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MONTANA STATE FUND
BOARD MEETING
September 16, 2016

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

Directors Attending

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

MSF Staff Attending

Laurence Hubbard, President/CEO
Verna Boucher, Special Asst to Pres/CEO
Curtis Larsen, Interim General Counsel
Kevin Braun, Assistant General Counsel
Mark Barry, Corporate Support VP
Sam Heigh, Insurance Ops Support VP
Rick Duane, Human Resources VP
Julie Jenkinson, Operations VP
Ethan Heverly, Dir. Gov. and Community Relations
Tammy Lynn, Safety Services Team Leader
Mary Boyle, Communications Specialist
Shannon Copps, Director, ESPM
Patti Grosfield, Internal Auditor
Rene Martello, Controller
Dan Gengler, Internal Actuary
Shalini Mahanty, Enterprise Applications Dir.
Nick Hopkins, Business Unit Director
Darcie Dunlap, Actuarial Analyst
Peter Strauss, Compliance Specialist

Others Attending

Russell Greig, Willis Towers Watson
Bill Wheeler, Legislative Audit
Mari Kindberg, State Auditor's Office
Bob Biskupiak, IIAC
Rep. Ryan Lynch
Eric Strauss, ERD Administrator
Leslie Vernon, Willis Towers Watson
Brenda Miller, Liberty
Steve Matthews, State Auditor's Office
Bridger Mahlum, Montana Chamber
Pat Murdo, LSD

I. Meeting Preliminaries

A. Call to Order

Chair Lance Zanto called the meeting to order at 8:32 a.m. He thanked those present for attending and noted that Board Member, Matt Mohr was commuting from Big Sky that morning and would be a little late.

B. Approval of May 13, 2016 Board Meeting Minutes

Chair Zanto noted that the first order of business was the approval of the Board meeting minutes for May 13, 2016.

Jan Van Riper made a motion to approve the May 13, 2016 minutes. The motion was seconded by Richard Miltenberger. 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 was unanimously approved.

II. Miscellaneous – Laurence Hubbard, President

A. Miscellaneous – Laurence Hubbard, President/CEO

President Hubbard also welcomed the attendees and thanked them for attending.

- President Hubbard introduced Kevin Braun, the newly hired General Counsel for MSF. He noted that Mr. Braun has been with MSF since 2005 and has served as Counsel and Assistant General Counsel with a focus on claim function management and management of the claim attorneys. He is a graduate of the University of Montana and spent ten years as the Chief Legal Counsel at the Department of Labor and Industry prior to coming to MSF. He said Mr. Braun is a remarkable leader and MSF is very pleased to have him join the Executive Team.

  President Hubbard also took a moment to thank Curtis Larsen, Assistant General Counsel for serving as the Interim General Counsel from Nancy Butler's retirement in January until Mr. Braun's hire. He said Mr. Larsen provided excellent support and leadership to the Executive Team as well as the Legal Department during that interim.

Board Member Matt Mohr joined the meeting.

- President Hubbard shared the proposed 2017 Board meeting schedule with the Board and asked them to review their calendars and provide their availability conflicts or concerns to Ms. Boucher. He noted that the March rate making meeting and the September consideration of dividend issuance are key meeting dates as well as the December meeting that approves the budget and business plan for the next business year. He also advised the Board that it may be necessary to call a Board meeting during the 2017 Legislative Session. Mr. Hubbard said he appreciates the Board members' dedication and service to MSF. The members' leadership and participation in these very important decisions is valued greatly by MSF staff and management.

- Mr. Hubbard reported that the Annual Business Plan, which Shannon Copps will provide an update on later in the meeting, includes a very significant business initiative, the Policy and Billing Replacement Initiative (PBRI). The Board had approved hiring a consultant to assist in the development and documentation of requirements for a new system. He explained there are two components to the system; claim center which is supported by Guidewire and the policy system that is supported in house. He said the current policy system is 17 years old and has served MSF well; however, it is not technology that allows MSF to interact and interface with its customers in a user-friendly way. There are additional compliance requirements now that MSF's oversight is through the Commissioner of Securities and Insurance (CSI). He said eventually, he will be approaching the Board for a \$10 to \$15 million investment in a replacement system and wanted to prepare them in advance for the budget request for this important initiative. President Hubbard said there are a number of steps that must be completed before that final request. The requirements must be defined and a Request for Information (RFI) will need to be issued to determine the pricing structures and mechanisms vendors are using for these products. There are approximately 105 global requirements that have been identified by the requirements team and of those, 57 are core requirements that are already in current processes and will need to be retained in the new system. He said 34 new functionalities not in the current system have been identified and determined to be essential for the new system. He added that 14 of the processes relate to the automatization of processes that are currently completed manually. As the project moves forward and the requirements are determined, the Board will be updated and approached with a final proposal; however, until that time, he assured the Board that no action or commitments have been entered into unless previously approved by the Board. He said it is anticipated this project will last several years.

- President Hubbard reported that Peter Strauss, MSF Compliance Officer, has been working with Joe Beniek, an experienced micro market conduct examiner in the insurance industry. Mr. Beniek has been reviewing MSF's processes, guidelines, policies and procedures to assure they are in compliance with the insurance regulator's requirements prior to CSI conducting a market conduct exam on MSF. He is reviewing approximately 50 files to test MSF's documentation of policy files issued since January to determine if there are any gaps that need to be corrected.

Chair Zanto asked if the selection of policies for review was a random sampling.

Mr. Strauss said the sampling is random.

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

Ms. Grosfield reported the governmental financial statement audit for the six-month period ending December 31, 2015 was completed by the Legislative Audit Division (LAD) and presented to the Legislative Audit Committee (LAC) on June 16, 2016. Representatives from MSF attended the LAC hearing, provided a response and answered questions. MSF received a clean audit report with an unmodified opinion and no recommendations.

External

- She reported that the Pharmacy Benefit Manager audit was in progress for the current vendor, Express Scripts (ESI). The consulting firm of David Donn Consulting is currently reviewing the data and a November 15, 2016 report is expected on the workings and controls surrounding the vendor.
- Ms. Grosfield said MSF's first calendar year statutory financial statements audit for CY2016 will begin soon. There will be preliminary fieldwork in December 2016 with pre-testing because a report is due by March 1, 2016. The final fieldwork will be completed in February 2017, with the final report to follow in the spring.
- She said the first calendar year Legislative Audit Division governmental statements audit for 2016 will begin with fieldwork in the spring of 2017.

Internal

- She noted that if the Board declares a dividend today, she will begin that audit in the next few weeks.
- The agent incentives audit which is based on agents' books of business and their profitability and retention, will be conducted by January 2017.
- She will also be reviewing various internal controls on an on-going basis.
- Ms. Grosfield said the Enterprise Risk Management (ERM) team recently identified the top risks for 2017 and she will begin to audit the controls to assure they are in place and working as intended.

Chair Zanto asked what the Pharmacy Benefit Manager audit would be looking for when auditing Express Scripts.

Ms. Grosfield said they will be looking at compliance with our service level agreements and clarified that this is not a financial audit of Express Scripts; it is an audit to determine that controls are in place surrounding their services to MSF.

Chair Zanto called for questions; there were none.

C. *Statutory-Basis Financial Statement Auditing Services – Award of Contract – Patti Grosfield, Internal Auditor*

Ms. Grosfield said per regulation, it is mandatory to prepare and have audited MSF's statutory financial statements every year. The auditing firm that was hired in the last request for proposal (RFP) was Eide Bailly. The RFP cycle runs seven years and is currently in the last year; therefore, the Board directed MSF to issue an RFP for audit services. The RFP was issued on May 24, 2016. An RFP Evaluation Committee was formed consisting of Board members Jan VanRiper and Richard Miltenberger and MSF staff Patti Grosfield, Internal Auditor; Rene Martello, Controller; and John Carpenter, Senior Accountant. Curtis Larsen, Interim General Counsel, participated in an advisory capacity. Five proposals were received; one was disqualified due to missing the July 15, 2016 deadline. The proposals were individually rated, the Evaluation Committee engaged in active discussion and the consensus scoring was completed at a public meeting that was noticed as required by law. Eide Bailly achieved 95 total points to win the contract.

She stated that the RFP initial contract period is two years, October 1, 2016 through September 30, 2018 and is renewable in one-year intervals up to a total of seven years with a cost not to exceed $79,000 per year. She noted that the draft of the contract included in the Board's packet did not contain the following standard contract term: "The parties may mutually agree to a renewal of this contract in one year intervals or any interval that is advantageous to MSF. This contract including any renewals may not exceed a total of seven years at MSF's option." She requested that the Board approve the addition of this language when and if they approved awarding the contract to Eide Bailly LLP.

President Hubbard asked MSF staff to have copies with the complete language available for the Board.

Ms. Grosfield concluded that the RFP Evaluation Committee recommends the contract for upcoming statutory financial statement audit services be awarded to Eide Bailly LLP and requested the Board's approval.

Bruce Mihelish made a motion to approve awarding the contract for Statutory Basis Financial Statement Auditing services to Eide Bailly. Jack Owens seconded the motion. Chair Zanto called for discussion.

Ms. Van Riper commented that this was her first opportunity to serve on a subcommittee of the MSF Board and work closely with staff. She commended the MSF staff for their professionalism and said she felt privileged to have worked with them.

Chair Zanto thanked Mr. Miltenberger and Ms. VanRiper for accepting this RFP assignment and working with the committee to complete the process.

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

Chair Zanto recognized Representative Ryan Lynch, MSF's Legislative Liaison to the Economic Affairs Interim Committee (EAIC) and thanked him for attending. He also took a moment to welcome Eric Strauss, Administrator of the Employment Relations Division at the Department of Labor and Industry, as well as Steve Matthews from the State Auditor's Office.

D. *Willis Towers Watson Actuarial Contract*

President Hubbard provided information on the renewal of the Willis Towers Watson contract. He explained that during each interim year there is an opportunity to discuss increases in the hourly billing rates for the Willis Towers Watson actuarial contract. He noted that the proposed increase was approximately 2.5 percent and that management found this request reasonable. Mr. Hubbard said management recommended the Board approve the rate increase and extend the contract for another year.

Chair Zanto called for a motion.

Mr. Miltenberger made a motion to approve the proposed amendment of the independent actuary contract with Willis Towers Watson. Lynda Moss seconded the motion. Chair Zanto called for discussion and public comment. Seeing none, he called for the vote and the motion passed unanimously.

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

Ms. Copps provided the Calendar Year 2016 Business Plan performance update. She provided the Key Success Measures outlined below.

Key Success Measures

KSM	2016 BP	2016 Projected
Net Earned Premium	$162.0M	$165.3M
Fiscal Year Loss Ratio	78.6%	76.0%
Expense Ratio	28.6%	28.0%
Investment Income	$44.1M	$50.1M
Net Operating Income (before dividend)	$27.3M	$40.1M
Achieve Enterprise Wide Initiatives		

Chair Zanto called for questions. There were none.

Ms. Copps defined the Enterprise Wide Initiatives

Customer Service

- Policy and Billing System Replacement – Sponsors: Julie Jenkinson, Al Parisian and Sam Heigh – this project is to replace a policy and billing system that was implemented in 1997 to improve functionality and efficiencies. This multi-year project is off track due to a two month delayed start date of the requirements gathering sessions to allow business team members to focus on renewals for July 1 as well as key regulation activities that were occurring in March and April.
- Since implementation, progress has been good and the requirements development is nearly completed.

Infrastructure

- Regulation – Sponsors: Mark Barry and Julie Jenkinson – implementation of Title 33 continues. This project is on track and will be completed by year end.
- Calendar Year Conversion - Sponsors: Mark Barry and Al Parisian – Completed
- Rates and Rate Filing - Sponsor: Mark Barry – Completed
- Change Management and Communication – Sponsors: Mark Barry and Al Parisian – The focus of this project was to provide updated information to employees so they remained well informed of the conversion process and changes. – This project is on track and completed.

Chair Zanto called for questions or comments; there were none.

III. Corporate Support – Mark Barry, VP Corporate Support

A. *Calendar Year 2016 Second Quarter Financial Report – Mark Barry, V.P. Corporate Support*

Mr. Barry provided the Calendar Year 2016 second quarter financial report. He noted that the financial report highlights policyholder equity which is a key discussion point when determining a dividend declaration. He said the dividend declaration would be based on last year's audited policyholder equity as it was reported on the balance sheet; however, an overview of MSF's current financial status is also imperative to a dividend discussion. He provided the overall financial results and projections through the end of the year. He said assets decreased approximately $30 million, including an invested assets decrease of $1.7 million for the first six months of 2016. He noted that the Board of Investments (BOI) sold $15 million worth of equities to better align the allowed investment balance within the targeted range. He provided an overview of MSF's investments and assets for the second quarter of 2016 and noted this balance sheet is comparable to the same time frame last year. He stated MSF's liabilities have also decreased this year by $50 million and overall policyholder equity increased $20 million. He said based on those numbers MSF is projected to have a reserve to equity ratio of 1.68 which does not take into consideration any declared dividend amount. On December 31, 2015, the reserve to equity ratio was 1.78 after the $35 million dividend.

He shared the income statement with the Board which reflected the actuals and projections for the 2016 Calendar Year. He said net earned premium was projected to be $165.3 million for the year or approximately $3 million more than originally planned. A deeper dive into MSF's income actually reflects a net loss of business; however, that is offset by higher wages, higher payroll and a change in higher rated classifications which results in more premium. He added that losses were better than targeted as was prior year development. The reinsurance programs have been effective and provided an additional $1.3 million recoverable which reduces incurred losses. The projected loss ratio was 76 percent which compared favorably to the planned 78.6 percent loss ratio. Underwriting and loss adjustment expenses were on target and investment income was above plan.

Mr. Barry concluded that net income was projected to be $40.1 million before dividend which is $12.8 million above the Annual Business Plan estimate of $27.3 million.

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

B. *Analysis of Surplus Adequacy and Policyholder Dividend Program – Russell Greig, Director and Leslie Vernon, Senior Consulting Actuary – Willis Towers Watson*

Mr. Greig explained that his report would represent the support that Willis Towers Watson has for the Board declaring a policyholder dividend.

MSF management asked that Willis Towers Watson address several interrelated questions; a) how much policyholder equity does MSF need in order to support its long-term viability and stability for Montana employers and MSF's long–term business plans and projections, b) how is the required amount of policyholder equity affected by changes in the business environment and c) does this year's financial situation support a policyholder dividend? Mr. Greig noted that the Board and management have addressed dividend considerations and discussions for eighteen straight years. Further review of MSF's fiscal status from 2008 provided an illustration that MSF's financial strength has improved relative to the reserves and resulted in increasing dividend declaration amounts as the reserve to equity ratio declined. He noted that MSF took steps to improve its financial strengths rather than trying to increase rates by a significant margin to reduce the reserve to equity ratio.

Mr. Greig explained that policyholder equity serves a key role for the proper management of a property-casualty insurance company. Based on sound industry standards, policyholder equity stabilizes costs to business, fosters regional economic competitiveness for Montana and minimizes the probability of MSF insolvency. Ultimately, equity is intended to assure that the insurer will be able to fulfill its obligations to policyholders and injured employees via management of the risks in the insurer's underwriting and investment portfolios. These characteristics distinguish insurance from virtually all businesses that provide goods and services, where the price is established after most costs of production and delivery are known.

He said policyholder equity is not "extra", not "excess", and not un-needed funds. If insurers retained no equity, potentially half the companies would become insolvent each year. On the other hand, an insurance company would need to maintain an infinitely large pool of equity to provide absolute assurance that it could never suffer financial failure. Building infinite equity is neither possible, nor is it the best use of financial resources and insurance prices would be much higher than employers would be willing to pay.

Mr. Miltenberger asked if the unexpected development of unpaid losses in the period for 1990 to 1996 reflected an underlying improvement in MSF's business practices or was a work of MSF's actuaries.

Mr. Grieg replied that there could be a case made that it was the actuaries; however, during that period of time, MSF had several initiatives in place to keep loss development under control. Those initiatives included the pharmacy benefit program, a claim database development, and an increase in closures. He said based on the relationship that MSF staff maintains with its actuaries, discussions are held when there is a change in operations so that the actuaries can reflect those changes in their predictions.

President Hubbard noted that he and Ms. VanRiper were at MSF during that time period and he recalled that though Tillinghast (now Towers Watson) was the consulting actuary firm, the actuary was Bob Conger. There were a number of challenges during that period of time, particularly legislative reforms to reduce workers' compensation costs that had a substantial effect on MSF's reserves. The Old Fund liability crisis was also being addressed by the legislature at that time. Losses were grossly under reserved for the true cost of ultimate liabilities. The actuary at the time was using the historical paid claim patterns which reflected that old bad development and tried to develop accurate estimates and levels which was a difficult task. In approximately 1994, when Mr. Barry joined MSF, the team discussed the legislative changes with the actuary and addressed the need to recognize the change in benefit levels and that the payout patterns were going to change. Those changes were definitely a combination of legislative reforms and a change in the actuarial approach.

Ms. VanRiper added that in the 80s and into the 90s, when Ms. VanRiper was heading up MSF, the team would consult with the actuaries to determine rates and then take them to the governor's office. The governor's office would then determine what MSF could charge. She noted that she believed it helped to take that politicism out of the equation.

Mr. Greig said MSF, as a workers' compensation state fund, has several characteristics that highlight the importance of policyholder equity to absorb adverse financial results: extremely long-term obligations associated with workers' compensation claims especially as medical continues to grow, writes only one line of highly regulated insurance, writes in a single state and provides the guaranteed market. He added that there is also the uncertainty from significant Montana benefit changes such as House Bill 334 (HB 334), the effects of which have yet to be determined. MSF also cannot access additional capital to finance future growth or to cover adverse financial results. He said MSF's equity must be adequate not only to cover current and next year's obligations, but also to support the long-term strategy. Therefore, MSF needs stronger-than-average policyholder equity to address these unique issues.

He said that for the same reasons that equity is necessary, policyholder equity fluctuations are to be expected. Equity is there to absorb adverse financial results and corrective actions have been required and taken in order to reign in the adverse medical development. The financial fluctuations are expected, so do not warrant abandoning long-term strategic initiatives. They require the balancing of long and short-term considerations.

Mr. Greig said policyholder dividends are an important element in the long-term relationship between an insurer and the employer. Dividends return a portion of current earnings to the policyholders that had better-than-average loss experience relative to what was forecasted. Dividends can also return policyholder equity that is significantly above a target amount and are a means of sharing positive overall results with the policyholders. They also provide an incentive value for policyholders to focus on safety and loss prevention as well as return-to-work programs. These factors help to build a long-term relationship or partnership between the insurer and the policyholder.

He said that Willis Towers Watson agrees with management that MSF needs to maintain policyholder equity relative to loss reserves. He noted that MSF's policyholder equity level is currently at the financially strong level which is a guiding principle of the Board. Being financially strong positions MSF to be well prepared to handle multiple adverse deviations in financial results in the short term. The heightened awareness of potential exposures to terrorism and other catastrophes was also considered by the actuary when addressing a possible dividend declaration.

Mr. Greig addressed MSF's objective of producing modest operating income. He said operating income recognizes the risk and uncertainty inherent in pricing future business, makes ongoing contributions to growing policyholder equity as needed and supports an ongoing dividend strategy.

He added that MSF's December 31, 2015 policyholder equity of $505 million significantly exceeds the "regulatory solvency perspective" equity benchmarks. He compared MSF's policyholder equity level to three separate benchmarks and provided the Board with a review of how MSF stacked up to those.

Mr. Greig said the reserve to equity ratio quantifies how much adverse development a company can handle. He provided the chart depicted below to provide an illustration to the Board of the comparisons of MSF to A- and A rated state funds and the workers' compensation industry.

SUMMARY OF ANALYTICAL RESULTS

Comparisons to A- and A rated State Funds and the workers' compensation industry (assumes reserve adequacy) suggest a 12/31/15 MSF policyholder equity range of approximately $350 - $750 million

	Peer Group				
	Private Carriers				
	Mean of Lower Quartile	Median	Mean of Upper Quartile	A- and A State Funds*	Workers' Compensation Industry
Premium-to-equity ratio	1.2	0.9	0.5	0.6	0.5
Implied MSF equity	$177 million	$236 million	$424 million	$354 million	$424 million
Gross leverage **	5.8	3.3	2.3	2.7	3.2
Implied MSF equity	$221 million	$389 million	$559 million	$476 million	$401 million
Net leverage **	4.3	3.0	2.1	2.4	2.7
Implied MSF equity	$289 million	$414 million	$591 million	$517 million	$460 million
Reserve to equity ratio	2.3	1.3	0.9	1.2	1.7
Implied MSF equity	$391 million	$693 million	$1.0 billion	$750 million	$530 million
Equity to RBC ratio **	2.3	3.9	6.0	6.5	N/A
Implied MSF equity	$246 million	$417 million	$642 million	$695 million	N/A

MSF's December 31, 2015 equity position of $505 million places MSF toward the middle of the range indicated by A- and A state funds and by the workers' compensation industry

* Unweighted average of Hawaii, Kentucky, Louisiana, Maine, Missouri, Nevada, New Mexico, Texas, and Utah.

** Gross Leverage =(Gross Written Prem + Gross Loss Reserves + Other liabilities)/equity, Net Leverage = (Net Written Prem + Net loss reserves + other liabilities)/equity using MSF's FY2015.5 statutory financial statements, Equity to RBC ratio = Policyholder Equity / Risk-Based Capital

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Mr. Miltenberger asked for clarification on the equity and RBC ratio. He asked Mr. Greig if the 3.9 equity to RBC ratio on the median private carriers with an implied MSF equity of $417 million equated to MSF's higher company action level requirement.

Mr. Greig explained that the implied level for MSF is based on the generally applicable company action level so that the comparison is "apples to apples."

He provided Willis Towers Watson's conclusions and recommendations to the Board. He said their analysis suggests several general policyholder equity considerations: 1) Worker's compensation is the longest-tail line of any non-reinsurance line of business; therefore must be supported by significant levels of equity, due to the volatility risk to the insurer, exacerbated by the long recognition period and the tendency for good and bad years to run in strings. The real world poses more risks than models can measure or predict. 2). No reasonable amount of equity can fully guarantee against an insurer's failure. 3) Management intervention is required to keep an insurer on track. 4) There is no one correct level of equity for all time periods.

MSF's equity has done its job extremely well over the decades. It has absorbed approximately $225 million from FY2002 to FY2015.5 of adverse loss and LAE reserve development and absorbed retroactive benefit changes reflected in court decisions as well as absorbed volatile investment climate. MSF policyholder equity has also provided relatively stable rates and lower rates via a smaller (minimum) profit and contingencies provision. MSF's position is considered financially strong; however, MSF will want to maintain a strong equity level relative to loss reserves and the fact that MSF requires stronger than average policyholder equity to address its state fund specific role.

Mr. Greig concluded from Willis Towers Watson's analysis that MSF has enough policyholder equity and financial performance to pay a large dividend. He said the policyholder equity has done its job of absorbing adverse financial results. And, he added, MSF's decision regarding a dividend declaration also needs to consider the strategic role of dividends with respect to its most profitable and long-term customers.

Chair Zanto called for questions.

Mr. Mihelish noted that MSF's equity was approximately $500 million and wondered if the constant threat of medical inflation and other inflationary issues could put the current level of equity at risk of being too low?

Mr. Greig said that medical inflation in recent years has been relatively tame at two to three percent per year; however historically it has been six to eight percent per year. He noted that one constant in the insurance industry is that things will revert to the mean and he said it is important to be careful and have a plan to hedge for the time when medical severity increases and a concern appears.

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

C. Surplus Level Determination and Declaration of Dividend – Management Recommendation - Laurence Hubbard, President/CEO

President Hubbard asked the Board to use considered and measured discussions in determining whether to declare a dividend and if so, at what level. He outlined a number of possible concerns and considerations that should be addressed, such as MSF's current financial performance, MSF's status as a regulated entity and all that entails, the volatility of medical development on costs, and the possible financial and legal ramifications if HB 334 is found unconstitutional, as well as other considerations. He noted that MSF has adopted and continues to implement a long term, stable financial strategy as opposed to short term responsiveness. He said the Board could safely declare a dividend in the $30 to $40 million range. Mr. Hubbard said management recommends a dividend amount of $35 million should the Board determine it appropriate to declare a dividend.

Ms. Van Riper noted that item three of the State Fund dividend policy is consistency and predictability over time in the amount and structure of the policyholder dividend. She asked how that consideration would play into President Hubbard's $35 million dividend recommendation, particularly in light of the steady increases in dividend amounts since 2011.

President Hubbard said when the dividend declarations are modeled with assumptions about payroll growth of approximately three percent per year, modest rate adjustments of two percent and some additional prospective modeling, that amount would be sustainable with the inclusion of the investment performance at the levels that are currently being achieved. He added that investment income is key and if that level materially changes, the Board would not be looking at this level of dividends.

Mr. Mihelish observed that comparison of 2013 and 2014 financial results reflect nearly identical performances and since that did not create any concerning reverberations to the system last year when the Board declared a $35 million dollar dividend, he said he would like to see this year's declaration set at $37.5 million.

Chair Zanto agreed with Mr. Mihelish's comments yet expressed concern that a year-over-year variability of increased declaration would set an expectation that the amount would be increased every year. He expressed further concern that though MSF's financial condition is healthy, he has some concerns about the future legislative actions that could impact MSF.

Mr. Mihelish said if the Board has the ability to do this, they should, it is just that simple. He said he believed the customers are intelligent enough to realize that if there is an off year, it will not happen that way. He said a good communication along with the dividend checks could explain all of that in a simple fashion.

Chair Zanto called for additional comments.

Mr. Miltenberger echoed the comments stated thus far. He said if the safety culture is emphasized in the communications to the employers as well as the explanation that MSF has had a good year with investments, it would send a great message to the employers to declare a $37.5 million dividend.

Mr. Mihelish commented that he has always been a proponent of rate relief because he believes it is a more permanent thing and it stimulates the Montana economy. He said he believes that is what the Board is here to do; assure the economy stays healthy, and workers' compensation rates play into that a lot. He stated that he is now a convert and firmly believes that dividends are a form of rate relief. He said he recently realized that 95 percent of MSF policyholders will receive a dividend and that he remarked that he did not realize the number was that high for past dividends as well. The fact that the Board held the rate at zero last year could actually be deemed as a rate decrease if you take inflation into account. He said he believes the Board is doing all it can to make workers' compensation affordable in Montana. With the concerns over the constitutionality of HB 334 and the 20 percent decrease that occurred in 2011, he believes MSF is doing its part.

General discussion regarding any issues that would arise should the Board declare a dividend of $37.5 million established it would simply require a delay of the Board meeting while the internal actuary, Dan Gengler, developed a new table of dividend factors that addressed this amount.

Ms. Moss said she respected her fellow Board members' perspectives and noted that she takes the viewpoint that funds must be managed prudently. She expressed concern about remaining viable in the long term and continuing to address the "long tail" that workers' compensation insurance carries. Though optimistic, she felt concern for future potential disruptions in many parts of the economy and the political landscape. She noted that she preferred the consistency and predictability of the recommended $35 million range. She said she appreciates the analysis and the data that is made available for the Board's decision making; however, she felt it was important to remember that basically MSF and the Board are here for the workers and the business owners in Montana. The Board must remain mindful of and respectful of their perspective and work to maintain predictability, stability and understand the importance of managing the funds of MSF wisely and prudently.

Chair Zanto called for additional comments. Seeing none, he called for a motion.

Jack Owens said he agreed with Ms. Moss and is very comfortable with maintaining consistency by declaring a dividend of $35 million to match last year.

Chair Zanto made a motion that the Board, based on the unreserved surplus of $505,157,612 as of December 31, 2015, declare a dividend to policy year 2014 policies of approximately $35 million, not to exceed two percent above or more than two percent below the declared dividend, exclusive of any uncashed warrants. The motion was seconded by Mr. Miltenberger. Chair Zanto called for questions or discussion from the Board and the public. Seeing none, he called for the vote and the motion passed unanimously.

IV. Dividend Distribution – Rene Martello, Controller

A. Minimum Dividend and Level of Warrant Amount or Credit to Account

Ms. Martello provided the parameters used to distribute the dividend to MSF's customers. She remarked that since the dividend amount is the same as last year, she would be able to offer a more specific idea of the number of transactions that will be involved.

She said there were about 23,000 dividend warrants or payments that occurred from the $35 million dividend declaration in 2015. She explained that letters are sent to customers first, including those with cancelled accounts notifying them of the amount of the dividend declaration and what, if anything, they can expect. Approximately $16 million of the 2015 dividend was distributed through agents and approximately $16 million (about 15,000) was sent out as warrants or checks to policyholders. There will be increased coordination and controls required throughout the company to complete the process.

She noted that the first step for the Board in establishing the dividend distribution process is to set the minimum dividend amount staff requested that amount be set at $10. She noted that it is very rare to actually see a payment that small. She said staff also requested that the Board establish a minimum warrant or credit to account. Staff requested a $200 minimum warrant this year, which is a $100 increase over last year. That would mean if the amount were less than $200 a credit would be applied to the account rather than a warrant being issued. She stated the increase to $200 would reduce the number of checks distributed by about 2,000 which also saves MSF staff time and printing costs.

Mr. Miltenberger expressed concern that the policyholders that fall within that $100 to $200 range that will now not be receiving a check will feel less of the impact of the dividend declaration. He said he recognized there was additional cost and time to process the 2,000 additional checks; however, he believed that in terms of re-emphasizing the safety component, the physical check packs more punch. He said he would prefer to keep the $100 threshold.

Ms. Moss said she agreed with Mr. Miltenberger and felt the letter and the check were worth the expense.

Mr. Mihelish also agreed the checks do have an impact and it was worth the extra expense.

Ms. Martello assured the Board that staff can continue to accommodate the $100 level and had discussed those same concerns when reviewing the issue for presentation to the Board. She mentioned that there are also phone calls from customers questioning the issuance of a check at the lower level.

Chair Zanto asked if there was a strong feeling from the Board to keep the minimum warrant level at $100 rather than the proposed $200 level.

Mr. Miltenberger said he understood that processing the 2,000 additional checks was a burden for staff; however, he felt that it is worthwhile. He recommended suggesting, as part of the marketing effort, that employers consider having a safety event at their office to highlight the safety message.

Ms. Martello moved to the next item and explained that staff was requesting the Board take no action on this item. She noted that the current Board guideline allows that a dividend would be applied to the account if the following exists:

- A current policy has a past due premium or other debt pending
- A canceled policy with an obligation owed to MSF or an outstanding payroll report is due.

She noted that $1.5 million of outstanding balances owed to MSF were recovered following the last dividend declaration.

Chair Zanto recommended utilizing the Safety Management Consultants for hand delivery of some of the dividend checks with a message reinforcing the policyholder's efforts toward an improved safety culture.

President Hubbard said MSF works to leverage all the opportunities possible to personally deliver dividend checks to policyholders and reinforce the safety message.

Mr. Mihelish made a motion that the Board approve a minimum dividend payment amount of $10.00 and a minimum warrant amount of $100.00. Ms. Moss seconded the motion. Chair Zanto called for discussion or questions from those present; there were none. He called for the vote and the motion passed unanimously.

B. *Authority to Issue Dividend Warrant To a Cancelled Policy with a Past Due Premium or Other Debt Pending*

The Board did not make any changes or take action on this item.

C. *Table of Dividend Factors and Actuarial Certification of Approved Table of Dividend Factors – Dan Gengler, Internal Actuary*

Mr. Gengler presented the table of dividend factors for the $35 million declaration. He noted that there would be some variance around the $35 million amount due to rounding, which is why the motion contains plus or minus language. The dividend is payable to policies written July 1, 2013 to June 30, 2014 with at least six months of continuous coverage. He explained that the table distributes the dividend proportionally to actuarial determined profit. He provided the Board with an overview of the methods used to establish the table and utilized to assure the table distributed the dividend fairly and equally to all qualifying accounts. He noted that the table of dividend factors was reviewed and certified by the consulting actuary, Willis Towers Watson and the certification letter was provided to each Board member. He said management requests that the Board approve the table of dividend factors for the $35 million dividend declaration.

Chair Zanto called for questions; seeing none he called for the motion.

Chair Zanto made a motion to approve the table of dividend factors as presented and as certified by the independent actuary; and distribute the dividend to all qualifying policyholders with new or renewal dates within the dividend year of July 1, 2013 through June 30, 2014, and *who had at least six months continuous coverage during their policy period. The motion was seconded by Mr. Miltenberger. Chair Zanto called for discussion or questions from the Board and the public; there being none, he called for the vote. The motion passed unanimously.*

V. Reserve Report

A. Overview of Old Fund statutes – Rene Martello, Controller

Ms. Martello provided an overview of the Old Fund statutes. She said 39-71-2351 of Montana Code Annotated establishes separate funding of the Old Fund and the New Fund. The legislature has determined that the most cost-effective and efficient way to provide a source of funding for, and to ensure payment of, the unfunded liability and the best way to administer the unfunded liability is to separate the liability of the state fund on the basis of whether a claim is for an injury resulting from an accident that occurred before July 1, 1990, or an accident that occurs on or after that date.

She said MCA 39-71-2352 establishes a separate payment structure and sources for the claims for injuries of the Old Fund and MSF. It also determines the cost to administer and pay claims of the Old Fund and separately determine the cost to administer and pay claims of MSF. It states that the administrative expenses and benefit payments for the Old Fund and MSF are funded separately from the sources provided by law. This statute also establishes that an independent actuary must be engaged by MSF to project the unpaid claims liability for claims for injuries resulting from accidents that occurred before July 1, 1990 each fiscal year until all claims are paid. Further, it states that if in any fiscal year the Old Fund is not adequately funded, which has been the case since 2011, any amount necessary to pay claims for injuries resulting from accidents that occurred before July 1, 1990, must be transferred from the general fund.

Chair Zanto called for questions; there were none.

B. Old Fund FY16 Reserve Report – Russell Greig, Director and Leslie Vernon, Senior Consulting Actuary – Willis Towers Watson

Mr. Vernon explained that their assigned objective as the independent consulting actuary is to estimate the aggregate amount of unpaid future claims benefits, including a provision for claim administration and future Montana Department of Labor and Industry (DOLI) assessments, and also to forecast the payout timing. He noted the Old Fund consists of claims that occurred prior to July 1, 1990 and that represents 680 open claims; 50 percent are permanent partial and 35 percent are permanent total and 10 percent are fatal. The ages range from 45 to 94 and the average age is 67.

Mr. Vernon provided an overview of the methodologies used to determine the actuarial estimate and range of estimates of the unpaid liability of the Old Fund as of June 30, 2016. He noted that their indemnity observations indicate payment activity has been slightly lower than projected for last year which is reflected in the slight decrease seen in the ultimates projected for this year. A continued decline in indemnity payment activity is projected as the Old Fund claims continue to mature. He noted that in recent fiscal years, actual medical payment activity has been above expectations and those higher activity levels have been weighted into their projections. He said Old Fund payments have not been declining as expected over recent fiscal years and as a result estimated unpaid losses have been increased. He explained the factors and considerations that Willis Towers Watson applied to the Old Fund to determine their final projections for FY2017.

Mr. Vernon said the Old Fund forecast for the next fiscal year is $6.9 million and the total undiscounted claim related unpaid actuarial central estimate is $38.4 million timed out to Fiscal Year 2050-2051.

President Hubbard asked if the actuaries were applying the reported additional Old Fund asbestos claims into their considerations.

Mr. Vernon said the data on those claims are included in their considerations; however, they are not doing anything specific to separate out the asbestos claims. In the future, they will monitor that activity to determine if that should be called for.

Mr. Hubbard asked staff for a current estimate of the asbestos related claims in the Old Fund.

Ms. Jenkinson said she did not have that information on hand but did recall there were no new asbestos related claims in the Old Fund over the past few months.

Chair Zanto called for additional questions; there were none.

C. Old Fund FY16 Reserve Recommendations – Laurence Hubbard, President/CEO

President Hubbard stated that management recommended that the Board adopt the actuary's central estimate to include loss and LAE as well as DOLI assessments of $38,410,391.

D. *Adoption of Old Fund FY16 Unpaid Loss and Loss Adjustment Expense Reserve Estimate – Laurence Hubbard, President/CEO*

Chair Zanto called for questions or comments from those present; there were none and he called for a motion.

Ms. Moss made a motion to adopt for the Old Fund, based on the actuary's best estimate of unpaid losses and loss adjustment expenses for Fiscal Year 2016, the amount of $38,410,391 undiscounted as of June 30, 2016. Mr. Mihelish seconded the motion. Chair Zanto called for questions or comments. There were none and he called for the vote. The motion passed unanimously.

VI. Corporate Support

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

Ms. Martello provided the second quarter budget report. She said total expenditures were budgeted for $182 million and are projected to come in at the end of the year at $179 million - three million below the budget. She said claim benefit indemnity payments were budgeted for $38.4 million and are expected to be approximately $438 thousand under and medical benefit payments were projected to be $1.2 million under budget. Operational expenditures are also projected to be under budget overall by $1.3 million or 97.7 percent of the budget expended.

Chair Zanto called for questions; there were none.

Ms. Martello then provided the closing report for the Old Fund FY2016 as of June 30, 2016. She reminded the Board that the initial Old Fund funding estimate was $8.4 million; however, management requested that the Board increase the funding estimate by $1.7 million at the May Board meeting. The Governor's Office of Budget and Program Planning approved the budget change documents submitted totaling $1.5 million. The total adjusted funding estimate for FY16 was $9.9 million and actual expenditures were at 9.8 million with a variance of $59,000.
She said asbestos indemnity payments in the Old Fund were approximately $72 thousand and medical was $292,000 totaling approximately $346,000 for FY2016. Operational expenses were slightly over due to administrative costs associated with managing the Old Fund claims. There

were additional legal costs due to increased settlement activity as well as increased usage of medical consultants and medical invoice processing.

Chair Zanto called for questions. There were none.

VII. Old Business/New Business

Chair Zanto called for Old or New Business.

Chair Zanto noted that due to the upcoming Legislative Session, he anticipated increased conversations with Board members regarding proposed legislation that could affect MSF and workers' compensation in Montana.

He also noted that he has been working on the State Health Plan and has a new appreciation for pharmacy issues and has requested an update at the next meeting on the Express Scripts program and managing the related costs. He encouraged Board members to send any questions or concerns they had to President Hubbard so that information could also be provided.

Ms. Van Riper requested that the pharmacy review include cost information for MSF on the "monopoly drugs", the medications that go off patent and then are picked up by companies that charge excessive amounts for their products.

President Hubbard said that information would be included.

Mr. Miltenberger stated that in past years he has attended the medical conference sponsored by MSF and he asked for the dates and site. He also encouraged those present to attend the conference and said it was well worth the time invested.

Mr. Braun said the medical conference date is November 4 and the theme this year is causation.

Chair Zanto asked Pat Murdo, Research Analyst for the Economic Affairs Interim Committee if she wished to comment on the air ambulance issue that was being addressed by a special work group and would likely be addressed by the legislature during the next session.

Ms. Murdo said she received a call from the Government Accountability Office (GAO) and was informed that a member of Congress has requested GAO complete a study on a number of items, such as determining if the Department of Transportation has dealt with some of the billing issues. She indicated that the research done for the EAIC indicates that DOT has not and the air ambulance companies have had free rein regarding billings. She said the requested study is good news because it could mean Congress would impose regulations on the air ambulance companies.

She reported that in the Montana legislature there is a committee bill from the EAIC and a placeholder for the SAO to have a bill addressing the air ambulance billing practices. Currently the two bills are the same and as the session begins, the bills will progress and be introduced as needed. Senator Gordon Vance, Bozeman, is the sponsor of the EAIC bill which deals with a hold harmless approach that allows a voluntary agreement between the air ambulance provider and the insurance company for the patient to enter into a dispute resolution. This approach removes the patient from the mediation process by holding the patient harmless and allowing the insurance company to negotiate and pay on behalf of the patient. This bill would not address issues for uninsured patients, the Medicaid components, or the full range of situations that need to be addressed. The air ambulance companies have indicated they do not intend to legally challenge this bill to determine if the statute would pass Federal muster so that would fall on the insurance companies.

The SAO bill removes the exception for the membership component that air ambulance companies currently sell, placing the regulation of the sale of memberships under the regulatory authority of the SAO.

Chair Zanto called for additional old and new. There was none.

XII. Public Comment

Chair Zanto called for public comment; there was none.

The meeting was adjourned at 12:48 p.m. The next scheduled board meeting will be held on Friday, December 16, 2016 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