent below for generics. This cost saving would not be available to MSF without the pharmacy benefit manager program. This program also provides direct physician outreach and an MED program which is a morphine equivalent standard or a numerical standard for which opioids can be measured.

Ms. Heigh explained that the cost containment programs being utilized are not at the expense of the injured workers. The goal is to assure injured workers are provided the medical services they need and the care is appropriate for the injury.

Chair Zanto pointed out that almost 38 percent of the total pharmacy spend is for narcotics, which is the cost the State of Montana is trying to address by adopting a drug formulary without taking needed benefits away from the injured workers. It is hoped that lowering this cost will improve the health of injured workers by not getting them addicted to these narcotics.

Ms. Heigh pointed out that ESI's workers' compensation book of business spend on narcotics was 28 percent and clarified upon further questioning from President Hubbard that ESI's book of business reflected data from states that currently have drug formularies.

Jan Van Riper asked for clarification as to how a formulary functions. She said her understanding was that if certain drugs are on the formulary there is coverage and if not, the drug cost is higher, therefore the savings through the formulary are realized by disallowing certain drugs.

Chair Zanto said a formulary does put restrictions on some medications; however, there are other processes within a formulary that allow a physician to request prior authorization approval of a specific medication. The medication restriction is not there to focus on the cost of a medication, but rather the impact on an individual's overall health. Drug formularies are an attempt to manage how much of that medication is prescribed.

Ms. Heigh provided further highlights of the methods used by ESI to contain costs and provide controls for opioid distribution which include a) direct physician outreach letters regarding medical necessity and MED levels b) working with MSF to create a unified approach to adding additional controls, c) improving provider communications, outreach and education and d) working toward the development of a Montana formulary. She said MSF has a representative working on the formulary project with the Department of Labor and Industry and outlined the actions taken to date.

She said drug formularies provide more controls over the use of opioids, including a pre-authorization requirement for every prescription fill and forcing physicians to consider other modalities and change their prescribing behaviors. They have been proven to improve injured worker outcomes and it provides insurers with better guidelines to address over-prescribing.

Chair Zanto called for questions from the Board. Board members had no questions; however, Chair Zanto mentioned that in his position with the State of Montana, he had recently completed an RFP process for the same services and recommended, in light of rebates, that MSF look at a fully transparent model.

Chair Zanto called on Eric Strauss, Administrator, Employment Relations Division (ERD), DOLI.

Mr. Strauss said ERD is taking a very deliberate approach on development of a drug formulary. He noted that input from the last Labor Management Advisory Council (LMAC) meeting recommended that an efficient dispute process is vital for the drug formulary so that injured workers are able to attain medications that they need in a timely manner. They are also working to assure the drug formulary is evidence-based so there are not contrary opinions about the efficacy of some of the medications. He said it will be important to address legacy claims carefully as well so that injured workers cut off of narcotics are not pushed to the use of heroin as a substitute but are treated appropriately so the injured worker can be weaned off opioids timely and safely.

Chair Zanto called for the next presentation.

E. Amended Supplemental Filing, Eligibility and Criteria – Julie Jenkinson, VP Insurance Operations- Board Action

Ms. Jenkinson said since MSF is now regulated by the Commissioner of Securities and Insurance (CSI), MSF has formally adopted the NCCI Basic Manual. Upon further review of MSF's guidelines and processes for needed clarifications or additions, MSF found the need to clarify its handling of scheduled rating in its rate filing. In the past, there was a $15,000 threshold for applying scheduled rating to MSF's policies when quotes were being completed. The recent filing MSF submitted to CSI did not specifically state that threshold.

Ms. Jenkinson requested that the Board formally adopt and amend the $15,000 threshold level to MSF's rate filing effective retroactively to policies incepting on or after July 1, 2016.

President Hubbard clarified that though it may see odd that the Board is addressing MSF's underwriting level, as a public entity, anything that would be filed as part of the rates must be addressed by the Board.

Mr. Mihelish made a motion to adopt an eligibility threshold for schedule rating of $15,000 or more in annual premium at manual rates for new and renewal policies effective July 1, 2016. Mr. Mohr seconded the motion. Chair Zanto called for further discussion and comments from the public. There were none and he called for the vote. It passed unanimously.

III. Reserve Reports – Montana State Fund

A. Introduction – Laurence Hubbard, President/CEO

President Hubbard introduced Russell Greig from Willis Towers Watson to present the reserve report. He explained that this report will assist the Board in adopting the loss and loss adjustment expense (LAE) for financial statement purposes. This process must be completed now so that the filing can be prepared and submitted to CSI by March 1, 2017. Some of Mr. Greig's report will contain estimated numbers for the last quarter of 2016 which will require an amended report after 2016 financials close.

B. Montana State Fund Calendar 2016 Reserve Report – Russell Greig, Director, Willis Towers Watson

Mr. Greig said the objective of Willis Towers Watson's (WTW) analysis was to provide an aggregate amount of the unpaid claims benefits and include provision for claim administration expense or LAE. He provided a review of the methodologies that were used to determine the aggregate amount of unpaid claims and explained how each was applied. He reported that over the last nine months, the change in WTW's total projection of loss reflects an increase of $1.9 million or point one percent.

President Hubbard asked Mr. Greig to provide insight to the Board as to how WTW tempered the accelerated payment activity that resulted from increased settlement activity for undisputed medical claims. Prior to the passage of HB334, these settlements were not possible. Passage of that legislation has increased that activity on the ultimate liability.

Mr. Greig noted that actual payment activity came in $6.2 million higher than projected and the primary driver of that is the medical settlements. He said that because the communication link with MSF is so strong, WTW was aware of the increased settlement activity. Otherwise, that increase would have shown up as adverse development and WTW would have projected ultimates to be higher for medical. WTW has included an adjustment in the projection methods where they track medical settlements' historical trends and remove the excess level of medical settlements. Mr. Greig said WTW has also adjusted the underlying development patterns on the indemnity side and accelerated or lowered the development patterns that get applied to these losses.

Mr. Greig said uncertainty is embedded in every actuarial and financial model because the aggregate amount of unpaid claims is an estimate. Therefore, there are several contingencies that can impact future analyses. Medical costs may increase more than expected due to medical technology, utilization and higher frequency of severe diagnosis. Frequency and severity trends can fluctuate and benefit changes can result from law changes and/or court decisions and the level of attorney involvement. The expansion and contraction of economic cycles and social trends can have an effect as well as the duration of injuries.

He said medical development patterns continued to stabilize even though development in the past nine months has been above expectations which is a result of increased settlement activity. Actual payments exceeded projections by $6.2 million in the past nine months and $8.2 million in the past 15 months. He said WTW believes that MSF will have favorable "tail" development in the future. Indemnity development patterns have been generally well-behaved and actual payments have been $2.2 million below expected in the past nine months or $2.8 million in the past 15 months.

Mr. Greig said over the last ten years, loss ratios have been relatively stable.

Mr. Mihelish asked if there were two or three major external factors that have contributed to the stabilization MSF and the industry have been experiencing.

Mr. Greig said the primary contributing factor to the continued stabilization is the increased focus on safety and loss prevention. He also said the increased focus on underwriting has improved which allows companies to price their book of business better. The third contributing factor is predictive modeling which also helps to right price.

He stated there is a considerable range of uncertainty around WTW's actuarial central estimate and MSF's equity is required to support the continued growth of MSF and to minimize the impact of unexpected events on MSF's financials. MSF's equity could be significantly impacted in the case of a sustained change in expected trends. He noted that if medical inflation rates were to exceed long-term averages by two percentage point annually for the next ten years, medical payments would increase by approximately $100.6 million above the actuarial central estimate.

Mr. Greig provided the overall conclusion depicted on the next page.

Overall Conclusion as of December 31, 2016

- Unpaid claims benefits & LAE – Actuarial Central Estimate

Medical	$621.2 million
Indemnity	164.3
Unpaid claims administration expense	111.5
Total gross unpaid benefits & administration	$897.1 million
Reinsurance	(17.4)
Total net unpaid benefits & administration	$879.6 million

- Considerable uncertainty is associated with projections of unpaid claims & LAE
  - Low estimate, $761.4 million
  - High estimate, $1,017.6 million

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Chair Zanto called for questions from the Board and the public. There were no questions.

C. *Montana State Fund Calendar Year 2016 Reserve Recommendations – Laurence Hubbard, President/CEO*

President Hubbard presented management's recommended loss and LAE reconciliation. He explained that there are additional items, such as reserve strengthening, other states exposure/employers liability and additional LAE that are necessary to address when the Board is adopting MSF's loss and LAE. Management recommends a slightly more conservative estimation of net unpaid losses and LAE at $918.7 million. Mr. Hubbard asked Mark Barry, MSF Vice President, Corporate Support to illustrate the impact of this recommendation on the financial statements.

As of December 31, 2016 (In Millions)		
	Willis Towers Watson	MSF
Unpaid Losses	785.5	785.5
LAE	111.5	111.5
Gross Losses and LAE	897.0	897.0
Adjustments:		
Reinsurance	(17.4)	(18.4)
Reserve Strengthening		32.1
Other States/EL		3.3
Additional LAE		4.7
Net Unpaid Losses and LAE	$ 879.6	$ 918.7

Total MSF Recommended Losses and LAE	$ 802.9
	$ 115.8

D. *Calendar Year 2016 Projected Financial Report – Mark Barry, VP Corporate Support*

Mr. Barry reviewed the financial reporting timeline and clarified that the primary reason for asking the Board to adopt the reserves prior to the end of the calendar year is because MSF must file its annual statement by March 1, 2017 and staff will need time to complete the necessary financial reports and adjustments to assure that deadline is met. The audited statutory statements must be filed with CSI by June 1, 2017 and the Board will receive a full presentation at the June Board meeting.

He provided a year-to-year comparison of the loss and LAE reserves for 2015 and 2016 and noted that the estimates for 2016 were very close to actuals, primarily due to the stability of the current claim management trends. He noted that management's recommended adjustments to the loss reserves also include an increase in the excess-of-loss program of $5 million and the Aggregate Stop Loss program of $9 million. Those programs make up approximately 82 percent of the adjustment amount. The remainder of the $17.7 million MSF recommended adjustment is in other states coverage and reserve strengthening. The overall total adjustment recommended by management is $18.4 million which is a two-percent increase in loss reserves from the prior year end.

Mr. Barry presented the projected 2016 income statement and actuals through September 30, 2016. This report illustrated that policyholder equity was estimated to be $518.5 million at the end of the third quarter. The estimated policyholder equity for the end of the calendar year is $517 million due primarily to slightly higher incurred losses at the end of the year. He noted that management does not anticipate the final numbers at year end fluctuating significantly from this report. He said the largest change will likely be in investment numbers due to the fluctuations in the market which will impact the unrealized gains and losses. He provided an overview of the 2016 reinsurance activity. He said loss and LAE reserves are expected to increase two percent, policyholder equity has remained fairly flat since 2015 and the reserve-to-equity ratio is expected to match the 2015 level at 1.78 after the $35 million dividend.

Mr. Barry asked the Board to approve loss and LAE reserves at $918.7 million with the understanding that if paid results come in significantly higher or lower, adjustments can be made.

Chair Zanto called for questions. Mr. Miltenberger and Mr. Mihelish sought clarification on a couple of recommended items and Mr. Barry and President Hubbard provided further feedback and input to satisfy their information requests.

Chair Zanto called for additional questions. There were none.

E. Adoption of Montana State Fund Calendar Year 2016 Unpaid Loss and Loss Adjustment Expense Reserve Estimate – Laurence Hubbard, President/CEO

Mr. Miltenberger made a motion that based on the actuary's best estimate of unpaid losses and loss adjustment expenses, adjusted for projected reinsurance recoverable, and for President Hubbard's recommendation for loss reserves for Other States Coverage, Employers' Liability, and reserve strengthening, undiscounted as of December 31, 2016, the Board adopt $802,973,266 as the unpaid loss reserve and $115,754,973 as the loss adjustment expense reserve estimates for the Montana State Fund financial statements for the year ending on December 31, 2016, to be adjusted for changes based on the actual benefits paid at the end of the year. Ms. VanRiper seconded the motion. Chair Zanto called for additional questions or discussion from the Board and the public; seeing none, he called for the vote and the motion passed unanimously.

IV. Calendar Year 2017Annual Business Plan – Laurence Hubbard, President/CEO

A. Annual Business Plan Introduction

President Hubbard thanked the Board for approval of the loss and LAE reserves. He then called upon Shannon Copps to present the proposed Calendar Year 2017 Business Plan. He teed up the presentation with a description of the process used to develop and implement the strategic business plan year after year.

B. Calendar Year 2016 Annual Business Plan Status – Shannon Copps, Director of Enterprise Strategy and Project Management

Ms. Copps provide an update on the status of the 2016 Business Plan Initiatives.

She provided the Key Success Measures shown on the next page and noted that the projections are based on the third quarter financial information. She said the net earned premium was $4.7 million more than planned and loss ratio and expense ratios were below projections. Investment income was $6 million above plan and net operating income before dividend was $16.3 million above the 2016 projection. The key increases were from investments and premium.

Key Success Measures

KSM	2016 BP	2016 Projected
Net Earned Premium	$162.0M	$166.7M
Fiscal Year Loss Ratio	78.6%	74.5%
Expense Ratio	28.6%	27.3%
Investment Income	$44.1M	$50.1M
Net Operating Income (before dividend)	$27.3M	$43.6M
Achieve Enterprise Wide Initiatives		

Chair Zanto called for questions; there were none.

Ms. Copps said the projects were focused in two main areas: infrastructure and customer service. The customer service project is to replace the policy and billing application which was implemented in 1997. A new system will enhance MSF’s service with improved functionality and efficiency. This project is currently off track due to the decision to delay requirements documentation for two months to allow the business team members to focus on July 1 renewals as well as complete key work on regulation projects. The team has now completed the requirements and documentation for a comprehensive RFP.

The infrastructure initiative includes four projects to coordinate the implementation of regulation under Title 33 Montana Insurance Code. The projects: Regulation, Calendar Year Conversion, Rates and Rate Filing, and Change Management and Communication are all on track or completed.

Ms. Copps noted that the first rate filing was approved by CSI and the team implemented provisions of the NCCI Basic Manual that needed to be in place by March.

Mr. Mihelish requested clarification on net operating income coming in for 2016 at $43.6 million, yet the goal for 2017 has been set at $28.3 million and wondered why there is such a large discrepancy.

Mr. Barry said MSF's modeling takes into account loss reserves and expected payout patterns. The amounts that make up the income are estimated and since some of the impact is from investment income, that is difficult to estimate. For CY2016 MSF's loss ratio is lower and premium is higher which adds up to increased net operating income. Management looks at things conservatively and for 2016 things are turning out better than were originally planned. He said the difference is not the result of any one thing.

Mr. Hubbard explained that establishment of the key success measures is based on modeling using historical performance and the financial targets that MSF is likely to achieve.

Mr. Mihelish said he is a "big fan of incentive base pay" and feels it is unfortunate that MSF lost that component. He said he believes that MSF should establish stretch goals. He noted he was not criticizing management; however, he would like to see incentive-based pay reinstated for MSF employees to revitalize the setting of measures.

C. Calendar Year 2017 Annual Business Plan – Shannon Copps and MSF Staff

Ms. Copps moved to the Calendar Year 2017 Annual Business Plan and presented the Key Success Measures:

- Generate Total Net Earned Premium of $167.0 million – which included producing $16.6 million of new premium and achieving a 91.2 percent premium retention.
- Achieve 79 percent loss ratio and manage prior period reserve adjustments to $5.2 million.
- Achieve 30.3 percent expense ratio.
- Achieve investment income of $48.1 million.
- Achieve Net Operating Income of $28.3 million before dividend.
- Achieve Enterprise Wide Initiatives.

Ms. Copps further addressed the Enterprise Wide Initiatives. She said the CY2017 initiatives are all focused on customer service. She asked Ms. Heigh to present the Policy and Billing System Replacement Initiative.

Ms. Heigh said the Policy and Billing System Replacement initiative is a multi-year project to replace core insurance systems which will continue in CY2017. The sponsors of the project are Sam Heigh, Julie Jenkinson, Vice President, Operations and Al Parisian, Chief Information Officer. Project Managers are Erika Ayers from Operations and Sandy Leyva from IT. Phase I was implemented in 2015 when the Board approved securing Independent Verification & Validation (IV&V) services to develop project strategies and value metrics, and identify business and technical requirements. Phase II will begin in July 2017 and run through 2019. That phase will implement planning, execution, a go-live date and a stabilization period. Phase III will include the development and implementation of customized enhancement features and that timeframe has not yet been determined.

She said the executive staff will then approve an overall implementation plan by October 31, 2017 which is when development with the selected vendor will begin. She noted that this project is comparable in size and scope to three or four normal projects which is why the number of proposed projects has been restricted for 2017.

President Hubbard added that discussion about this project began with the Board two years ago and the Board has supported incremental development of a project approach and governance with the retention of Sabot Consulting in 2015. He said Sabot has reported directly to him and has been working with the project team. They provided quarterly and monthly deliverables and updates on the project status. Sabot provided a letter to the Board dated December 8, 2016 that reprises their involvement in the IV&V process. The letter contains a variety of assessments and findings which indicate that the PBRI project is in good health and well positioned for the successful selection of the policy and billing system replacement vendor. He said that by taking the step of hiring the IV&V consultant, MSF will be able to direct the necessary resources to the project, avoiding additional years of delay and implementation and significant cost overruns. This process as also helped to define the scope of the systems for appropriate vendor and product selection match. He commended the project team for doing an excellent job thus far.
Mr. Hubbard mentioned that Board Member Richard Miltenberger had asked about the appropriateness of outsourcing policy and billing services rather than purchasing and implementing an entirely new in-house system. He said that MSF does have processes that are outsourced and understands the benefits of appropriate functional outsourcing. Based on Mr. Miltenberger recommendation, MSF staff will do a strategic assessment of those outsourcing opportunities and report those findings back to the Board.

Chair Zanto called for questions. There were none.

Ms. Jenkinson presented the safety initiatives: WorkSafe Champions and Growing a Safer Montana. She said the WorkSafe Champions Initiative is a continuation of MSF's flagship safety program which was established in 2008. The sponsors are Rick Duane, Vice President Human Resources and Julie Jenkinson. The project managers are Kirk Smith, Safety Service Specialist, Mark Rosenleaf, Safety Management Consultant and Tammy Lynn, Safety Services Director. The intent of WorkSafe Champions is to change the safety culture of Montana through education by creating policyholder awareness of the need to implement and employ safety programs. This program has evolved to include the combination of on-site programs for larger policyholders and regional programs for smaller policyholders.

Chair Zanto called for questions.

Mr. Mihelish asked how MSF is reaching the small "mom and pop" businesses.

Ms. Jenkinson said the regional safety programs lead by Kirk Smith are designed specifically to address the safety education needs of small employers and are open to all employers, not just policyholders of MSF. MSF's safety management consultants work to identify small employers that could benefit from these programs or WorkSafe Champions.

Ms. Jenkinson then introduced the Growing a Safer Montana project. The sponsors are Al Parisian and Julie Jenkinson and the Project Managers are Tammy Lynn and Dan Johnson, Safety Management Consultant. She said it is designed to impact the safety culture for the next generation of Montana employees. She said that nationally one third of all injuries are suffered by employees under the age of 18. The injury rate for workers under the age of 25 is almost two times higher than the injury rate for workers over the age of 25. In Montana, 14 percent of all injuries are suffered by employees under the age of 24; however, the 18 to 34 age group suffered 37 percent or over one third of the injuries that occurred in 2016. This program is designed to teach safety to create a healthier workforce in Montana. This program will provide grants to high school trade and industry classrooms for safety materials, equipment or protective gear. Additionally, this program will grant scholarships to students in trade, health and safety professionals that are being trained at Montana Tech. She said this scholarship program will be patterned after the existing scholarship program for the dependents of fatally injured workers.

She mentioned a recent effort that involved the Helena Chamber of Commerce, Leadership Helena and MSF in providing some safety equipment to the Capital High and Helena High shop programs. MSF's participation in this effort was the genesis for development of the grant program for safety materials in high schools.

Chair Zanto asked for clarification on the dependents' scholarship program and mentioned that Kids Chance, a similar national program was mentioned at the LMAC and is a program that is trying to get established in Montana.

Ms. Jenkinson said that Paradigm participates in Kids Chance and they have been talking to MSF about participating in that program.

Chair Zanto called for additional questions; there were none.

Ms. Copps summarized the presentation and noted that the financial commitment for the CY2017 projects is approximately $4.3 million, with the PBRI project carrying the majority of this cost at $4.1 million. She asked the Board to approve the CY2017 Business Plan.

Chair Zanto called for questions. There were none.

Mr. Mihelish made the motion that the Board adopt the proposed Calendar Year 2017 Annual Business Plan. Mr. Owens seconded the motion. Chair Zanto called for discussion or public comment. Seeing none, he called for the vote and the motion passed unanimously.

V. Calendar Year 2017 Budget – Laurence Hubbard, President/CEO

A. Budget Introduction

Chair Zanto reminded the presenters to speak clearly into the microphone for the Board members participating telephonically.

President Hubbard thanked the Board for the approval of the Calendar Year 2017 Business Plan and called upon Mr. Barry to present the proposed Calendar Year 2017 Budget. He noted that Mr. Barry would provide the presentation; however, there was also a very thorough line item presentation in the Board's packet. He noted there were some large requests compared to past budget requests due to increased expenses and project costs.

B. 2017 Budget – Mark Barry, VP Corporate Support

Mr. Barry provided the 2017 Budget proposal request. He said the proposed Fiscal Year 2017 total budget is $189.7. The budget breakdown is $128 million for claim benefits and $61.5 million for operating expenses. He clarified that operating expenses include all of the department and project costs as well as the allocated loss adjustment expense and purchases of equipment. Comparatively, anticipated revenues are $215 million with net earned premium of $167 million and investment income at $48.1 million. Calendar Year 2016 budget comparison was planned at $206 million of total income and benefits and operations costs at $182 million. Currently, 2016 income is at $217 million. Mr. Barry said the CY17 Budget proposes a 1.6 percent increase in claim benefits payments and a 10.4 percent increase in the operational budget. Overall, this CY17 budget proposal includes a 4.2 percent increase over the CY2016 budget. He explained that CY17 budget has approximately $5 million of project money which is a large increase over the CY16 $1.3 million. He said $4.2 million is for the projects in the Annual Business Plan; however there are additional projects not in the business plan that total $896,000. That is a $3.7 million increase in proposed project costs which makes up a large portion of the increase in the operational expenses.

(000s)	FY15 Actuals	CY16 Budget	CY17 change from CY16	CY17 Budget
Net Earned Premium	$164,557	$162,010	3.1%	$167,014
Investment Income /Gain *	50,708	44,147	9.0%	48,135
TOTAL INCOME	**$215,265**	**$206,157**	**4.4%**	**$215,149**
Claim Benefits Payments	114,428	126,298	1.6%	128,265
Operational Budgets	50,700	55,711	10.4%	61,477
TOTAL EXPENDITURES	**$165,128**	**$182,009**	**4.2%**	**$189,743**

Chair Zanto called for questions.

Mr. Mihelish asked if there would be ongoing costs in the future for the PBRI project due to depreciation.

Mr. Barry said overall total cost of the project is estimated at $15 million and is anticipated to be funded over a three-year period. There will be depreciation costs after the solution is implemented.

Mr. Barry continued the budget presentation and noted that MSF's operational trends indicate MSF is servicing approximately 18,000 claims a year and is writing about 26,000 policies. He stated that the premium level is estimated at $167 million and assumes no rate adjustment for 2017. Though there are indicators that operating costs have been increasing, primarily due to internal wage growth, there has been no rate increase to address the additional costs.

Chair Zanto sought clarification on his assumption that the largest increase is being seen in personal services.

Mr. Barry confirmed personal services in 2016 were budgeted at $28 million and for 2017 are budgeted at $29.8 million.

Mr. Barry explained the statutory operating expense ratio and how it was derived and said it was estimated at 30.3 percent or a $50.5 million net operating expense for 2017 compared to 2016's $45 million estimate. He noted that this expense ratio compares favorably to the national industry with MSF typically well below the average of other large Montana carriers.

He said this budget estimates claim payments will be $128.3 million with $38.5 million indemnity and $89.8 million in medical costs. Personal services are projected to be $29.8 million and operating expenses $25 million. MSF pays for two staff members at CSI which estimated funding for those positions in 2017 to be $379,000. That is an increase from the 2016 cost of $175,000. Equipment and intangible assets are projected to be $2.6 million and ALAE to be $3.6 million.

Mr. Zanto asked what assurance MSF has that $380,000 is the appropriate level of funding at CSI for staffing two positions.

Mr. Barry said that by agreement, CSI provides MSF with their budget for review and MSF has not questioned it in the past. Rene Martello, MSF Controller, added that this cost is prefunded to CSI and then reconciled after a year.

He continued to break down the budget costs and claim payments further for the Board members. He provided further illustration that the increases in medical payment estimates is due primarily to an increase in undisputed medical settlement activity. That was true for 2016 and is anticipated to continue in 2017.

Board Member Lynda Moss left the teleconference at 1:00 pm.

Chair Zanto asked if MSF intends to continue aggressively seeking undisputed medical settlements or if that will begin to level off?

Ms. Jenkinson said MSF expects to see the increased activity continue for approximately another year before it begins to taper off.

Mr. Barry provided more detail on settlements, indemnity and medical costs. He then addressed details regarding personal services and addressed MSF's staffing issues for the prior year as well as expected changes for CY2017. He noted the MSF employer contribution to the state retirement system will see a rate increase at the end of June 2017 to 8.57 percent from 8.47 percent and the employer's share of group insurance increased eight percent or $976 per employee over 2016. He addressed operating expenses and highlighted the changes and increases that this proposed budget included. He listed the total proposed projects for CY2017 including those not listed in the Annual Business Plan such as regulation, documentation gaps and examinations, the executive development program and the medical billing system. He noted that allocated loss adjustment expenses are projected to decrease in 2017 by about $3.6 million. Overall, he said net earned premium is fairly flat, benefits have been increasing due to medical settlement costs and there is a slight increase in operational expenses. He stated that expenses will be managed to the budget accordingly and there is always the possibility for cost savings. The review of past budgets indicates MSF spends about 96 percent of the approved budget which equates typically to $2 million in savings.

Mr. Barry said management requests the Board's approval for the proposed budget for Calendar Year 2017 for total operations expenditures of $61,477,361 and claims and benefits payments of $128,265,148 for a total budget request of $189,742,509 as well as providing the President the authority to move, within the approved budget, funding between the expense categories and make staffing adjustments as necessary.

Chair Zanto called for questions.

Mr. Miltenberger thanked staff for the presentation; however he asked that last year's budget expense information be projected for the entire year and compared to the requested budget, rather than just actuals to the end of the third quarter.

Chair Zanto called for comments or questions from the Board and the public. Seeing none, he called for a motion.

Chair Zanto made a motion the Board approve the proposed Montana State Fund budget for Calendar Year 2017 totaling $189,742,509 as follows:

- *Total Operational Expenditures of $61,477,361, including the costs that are reimbursed to Montana State Fund for Old Fund administration; and*
- *Montana State Fund Benefit Payments of $128,265,148.*

The President is to retain and may utilize the prior direction from the Board to adjust expenditures among first level expenditure categories, and may increase staffing, as long as the total approved budget amount is not exceeded. Mr. Mohr seconded the motion. Chair Zanto called for questions or comments from the Board and those present. Seeing none, he called for the vote and the motion passed unanimously.

VI. Insurance Operations Support – Christy Weikart, Underwriting Services Leader

A. Construction Industry Premium Credit Program Approval

Ms. Weikart provided historical background on the development and implementation of the construction industry premium credit program in the 1990s. She explained that this program was developed to maintain a level playing field for construction industry contractors within the workers' compensation system. Wage rate variances exist from employer to employer yet workers' compensation premiums are based on total payroll reported. Without this program, employers who pay higher hourly wages for the same type of work would pay higher workers' compensation premiums. She assured the Board that the employee's exposure to loss remains the same and is unaffected by this program.

She noted that MSF has the ability to craft their own plan or use the NCCI formulaic plan. MSF has found the use of a table to be more transparent for clients. Additionally, by developing and implementing its own plan, MSF saves approximately $100 thousand per year.

The table is adjusted each year as the state's average weekly wage increases. Policyholders must have specific class codes to be eligible for this program. Statute outlines which class codes, mapped to the NAICS classification system, are eligible to be in the construction credit program.

Montana State Fund
Construction Industry Premium Credit Program
Applicable to policies effective July 1, 2017 to July 1, 2018

Average Hourly Wage	Credit Percentages
$22.05 or less	0.00%
$22.06 to $22.41	0.38%
$22.42 to $22.82	1.23%
$22.83 to $23.29	2.16%
$23.30 to $23.83	3.18%
$23.84 to $24.44	4.30%
$24.45 to $25.14	5.51%
$25.15 to $25.95	6.82%
$25.96 to $26.87	8.23%
$26.88 to $27.93	9.74%
$27.94 to $29.14	11.34%
$29.15 to $30.52	13.02%

$30.53 to $32.11	14.77%
$32.12 to $33.93	16.59%
$33.94 to $36.01	18.45%
$36.02 to $38.39	20.34%
$38.40 to $41.12	22.25%
$41.13 to $44.25	24.15%
$44.26 to $47.84	26.04%
$47.85 to $51.95	27.88%
$51.96 or more	29.68%

Ms. Weikart requested that the Board approve the proposed table for new and renewal policies with an effective date of July 1, 2017 as recommended by MSF management.

Chair Zanto called for questions. There were none.

Mr. Miltenberger moved the Board adopt the plan of credit percentages for Montana State Fund's Construction Industry Premium Credit Program, for new or renewal policies, with effective dates in Calendar Year 2017, as proposed by Montana State Fund management. Mr. Mihelish seconded the motion. Chair Zanto called for discussion; seeing none, he called for the vote. The motion passed unanimously.

B. Classification Code Update

Ms. Weikart provided the yearly update on the classification codes adopted by MSF from existing NCCI classification codes as well as the continuing effort to eliminate differences between the MSF classification system and the NCCI classification system.

Ms. Weikart outlined the classification codes modifications that were made in 2016:

Montana State Fund (MSF) adopted existing National Council on Compensation Insurance (NCCI) classification codes for MSF policyholders conducting operations that are properly classified to these classification codes:

- Effective May 19, 2016:
  Established classification code 2286 – Wool Spinning, Weaving & Yarn Manufacturing.

- Effective July 1, 2016:
  Established classification code 7370-00 - Taxicab Company.

- Established classification code 8058-00 - Store Employees to be assigned to building material dealers (including farm supply & sash, door & assembled millwork dealers).

- Established classification code 9033-00 - Housing Authority-Clerical, Salespersons & Drivers.

- Established classification code 9170-00 - Janitorial Services Contractor Above Ground Level.

MSF adopted changes to the following classification codes effective July 1, 2016:

- Revised the phraseology of classification code 3629-00 – Precision Machined Parts Manufacturing to remove the word precision, remove the tolerance requirements, establish new criteria for the classification code & establish phraseology for Additive Mfg. NOC-No Assembly.

- Revised the phraseology of classification code 3632-00 – Machine Shop-NOC to clarify that the classification code applies only to shop operations performed on the premises of the employer and to the manufacture or repair of machines, the repair of parts, the repair of engines that have been removed from the vehicle by others, and general job machining.

- Revised the phraseology of classification code 7395 - Diving-Marine-All Operations-State Act Only to remove the inclusion of drivers.

- Revised the phraseology of classification code 8010-01 - Store-Hardware & Drivers to remove the inclusion of drivers.

- Revised the phraseology of classification code 8013-04 - Optometrist to clarify that the code includes the sale of eyewear when gross receipts from the sale of eyewear are more than 50%.

- Revised the phraseology of classification code 8031-01 & 02- Store-Meat, Fish or Poultry/Cold Storage Locker & Drivers to remove the inclusion of drivers.

- Revised the phraseology of classification code 8279-01 - Stable or Breeding Farm & Drivers to remove general care of pleasure & working horses. Also removed language regarding horse & mule racing activities.

- Revised the phraseology of classification code 8720-03 - Racetrack Operation-Horse or Dog-Officials to remove clerical and announcers in booths.
- Revised the phraseology of classification code 8832-02 - Physician & Clerical to clarify that the classification code includes the sale of eyewear when gross receipts from the sale of eyewear are 50% or less.

- Revised the phraseology of classification code 9040-01 & 02 - Hospitals/Asylums-All Other Employees & Drivers to remove the inclusion of drivers.

- Revised the phraseology of classification code 9101-01, 02 & 03 - College/School/Church-All Other Employees & Drivers to remove the inclusion of drivers.

- Revised the phraseology of classification code 9420-00 – Municipal, Town, City and County Employees – All Other Employees & Drivers to remove the inclusion of pilots.

- Deleted classification code 0008-02 - Sugar Beets-Hand Hoe or Thin Only & replaced with classification code 0006-00 - Farm or Ranch - All Employees & Drivers.
- Deleted classification Code 7382-04 - Taxicab Company

She indicated that these changes bring MSF into full compliance with NCCI classification code usage with the exception that MSF has not yet begun to use the per capita class codes. That is an exception received from CSI until MSF has the ability to include that in its new policy system.

Chair Zanto called for questions or comments from the Board and the public; there were none.

VII. Corporate Support – Mark Barry, VP Corporate Support

A. Calendar Year 2016 Third Quarter Budget Report – Rene Martello, Controller

Ms. Martello noted that the information she was going to review had been mailed to the Board in September. She reviewed the budget status of CY2016 budget for the period ending September 30, 2016. She noted that claim benefits and operational expenditures were projected to be approximately $2 million under projected and recent developments indicate that amount will be closer to $4 million under by year end. It is expected that 97.8 percent of the budget will be spent. Indemnity is projected to be $1.4 million under budget and medical is projected to be over planned by .9 percent. She said 96.5 percent of the total operational expenses have been spent placing the item under budget by $393,000 or 1.7 percent.

Ms. Martello said a complete report of the budget activity will be presented at the March 2017 Board meeting and will illustrate the year end results.

Chair Zanto called for questions; there were none.

B. Old Fund Fiscal Year 2017 First Quarter Budget Summary – Rene Martello, Controller

Ms. Martello clarified that the Old Fund budget is based on the State of Montana's fiscal year cycle which runs from July 1, 2016 through June 30, 2017.
She said all expenditures for the Old Fund are funded from the General Fund as required by law. Total claim benefit payments are slightly under at $332,000 and operational expenses are estimated to be under by $8,000 or .7 percent. Indemnity payments are under by $65,000 and medical costs are also running lower than expected at $260,000. Operational expenses, which include the cost to administer the Old Fund and DOLI's assessments, are slightly over budget and ALAE is slight slightly under budget. The administrative cost is over due to additional legal costs for increased settlement activity on asbestos related claims in the Old Fund.

Chair Zanto called for questions from the Board and the public. There were none.

VIII. Old Business/New Business

Chair Zanto called for old business or new business; there was none.

IV. Public Comment

Chair Zanto called for public comment; there was none.

The meeting was adjourned at 2:06 p.m. The next scheduled Board meeting will be held on Friday, March 10, 2017 at Montana State Fund, 855 Front Street, Helena, Montana in the first floor Board Room.

Respectfully submitted,

Verna Boucher
Special Assistant to the President/CEO