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MONTANA STATE FUND
BOARD OF DIRECTORS MEETING
May 13, 2016

The Montana State Fund (MSF) Board of Directors meeting was held May 13, 2016 in the Board Room of Montana State Fund, 855 Front Street, Helena MT 59601.

Directors Attending

Lance Zanto, Helena
Bruce Mihelish, Lolo
Lynda Moss, Billings
Jack Owens, Missoula

State Fund Staff

Laurence Hubbard, President/CEO
Verna Boucher, Special Asst to Pres/CEO
Curtis Larsen, Interim General Counsel
Mark Barry, CFO
Rick Duane, Human Resources, VP
Sam Heigh, Operations Support VP
Al Parisian, CIO
Julie Jenkinson, Operations VP
Patti Grosfield, Internal Auditor
Christy Weikart, Underwriting Services Leader
Shannon Copps, Director, IT Plans & Controls
Mary Boyle, Communications Specialist
Mike Worden, HR Specialist
Peter Strauss, Compliance
Dan Gengler, Internal Actuary
Rene Martello, Controller

Others Attending

Mary Cochenour, DOJ
Jon Bennion, DOJ
Mari Kindberg, SAO
Rep. Ryan Lynch (by phone)
Webb Brown, MT Chamber
Russ Ehman, SAO
Eric Strauss, DOLI
Bob Biskupiak, IIAM
Senator Jim Keane
Brenda Miller, Liberty Mutual
Pat Murdo, Leg. Services
Bill Wheeler, DOLI
Sonia Powell, OBPP

I. Meeting Preliminaries

A. Call to Order

Lance Zanto, Chair, called the meeting to order at 8:31 am and welcomed Senator Jim Keane and Jon Bennion from the Department of Justice (DOJ) as well as noting that Representative Ryan Lynch was participating in this meeting by phone. He noted that Board members, Jan VanRiper, Matt Mohr and Richard Miltenberger were unable to attend this meeting due to schedule conflicts. He clarified that Mr. Miltenberger had offered to participate by phone if a divided vote required an additional Board member to achieve a voting quorum.

President Hubbard welcomed the Board members and noted that there was a correction to the March 11 minutes that required the Board's attention.

B. *Approval of March 11, 2016 Board Meeting Minutes*
Chair Zanto called for a motion to approve the March 11, 2016 minutes.

Lynda Moss made a motion to approve the March 11, 2016 minutes as presented. The motion was seconded by Jack Owens. Chair Zanto asked for any questions or comments from those present. There being none, he called for the vote and the motion was unanimously approved.

C. *Amended Motion for Loss Reserves for Fiscal year 15.5 Financial Statements*
President Hubbard explained that the draft motion that was provided to the Board for wording guidance at the March 11, 2016, Board meeting, inadvertently contained a typographical error with relation to the loss and loss adjustment expense reserve. The error was detected by a Legislative Auditor while completing MSF's legislative audit and the Board must take action to correct the motion. He said the unpaid loss adjustment expense reserve estimate should have been $114,990,651 not the $114,900,651 that was moved and passed at that meeting. He asked the Board to take action to correct the error.

Mr. Mihelish made a motion to change the amount on Page 19 of 28 to $114,990,651. Mr. Owens seconded the motion. Chair Zanto called for discussion or questions from the Board and the audience. Seeing none, he called for the vote and the motion passed unanimously.

II. Miscellaneous – Laurence Hubbard, President/CEO

A. *Miscellaneous*
Chair Zanto notified the attendees that the Federal Building would be having an evacuation drill between 9:00 and 9:30 a.m.

President Hubbard welcomed and introduced Jon Bennion, Chief Deputy Attorney General and Mary Cochenour, the Assistant Attorney responsible for prosecuting workers' compensation fraud issues for MSF.

Mr. Bennion thanked the Board for the opportunity to speak and noted the importance of touching base occasionally due to the special relationship the Attorney General's (AG) office has with MSF. He said Montana statute MCA 2-15-2015 established the workers' compensation fraud investigation and prosecution unit within the Attorney General's office. Due to the unique quasi-governmental makeup of MSF, the relationship with MSF resembles a private attorney/client situation rather than the standard representation of the people of Montana. He said the AG's office is proud of the work they have done for MSF primarily due to the work of one of the top prosecutors in the state, Mary Cochenour and investigator John Kamora. He invited Ms. Cochenour, Assistant Attorney General, to address the Board.

Ms. Cochenour addressed the Board and noted that she is assigned to handle all the MSF prosecutions. She then provided a "snap shot" of a trial that she prosecuted for MSF in December 2015. The case was the State of Montana vs. Matt Ahler, an injured employee with a relatively minor injury from a car accident in 2012. After his doctor released him back to work, Mr. Ahler, who worked for a janitorial service in Missoula, planned and staged a work related accident so that he could again file a workers' compensation claim to, hopefully, receive a permanent injury for life. Mr. Ahler recruited two friends to assist placing a large floor burnisher/buffer on his chest as he lay on the ground. The friends rocked the burnisher back and forth in an attempt to cause an injury. Their efforts did not produce a significant enough injury for Mr. Ahler to be able to file a compensation claim so his friend punched him in the chest approximately 20 to 50 times hoping to produce a qualifying injury. When Mr. Ahler was taken to the hospital, the physicians were perplexed because the reported incident and subsequent injury did not match and they were unable to determine his actual ailment. Mr. Ahler went on to file for and receive weekly wage loss benefits until one of the "friends" came forward and reported to MSF that the incident was staged. That began an investigation in which all three individuals were charged. The two friends pleaded guilty and testified against Mr. Ahler at his trial in December 2015. The trial lasted a week. The jury deliberated about two hours and found Mr. Ahler guilty. Ms. Cochenour noted that she is proud of the work she does for MSF.

Chair Zanto asked Ms. Cochenour to provide a definition of "fraud" since, in his position, he is asked that question quite often.

Ms. Cochenour said there are two types of cases that she prosecutes for MSF: claimant fraud and employer misconduct. Claimant fraud is when an employee files a claim that they were hurt on the job and begin receiving benefits for their work place injury and are either lying about the injury, exaggerating their injury or lying to remain on benefits long after the injury has healed. Additionally, if while collecting wage loss benefits, the claimant works for unreported cash payments that is also fraud. Employer misconduct is the falsification of documents or wage reporting; for instance, reporting they have two workers when in reality they are employing ten. The false report would mean a reduced premium for the employer or no premium at all if the employer reports zero employees.

Mr. Mihelish asked what the sentence was for Mr. Ahler.

Ms. Cochenour said Mr. Ahler received a six-year deferred probationary sentence and must pay $65,000 in restitution. He is subject to adult parole and probation regulations. He did not receive jail time because the sentencing structure in Montana for property crime, such as theft or burglary, encourages judges to impose a probationary sentence. The reason incarceration is discouraged is due to jail overcrowding and the need for cell space for more violent offenders.

Mr. Mihelish asked if MSF is responsible for following up on the payment of the court ordered restitution.

Ms. Cochenour said parole and probation actually do the collection of restitution for all felony offenders through their restitution office. The AG's Fraud Unit does monitor the balances; however, typically not a lot of the money is recouped from claimant offenders. The largest share of the savings that MSF realizes is cutting off the claim so that those funds do not continue to be spent.

President Hubbard thanked Mr. Bennion and Ms. Cochenour for the presentation and for providing logic behind probation versus prison sentences. He noted that fraud is an issue nationally and it hurts employers and claimants who are rightfully entitled to workers' compensation services and benefits. MSF will continue to have zero tolerance for fraud wherever it occurs. Fraud, whether it is worker, employer or provider fraud, can be a challenge to investigate and prosecute effectively and MSF appreciates the partnership with the AG's office to assure fairness for the workers' compensation system and for the people of Montana.

Chair Zanto called for additional questions; there were none. He thanked Mr. Bennion and Ms. Cochenour for their time and presentation.

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

Ms. Grosfield provided an update on the statutory financial statement audit performed by Eide Bailly, LLP for the six-month period ending December 31, 2015. She noted that for the past 15 1/2 years, MSF voluntarily prepared and has had an independent audit of MSF's statutory basis financial statements; however, on January 1, 2016 that audit requirement became mandatory as MSF's regulatory oversight moved to CSI. Statutory audits are completed using an insurance basis (NAIC) for accounting. She explained that Eide Bailly issued two opinions: the first is an adverse opinion based on the Generally Accepted Accounting Principles (GAAP). This is expected on a statutory basis financial statement audit as GAAP and statutory financial statements are based on distinctly different accounting principles. MSF received unqualified opinions from the Legislative Audit Division (LAD) on the governmental basis financial statements that use GAAP.

She said the second opinion is based on the regulatory required statutory basis of accounting. MSF received an unqualified or clean opinion on the statutory basis of accounting, which means the financial statements are presented fairly in all material respects. The auditors also review internal controls and are required to point out any significant deficiencies; they found none. They also stated there were no difficulties encountered in performing the audit and no significant deficiencies identified. There were no disagreements with management regarding financial accounting, reporting or auditing and the audit report contained no audit recommendations for improvement.

External

The Legislative Audit Division governmental statements for July 1, 2015 to December 31, 2015 are in final review and will be presented to the Legislative Audit Committee (LAC) at their June 16, meeting.

Internal

Ms. Grosfield is reviewing internal controls of the medical bill payer process and working to review controls of MSF's top risks as identified through the Enterprise Risk Management (ERM) program.

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

Auditing Firm Request for Proposal – Patti Grosfield, Internal Auditor

Ms. Grosfield explained that MSF's contract with Eide Bailly for independent auditing consultation is in the final year of the seven-year Request for Proposal (RFP) cycle. MSF will need to issue an RFP now in order to have the process and final procurement of an auditing firm in place before the next statutory audit must be completed. She said that per insurance regulation, the Board is required to approve the audit firm and requested that the Board approve staff proceeding with the RFP process for audit services. She said management recommends that several Board members serve on the selection committee. She provided a proposed tentative schedule that would begin with the issue date of May 24, 2016 and end with the intended date for contract award on September 16, 2016.

Chair Zanto called for discussion from the Board; seeing none, he requested a motion.

Lynda Moss made a motion the Board direct staff to proceed on behalf of the Board with a Request for Proposal (RFP) for selection of an auditing firm. Mr. Mihelish seconded the motion. Chair Zanto called for questions or discussion from the Board and the audience; there were none. He called for the vote and the motion passed unanimously.

Chair Zanto then called for volunteers to sit on the selection committee.

Mr. Mihelish recommended Jan VanRiper and Richard Miltenberger serve on the selection committee since they are both located in Helena which would ease travelling concerns for other Board members.

Chair Zanto said Mr. Miltenberger had indicated to him that he would be happy to serve on the selection committee. The Chair said he thought about volunteering for this task as well; however, he is already in an RFP process for a new pharmacy benefit manager on the State's health plan which overlaps the timeframe for MSF's RFP.

President Hubbard asked Ms. Grosfield and Curtis Larsen, Interim General Counsel, if two members of the Board would be a sufficient selection for the committee.

Ms. Grosfield said two Board members would be sufficient.

Chair Zanto confirmed that Ms. VanRiper and Mr. Miltenberger would serve on the auditing firm RFP evaluation committee.

President Hubbard notified the Board that since the March 11, 2016 Board meeting, MSF did file the loss cost multipliers with CSI which were then approved on April 11. This means MSF's first rate filing has been completed and approved. He congratulated the Board and staff for doing an excellent job completing the filing. He said there is more work to be done on forms approval and the group rating plan review that is currently in progress; however, MSF is moving forward. He also mentioned that the first Quarterly Financial Statement was filed the previous day with CSI.

C. *Annual Business Plan – Shannon Copps, Director of Enterprise Strategy and Project Management*

Ms. Copps provided the key success measures for the 2016 Business Plan and the projections to date.

Key Success Measures

KSM	2016 BP	2016 Projected
Net Earned Premium	$162.0M	$165.1M
Fiscal Year Loss Ratio	78.6%	75.1%
Expense Ratio	28.6%	26.9%
Investment Income	$44.1M	$50.4M
Net Operating Income (before dividend)	$27.3M	$42.7M
Achieve Enterprise Wide Initiatives		

Ms. Copps explained that the net operating income is projected to be $15.4 million over the business plan of $27.3 million before dividend. She said the key drivers of that increased projection are investment income and premium increase and $3 million less in losses than was planned.

Chair Zanto called for questions; there were none.

Ms. Copps then provided a review of the status of the enterprise wide initiatives which concentrate in customer service and infrastructure. She said the Policy and Billing System Replacement project in the Customer Service category was off track due to the initial assessment of the vendor that indicated areas for improvement within the project. The called-for improvements created time constraints to the project due to the need for increased team members, yet those team members were already dedicated to other pressing business functions such as continued regulation implementation. To mitigate this risk, the project schedule to begin requirements documentation was moved out two months which also moved the RFP schedule out two months as well.

The Infrastructure projects regarding change management and communication, rates and rate filing, regulation and calendar year conversion were on track and projected to be completed by year end. She provided an update on the functions being completed within each initiative and the commitments that will be completed by year end.

Chair Zanto called for questions. There were none.

III. Purchase of Parking Structure from City of Helena – Laurence Hubbard, President/CEO

President Hubbard reminded the Board that a vote was taken by the Board on March 11, 2016 to approve staff to proceed with negotiations regarding the purchase of the parking structure attached to MSF's building. He stated on April 14, 2016, Helena City Manager, Ron Alles and President Hubbard appeared before the Economic Affairs Interim Committee (EAIC) to present the proposal and receive legislative input. The EAIC, with a vote of six to two, recommended against MSF purchasing the parking structure and stated such in a letter addressed to the Board and dated April 14, 2016. The EAIC recognized that the Board has sole authority to manage the operations of MSF to go forward with whatever it deemed prudent. President Hubbard provided a memo to the Board dated May 9, 2016 that summarized his recommendation:

He said while management continues to believe a negotiated purchase of the parking structure would be in the long-term best interest of Montana State Fund policyholders, it is important that the Board and management consider legislative input in making any recommendation and in the Board's decision making process. He quoted the memorandum, "On balance, the value of remaining sensitive to legislative policy maker's concerns outweighs the business value in acquiring the parking structure at this time. MSF negotiated and maintains a responsible lease arrangement with the City of Helena for employee parking. This arrangement meets the immediate and mid-term needs of MSF and its employees and customers. For the foregoing reasons, I am formally withdrawing my recommendation to pursue purchase of the 15th Street parking garage."

Chair Zanto moved the Board to direct staff not to proceed with negotiations for purchase of the parking structure from the City of Helena. Ms. Moss seconded the motion. Chair Zanto called for discussion.

Mr. Mihelish asked if the monthly fee that MSF pays to lease the parking structure was anticipated to increase and, if so, when.

President Hubbard said MSF is anticipating increases of three percent per year throughout the 30 year lease, however the City of Helena parking commission sets the rates based on the city-wide budget which takes all the parking structures owned by the city into consideration.

Chair Zanto called for additional questions from the Board and questions from the audience; there were none. He called for the vote and the motion passed unanimously.

IV. General Counsel's Office – Curtis Larsen, Interim General Counsel

A. Administrative Rules – Proposed Adoption of Amendment to ARM 2.55.502 – Individual Loss Sensitive Dividend Distribution Plan – Board Action

Mr. Larsen provided an update on the administrative rule adoption that was completed at the March 11, 2016 Board meeting and explained that as a result of SB123, the Montana Legislative Services Division (LSD), upon review, questioned whether the Board still has the authority to amend administrative rules after January 1, 2016. Upon further reflection, Mr. Larsen agreed that LSD had a valid point. He said that management recommends the Board not proceed with amending the ARM rule; however the amendments to the Board's policies, procedures, rules and guidelines can and should proceed at this time. He said the Board's policies and rules can be applied to all policies that participate in the dividend declaration, since the next declaration will take place after July 1, 2016.

He clarified that the proposed amendment to both the ARM and the Board's policies would allow individual retrospectively rated policies (retro policies) to participate in the Board's dividend declaration. Retro policies have the final premium calculated sometime after the policy period ends, typically 24 months after the policy start date. The proposed change will allow a retro policy to participate in a general dividend as long as final premium on the policy has been determined by the dividend valuation date. The final premium date for most retro policies will fall before the dividend valuation date, qualifying them to participate in a general dividend distribution. This rule change applies to approximately 8-12 policies.

Mr. Larsen said management's recommendation is to modify the language in the Board's policies and rules to provide that the dividend rules will apply to all policies and that the Board not proceed with the ARM rule change.

Chair Zanto called for questions or discussion from the Board and the public. There was none.

Mr. Mihelish moved the Board not to proceed with the adoption of the proposed amendment to ARM 2.55.502. Lynda Moss seconded the motion.

Chair Zanto asked if this non-action would align correctly with CSI regulation.

Mr. Larsen said this amendment really does not have much to do with MSF's insurance regulation by CSI. Dividends are not regulated by CSI; this is primarily under the Board's discretion.

President Hubbard explained further that this was an issue that affected retro policies due to fiscal year calculations and by the Board taking this action, MSF can provide better service to its customers.

Chair Zanto called for discussion and comments from the audience; seeing none, he called for the vote and the motion passed unanimously.

B. Adoption of Amendments to Board Policies, Procedures, Rules and Guidelines – Rule 14 - Individual Loss Sensitive Dividend Distribution Plan

Mr. Larsen requested that the Board adopt the motion to change the Board policies, procedures, rule and guidelines.

Lynda Moss moved the Board to adopt amendments to the rules in the Board Policies, Procedures, Rules and Guidelines, as presented to the Board, for the purpose of allowing retrospectively rated policies to participate in general dividend declarations. Mr. Owens seconded the motion. Chair Zanto called for questions or discussion from the Board and the public. There were none and he called for the vote. The motion passed unanimously.

V. Corporate Support – Mark Barry, VP Corporate Support

Chair Zanto stated that due to the Board being ahead of the proposed agenda times, agenda item five B would be presented and discussed to fill until the Board of Investments representatives arrived.

A. *Board of Investments Update – Joseph Cullen, Chief Investment Officer and Jon Putnam, Investment Analyst*

This item was deferred until later.

B. *Approval of Fiscal Year 15.5 Audited Financial Statements*

Mr. Barry introduced John Carpenter, Senior Accountant and Kent Schlosser, Financial Analyst and said they are responsible for financial reporting and tracking of MSF's investments.

He said draft financial statements were presented in March when the loss and LAE reserves were approved. MCA 39-71-2363, requires MSF to submit an annual financial report to the Governor and the Legislature that includes a statement of liabilities as determined by the independent actuary. Given that requirement, management will ask the Board to approve, for submittal to the Legislative Audit Committee (LAC), the Fiscal Year 15.5 financials. He noted that the statutory audit has been completed as reported earlier by Ms. Grosfield and MSF will appear before the LAC on the GASB financial audit in June 2016. He added that the first quarterly financial report was filed with CSI on May 12, 2016 three days prior to the May 15, 2016 due date.

Mr. Barry provided a review of the FY15.5 balance sheet assets, liabilities and equity. He noted that based on suggestions from MSF's auditor, more line items and descriptions were being provided to allow for greater transparency.

He then provided a review of the FY15.5 income statement and noted there was a $12.5 million loss after the $35 million dividend declaration which made the ending equity $505 million. The reconciliation of the FY15.5 statutory equity to GASB net position illustrated the reporting differences between those accounting principles and showed the statutory equity at $505 million with GASB net position at $514 million.

Mr. Barry asked the Board to approve the FY15.5 financial statements for MSF's annual reporting purposes.

Chair Zanto moved the Board approve the financial statements prepared on a statutory accounting basis as audited by Eide Bailly, along with a financial reconciliation of surplus between the GASB financial statements, subject to any adjustments, and the audited statutory financial statements. Mr. Mihelish seconded the motion. Chair Zanto called for questions or discussion; there were none. He called for the vote and the motion passed unanimously.

A. *Board of Investments Update – Joseph Cullen, Chief Investment Officer and Jon Putnam, Investment Analyst*

Mr. Barry said the Montana Constitution calls for the investments of MSF to be managed by the Montana Board of Investment (BOI). MSF works closely with BOI in monitoring and handling MSF's investments. He noted there was a management change at BOI when the Chief Investment

Officer and the Investment Manger that oversaw MSF's investment portfolio both retired. He introduced BOI's new Chief Investment Officer, Joe Cullen and MSF's Investment Manager, Jon Putnam.

Mr. Cullen said he was hired after the former Chief Investment Officer, Cliff Sheets' retirement and began with BOI on November 2, 2015. He has over 25 years of institutional investment experience in quite a spectrum of different asset classes and different institutions. Rich Cooley also retired and Jon Putnam has taken over the day-to-day responsibility of MSF's portfolio.

Mr. Putnam told the Board he has been with BOI for 11 years and began as an equity analyst. He said he worked on the fixed income portfolios with Mr. Cooley for the past nine years so is very familiar with the MSF portfolio.

Mr. Cullen said MSF's portfolio is largely composed of fixed income securities and smaller percentages in equities, real estate and cash. He said it is a very diversified portfolio but very much geared to the fixed income side given the income orientation. The allocations are within the policy percentages and the targets are appropriate. The performance has remained relatively stable; however, the returns have dropped because fixed income yields and rates have continued to come down over this period. The portfolio's actual performance has done better than expected and has benefited over the last few years from an additional allocation to equity and real estate. He said the portfolio has also benefited from active management on the fixed income side.

Mr. Cullen asked if there were any questions on the asset side of the portfolio.

President Hubbard thanked Mr. Cullen for presenting and asked that he address the adjustments to MSF's investment policy that were adopted by BOI.

Mr. Cullen said the adjustments to the investment policy were consistent with historical practices and though not extremely significant changes, they do provided clarification of a couple of items. For instance, there is policy statement clarification that highlights the ties to legal and constitutional authority. The allocations for fixed income have been set at a minimum of 75 percent which was previously expressed by a number of different ranges for types of fixed income. He said the change in policy did not have a meaningful impact in how the portfolio was managed; it simply clarified and simplified flexibility.

President Hubbard noted these changes mean the Board of Investments and portfolio managers are no longer forced to take transactions in order to stay within policy and can respond to the market dynamics without being detrimental to the portfolio.

Mr. Cullen said these changes are important for the equity and real estate side. Previously the equity had been defined as a range of eight to 12 percent and that was redefined as a maximum of 15 percent. This provides increased flexibility. This does not change the expected returns but allows BOI to manage the portfolio with a long-term perspective rather than a short-term reaction to what is happening in the market.

Mr. Mihelish asked how 9.3 percent gain in a year in the core real estate investment was achieved.

Mr. Cullen explained that the portfolio managers concentrate on buying institutional-quality real estate that is typically 90 percent leased or more. Over a longer period of time the expectation of this investment is income and income above what can usually be achieved in the fixed income markets.

Ms. Moss noted that her experience serving on the Northwest Area Foundation Board as well as their investment committee has taught her about filter usage for asset allocation and the Foundation's portfolio. She said the investment managers for the Foundation use environment, social and governance filters to assure investments really adhere to sound public policy. She asked if BOI utilizes these types of filters.

Mr. Cullen said BOI does not use those types of specific governance filters; however, they look for a high degree of ethics and quality in the managers hired as well as fixed income securities that are purchased on behalf of MSF. He said BOI invests in the broad opportunity set across the equity, fixed income and real estate markets.

President Hubbard said that was a timely question and asked if there were any governance filters applied to any of the investments that BOI makes for any of their clients in Montana.

Mr. Cullen said BOI does not utilize governance filters for any of the funds they invest for. He noted that there are probably several hundred filters that could be applied in this phase which could render investments virtually non-existent. He said BOI's focus is squarely on providing the best investment policy and portfolio that meets the best risk and return needs of MSF. He then turned the presentation over to Mr. Putnam.

Mr. Putnam provided a different way of measuring the performance of the portfolio by clarifying that BOI manages it as an income return. He said the primary goal of this portfolio is to provide investment income with a prudent level of risk. BOI looks for steady returns to meet liabilities and maintain stable, cost effective workers' compensation rates. He said income return is derived from collecting the interest in coupon payments from bonds or the lease and rental payments from MSF's core real estate portfolio. He provided the Board with an overview of MSF's investment performance and the transaction activity during the first quarter of 2016.

Mr. Putnam summarized that MSF's investment pool continues to perform well with an emphasis on income return versus price return. He said the low interest rate environment continues with low economic growth and weak economic growth outside the United States. Inflation is relatively low and U.S. equity and core real estate are at near highs. He said there is no expectation of a recession at this time.

Chair Zanto called for questions; there were none. He thanked the BOI representatives for their time and presentation.

C. *Calendar year 2016 First Quarter Financial Report*

Mr. Barry reported that as of the end of March 2016, MSF's assets had decreased by approximately $45 million with $24 million of that due primarily to the dividend that was paid out. He said the loss and LAE reserves increased $1.2 million during this quarter with $1 million of development on prior years. Prior year development was very moderate compared to projections, so was well within the planning horizon. Equity at the end of the first quarter was $515 million which indicated a $10 million increase from the end of the year. He said the reserve to equity ratio is strong; at the end of FY15.5 that ratio was 1.78 and is now 1.75.

He said income was at 6.7 million for the first quarter and projected to be $42.6 million for the year. Net earned premium is projected at $165 million which is 1.9 percent or $3.1 million above the annual business plan of $162 million. A zero rate change is anticipated and there are indications of strong account retention and some additional growth in wages. Operating results indicate that incurred losses are expected to be better than planned at $124.1 million, which is about $3 million below planned with a better loss ratio as well. He said net income is projected to be $42.7 million before any dividend declaration which will be addressed at the September Board meeting. He concluded that financials indicate another strong year highlighted by a series of years of very consistent performance for MSF.

Chair Zanto called for questions.

Mr. Mihelish asked if there was a way to measure how much new business was flowing into MSF and how much was being attracted to MSF.

Mr. Barry said currently there is a slight net loss of business.

Julie Jenkinson, Vice President, Operations, said the amount as of July 2016 is approximately $800,000 which is small amount compared to the overall book of business. MSF has been asked to quote about 100 accounts, which is a large number for MSF; however, a small number compared to other states and private carriers. She commented that MSF has seen a lot of trading of business; however that has begun to taper off.

Chair Zanto noted that he too wondered what the mix was for renewals.

Ms. Jenkinson said the retention rate is currently at 96 percent for both policies and premium, which is very strong. That rate is expected to drop slightly but not below 92 percent.

Mr. Mihelish noted that MSF just wrote the Helena School District and wondered if MSF was going to focus on attracting more school districts.

Ms. Jenkinson said that MSF is here as an available market but also wants to be competitive. Securing the Helena School District was in large part because of the response received from the Butte School District. MSF's safety representative worked with the Butte School District's representative and they were successful in improving their safety record there. The Helena School District was also not really happy with the service they were receiving from their last insurer and MSF is a leader in customer service and demonstrated that to the Helena School District. She said that though MSF will not be actively soliciting other school districts, MSF will work with its agents to take advantage of any opportunities that do arise.

Chair Zanto called on Bob Biskupiak to address the Board on this discussion item.

Mr. Biskupiak noted that it is the agent's job to grow the revenue and retain good business. He said that though there are a lot of new businesses in Montana, they are small so those new revenues do not add up to great amounts of money. He also mentioned that current discussions indicate that the Bakken is trending down and those opportunities are leveling out.

Chair Zanto called for additional questions and public comment; there were none.

D. *Calendar Year 2016 First Quarter Budget Report*

Ms. Martello said MSF variances for 2016 projections are based on actual expenditures of the first quarter. She said claim benefits payments were planned to be $126.3 million; however, are now projected to be at $123.2 million which is $3.1 million under budget due to medical expenditures. She said indemnity is expected to be close to plan though still under by $64 thousand however medical, excluding medical settlements, is projected to make up the $3.1

million under planned. Medical settlements and undisputed medical settlements are projected to be below planned amounts by 17.2%; however, these categories of medical expenditures have had significant monthly swings in the first quarter: $1.6 million in January and $2.9 million in March.

Ms. Martello provided a breakdown of the operations expenditures which are comprised of equipment and intangible assets, operating expenses and personal services and were planned at $55.7 million. Those expenditures are now projected to be $54.8 million which is approximately $956,000 under budget.

Chair Zanto asked if the savings that are being seen in medical were due to the rate reductions taken when HB334 was passed.

President Hubbard said MSF has been seeing improving trends in medicals which may or may not be related to HB334. He said improving medical trends are being seen nationally and it could be due to a heightened awareness regarding opioid abuse. MSF is concerned about the savings embedded in the rate structure for the HB334 provision allowing for termination of medical benefits after five years. It is unclear how substantial the constitutional challenges will be to that provision and it will take several years before those challenges will play out.

E. *Data Measurement Criteria for Premium & Incurred Losses for Potential Dividend Declaration*
Ms. Martello explained that the Board will be asked to approve a table of dividend factors at the September Board meeting. She said management recommended the Board establish the measurement criteria for when losses in premium will be valued utilizing June 30, 2016 for policies with coverage effective between July 1, 2013 and June 30, 2014.

Mr. Mihelish moved the Board approve management's recommendation to utilize June 30, 2016 as the date to value premium and incurred losses on new and renewal policies from July 1, 2013 through June 30, 2014 for potential dividend calculation purposes. Ms. Moss seconded the motion. Chair Zanto called for discussion and questions from the public; there were none. He called for the vote and the motion passed unanimously.

F. *Old Fund Variance Report – State Fiscal Year 2016 Third Quarter*
Ms. Martello reminded the Board that the Old Fund still functions on a Fiscal Year basis and will continue to do so. She provided an Old Fund variance report and noted that the funding estimate is over by $1.5 million due to benefits being over by $1.4 million and operational expenses over by $100,000. The funding for the Old Fund is provided by the General Fund and MSF staff have been in discussions with the Budget Office regarding the increased costs.

She provided a view of the claim caseload trends and fluctuations which illustrated the reason for the increased expenditures and the lack of predicted decreases in claim loads. She noted there has been an increase in asbestos claims reported as well as an increase in required medical procedures. She said indemnity payments are close to expected; however, medical expenses are over by $268,000 which was primarily caused by medical settlements. She said that as more benefits are paid, there is an increase in administrative costs and DOLI assessments. The budget change and the funding estimates have been increased so the funds are available to pay the expenses.

Ms. Moss asked for more detailed explanation of the settlement process and who originates the request to settle.

President Hubbard asked Ms. Jenkinson to explain the process.

Ms. Jenkinson said the request to settle can initiate from either the claimant or MSF. Once the claimant has reached a level of maximum medical improvement (MMI), MSF evaluates each claim carefully to determine if settlement is in the best interest of MSF and the injured employee. She noted that settlements offer injured employees the independence to determine their own medical issues. She said if an injury is so severe that the injured employee would not be capable of handling difficult medical decisions, MSF does not entertain a discussion to settle.

President Hubbard added that the Department of Labor and Industry reviews all settlements as an independent third party to ensure that they are fair and equitable.

Ms. Jenkinson added that in addition to that review, MSF submits information that illustrates why the settlement is in MSF's best interest and the injured employee also submits similar information.

Chair Zanto asked Ms. Jenkinson to elaborate on what causes an Old Fund claim to be re-opened.

Ms. Jenkinson said typically that is due to an injured employee having not sought treatment for a long period of time then suddenly seeking medical treatment for the original injury.

Chair Zanto asked how MSF was addressing the asbestos claims, particularly since many of the responsible employers are no longer in existence.

Ms. Jenkinson said MSF has assembled an asbestos panel that is comprised of legal representatives, a dedicated claims examiner from each of the six teams and their managers. The panel thoroughly investigates policy records to evaluate coverage responsibility and to determine when the employee experienced the asbestos exposure. Members of the panel then investigate to ensure an asbestos-related disease exists and the claimant is not just filing to preserve their rights. When the panel determines there is asbestos disease and MSF is the responsible insurer, the claim is accepted and handled or settled as any other claim would be.

Chair Zanto referred back to the medical re-openings and asked if those requests were scrutinized and thoroughly investigated.

Ms. Jenkinson said the re-openings are closely looked at to determine that the medical request is on the original injury and that the claimant did not suffer an additional injury. Once determined that the medical issue is related to the original injury, MSF sees that the needed medical services are provided.

President Hubbard added that the legal standards for the medical burden of proof on Old Fund claims are much less stringent than the laws that apply to the New Fund. Statute changes now require that there has be objective evidence and a more-probable-than-not determination by the medical provider that the issue related to the original injury.

Chair Zanto called for additional questions; there were none.

G. *Old Fund Funding Estimate – State Fiscal Year 2017*
Ms. Martello provided the FY17 funding estimate which, once approved, will be provided to the Budget Office and Department of Administration and establishes the spending authority on the state's accounting system for the next fiscal year.

She said management is recommending that the payment and operations expenditures remain at similar levels as the Fiscal Year 2016 estimate. She provided historical data on Old Fund benefit payments and stated that the high was $98 million in FY91; however by FY05 it had dropped to $10.7 million and has remained at or below that level since. The claims are expected to eventually expire; however, claim re-openings and medical inflation have kept the benefit estimate at approximately the same level for the past several years.

State of Montana – Old Fund
FY17 Funding Estimate

Claim Benefit Payments	$8,726,420
Operational Expenses	
Cost Administering Old Fund	$774,928
DoLI Assessments	168,368
Claim Liability Review	0
ALAE	183,110
Total Operational Expenses	$1,126,406
Total Old Fund	**$9,852,826**

Ms. Martello noted that Old Fund estimates are projected to remain flat; however, clarified that unexpected increases in unplanned asbestos claims or significant high dollar settlements could have an effect on the total expenses. She noted there is a decrease in the cost of handling the Old Fund claims which lowers the operations expenses; however, the DOLI assessments and allocated loss adjustment expenses will remain the same.

Chair Zanto called for questions.

Mr. Mihelish noted that the Old Fund has now been around for over 25 years and wondered if there were predictions as to when the Old Fund would play itself out.

Ms. Martello said the final estimated payment is projected to be paid out in 2052 with steep decreases expected to occur as the timeline goes on.

Mr. Mihelish sought clarification as to whether the age 65 cut off applied to Old Fund claims.

Ms. Martello said that law was passed later so the Old Fund claims are lifetime medical and benefits claims.

Chair Zanto asked if his recollection was correct that there were a small number of claims that account for the majority of costs in the Old Fund.

Ms. Martello said there are approximately ten claims that account for 75 percent of the liability. They are claims that are reserved at over a million dollars per claim and some at five or six million.

Mr. Hubbard asked Mr. Barry what the average age of the high-cost claims in the Old Fund were.

Mr. Barry said the average age is 62 years.

Mr. Zanto Called for additional questions or comments.

President Hubbard said that while there is considerable uncertainty about the length and duration of the ultimate future liabilities, he clarified that the Old Fund spending estimate is really for the dollars that MSF will be spending to manage the claims.

Mr. Owens made a motion the Board approve the executive staff recommendation of $9,852,826 for the FY17 Old Fund estimated benefit payments and administration costs for reporting to the State of Montana for funding from the general fund. Ms. Moss seconded the motion. Chair Zanto called for discussion or questions.

Chair Zanto recognized Senator Keane and thanked him for taking the time to attend the Board meeting.

Senator Jim Keane thanked Chair Zanto and the Board. He said as we approach the next legislative session, he often hears that State Fund is a business but it is a state business. And even though MSF is under the State Auditor's office, the legislature has a big responsibility and needs to understand how the business is being managed. He said, "As a long-time observer of the business, it has been my contention, over a number of years, that the equity is increasing at a [fast] rate. I understand that you need equity, but the amount of equity you need is different. And when someone stands up and says we have a strong year, that's great, you had a strong year for a lot of years. And I appreciate the Board putting out the dividend. And as you know I had a bill for $50 million for two years. Actually you would have been even if you had actually put $50 million out. So as you approach the dividend here, I think you need to take a look at how much the equity is. I am really struggling with the businesses of Montana. You return money to them and they have to pay taxes on it. That is what happens. They are already paying up front. I think it would be wise for the Board in the future to consider to reduce premiums across the board in order to adjust the equity. I mean, why should they pay more than they have to and then later you give them money back that they have to claim it and pay more taxes on? I just can't quite get there on that. The other issue, I know, you need a strong business but you don't need to overcharge. That's what's in Montana law and that's what… You are not supposed to collect more or less than is required and that is your decision as a Board. While we work with that in the legislature, there gets to be a contention of how that is supposed to operate but that is your job. So I think you need to take a look at reducing the business and when the NCCI says reduce by three percent and you guys, as a Board, that's where the decision comes from, hold even, I guess, I am struggling with why you didn't go to the reduction percentage that the NCCI recommended to everybody. And so I would request that you kind of take a look at that. If they say reduce three percent, reduce three percent, that is what the other providers are doing, it's my understanding. So I think that is something to consider.

The other thing I am having a tough time on is the Old Fund being managed by the State Fund. And I don't know how to quite get my mind around that but when we talk about reducing cases, and I get the medical and I get the other stuff, but we still stay at $9 million for the last number of years and that is coming out of the general fund. Every tax payer in the state of Montana is paying for that, and that's the way it is. But there should be some kind of a management tool and I've heard maybe you need to have the 12 cases but I guess what are we going to do? Keep adding asbestos cases. If we are going to add new cases and then automatically turn them over to the Old Fund is that fair? When a new asbestos case comes in, and you say well that happened in the Old Fund and we really don't know when it happened but we'll put it in the Old Fund where the tax payer of the state of Montana has to address that issues or pay for that issue until it is off the books. So, I am approaching the next legislative session and I want Mr. Hubbard to know that I will sure provide some creative business for him to the best of my ability to try to keep everybody happy here."

Chair Zanto called for additional public comment and comments from the Board members. Seeing none, he called for the vote and the motion passed unanimously.

VI. Old Business/New Business

Chair Zanto called for Old or New Business. There was none.

VII. Public Comment

Chair Zanto called for public comment. There was none.

The meeting was adjourned at 11:43 pm. The next scheduled Board Meeting will be held on Friday, September 16, 2016 at 8:30 a.m. in the Board Room at Montana State Fund, 855 Front Street, Helena, Montana.

Respectfully submitted,

Verna M. Boucher
Special Assistant to the President/CEO