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MONTANA STATE FUND
BOARD OF DIRECTORS MEETING
June 9, 2017

The Montana State Fund (MSF) Board of Directors meeting was held June 9, 2017 in the Board Room of Montana State Fund, 855 Front Street, Helena MT 59601.

Directors Attending

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

State Fund Staff

Laurence Hubbard, President/CEO
Verna Boucher, Special Asst to Pres/CEO
Kevin Braun, General Counsel
Mark Barry, CFO
Rick Duane, Human Resources, VP
Sam Heigh, Operations Support VP
Al Parisian, CIO
Julie Jenkinson, Operations VP
Erika Ayers, Team Leader
Nick Hopkins, Team Leader
Patti Grosfield, Internal Auditor
Ethan Heverly, Underwriting Services Leader
Shannon Copps, Director, IT Plans & Controls
Peter Strauss, Compliance Officer
Rene Martello, Controller
Mike Worden, HR Specialist
Tammy Lynn, Safety Services Director
Curt Larson, Assistant General Counsel
Sandy Leyva, Director, IT Applications

Others Attending

Bob Biskupiak, SAO
Brenda Miller, Liberty Mutual
Russell Ehman, SAO
Chris Eaves, Sabot
Pat Murdo, Leg. Services
Sonia Powell, LAD
Kari Leonard, SAO

I. Meeting Preliminaries

A. *Call to Order*
Lance Zanto, Chair, called the meeting to order at 8:35 am and thanked the Board and members of the audience for attending. He recognized Bob Biskupiak, Deputy Insurance Commissioner from the Commissioner of Securities and Insurance (CSI) office and Pat Murdo, Research Analyst for the Economic Affairs Interim Committee (EAIC).

B. *Approval of March 10, 2017 and March 21, 2017 Board Meeting Minutes*
Chair Zanto called for a motion to approve the March 10, 2017 minutes as well as the minutes from the March 21, 2017 Special Board Meeting.

He noted on the first page of the March 10, 2017 meeting minutes, under the "Others Attending" section, Josh Porter was shown as affiliated with Willis Towers Watson and is actually with JLT Re. The final minutes will be changed to reflect that correction.

Mr. Miltenberger made a motion to approve the March 10, 2017 and the March 21, 2017 minutes as presented. The motion was seconded by Ms. Van Riper. Chair Zanto asked for any questions or comments from those present.

Mr. Mihelish also noted a needed correction in the March 21, 2017 minutes on page seven – the word deceased should be changed to "decreased". That correction will also be reflected in the final published minutes.

Chair Zanto called for additional questions or changes, seeing none, he called for the vote and the motion was unanimously approved.

II. Miscellaneous – Laurence Hubbard, President/CEO

A. Miscellaneous

President Hubbard welcomed those in attendance. He noted that video cameras had recently been installed in the Board meeting room to allow MSF to film webinars, training sessions and perhaps, Board meetings for streaming on the internet so that other members of the public can participate and observe. He said this Board meeting was not being live-streamed; however, Ethan Heverly, Director of Government and Community Relations was in the studio learning how to use this new equipment. He said this is in the spirit of capturing the talent currently at MSF in training videos for future employees through a professionally-produced film and video library.

- He also recognized Pat Murdo, from the EAIC and thanked her for attending. Senate Joint Resolution 27 which was passed by the 2017 Legislature, calls for a study of MSF structure and other cost drivers of the workers' compensation system. The EAIC's first meeting of the year is scheduled for June 14, 2017. The committee consists of Sen. Edward Buttrey, Senator Tom Facey, Senator Gordon Vance, Senator Lea Whitford, Representative Nate McConnell, Representative Mark Noland, Representative Vince Ricci, and Representative Sharon Stewart-Peregoy. They will be charged with the responsibility of conducting the SJ27 study as well as other studies and will need to determine to what extent their time and resources will be dedicated to each study. At the EAIC's first meeting, they will elect a Chair and assign two committee members to be liaisons to MSF. He said MSF is prepared to engage with the EAIC on the study bill and hopes to provide as much input as possible. He provided the committee's agenda and the work plan which included an outline of the plans for the SJ27 study.

- He said Board members had received a Proposed Meeting Schedule for 2018 and asked that each please check their plans for next year and inform Ms. Boucher of any conflicts or concerns. The proposed meeting dates are: March 9, June 8, September 14 and December 14. He said adjustments can be made if necessary or arrangements can be made if Board members wish to participate telephonically for a particular meeting. He added that depending on the nature of the study, additional meetings may be called if needed.

- President Hubbard said MSF was currently in the Request for Proposal (RFP) process of determining a Pharmacy Benefit Manager. The selection panel, which includes Chair Zanto, just completed three in-person interviews.

  Chair Zanto added that all three candidates were very impressive. They are Express Scripts (MSF's current vendor), Coventry and Optum. The panel planned to meet the next week to select the final candidate and are hopeful the successful candidate will provide a productive relationship going forward with MSF.

- President Hubbard said MSF has released an RFP for actuarial services for the Board of Directors and is receiving responses now. Curt Larsen, Assistant General Counsel, clarified that the RFP interviews will be in approximately two weeks. Mr. Hubbard noted that Mr. Mihelish and Mr. Miltenberger will be serving on that selection panel.

President Hubbard asked Kevin Braun, General Counsel, to provide a report on the 2017 Legislative Session.

B. *Legislative Recap – Kevin*
Mr. Braun provided a brief report on the legislative pieces from the 2017 Legislative Session that had direct effect on MSF.

Workers' Compensation Bills
House Bill 346 established a designated fiscal agent who, for workers' compensation purposes, will be the employer. This bill was introduced at the request of the Missoula Aging Commission to assist them in avoiding the need for multiple policies for veterans who need home healthcare. Coverage from a single policy creates savings on the expense constant allowing better usage of their budget dollars. The designated fiscal agent is deemed the employer for workers' compensation purposes, though the veteran is the hiring party.

House Bill 449 revised the definition of wages in workers' compensation. Some employment situations include "room and board" in the wage or salary of the employee which requires that a value be ascribed to that benefit. All insurers have struggled in the past with trying to assess a fair value for the employer and the employee, particularly in rural areas with limited local rentals for providing comparison information. This bill grants the Department of Labor and Industry (DOLI) rulemaking authority to create some uniformity with regard to the value of "room and board." DOLI will meet on Monday, June 12, to begin the process of drafting those rules.

Senate Bill 142 revises laws related to volunteer emergency personnel. In Montana, some of the first responders are not required to have workers' compensation coverage which is true for EMT's and volunteer firefighters when the employer has not elected to get coverage. This bill requires the employer to provide specific notice on an annual basis to the volunteers that are not covered under a workers' compensation insurance coverage plan.

Senate Bill 275 is a clean-up bill that creates uniformity when addressing the construction credit program. This program has a long list of class codes and the National Council on Compensation Insurance (NCCI) determined that the codes were not consistent with the National Association of Insurance Commissioners (NAIC) manual definitions of the construction industry. A filing was submitted to remove 12 codes; however, after the passage of SB275 that filing was withdrawn.

Senate Bill 312 allows DOLI to adopt a drug formulary. He noted that Chair Zanto was instrumental in getting this bill passed. The Labor Management Advisory Council (LMAC) has been studying this proposal for some time. MSF's Medical Services Director, Michele Fairclough, also served on the subcommittee to assist in developing an evidence-based drug formulary that could be adopted and applied in Montana. Other states such as Washington, Texas and Ohio, as well as others, have adopted drug formularies as a cost savings measure. He noted that a drug formulary also addresses the efficacy of the drugs so that people are not suffering.

Insurance Bills

House Bill 120 is a NAIC accreditation bill which requires MSF to complete a report on its corporate governance structure addressing the interaction between the Board and MSF personnel. The bill becomes effective on January 1, 2018 and the first report is due on June 1, 2018.

House Bill 138 allows an individual producer to satisfy the appointment requirement by affiliating with a business entity insurance producer that has already been appointed by an insurer. This is an ease-of-doing-business piece, particularly for newer agents. The insurer still has the discretion to accept the individual producer.

House Bill 276 may have the potential to have impacts for claimants. The pharmacy can refuse to fulfill a script if the Pharmacy Benefit Manager has a below-cost reimbursement for that script. He said if the pharmacy has to pay $12 for a particular drug, but the reimbursement cost is only $10, the pharmacy can refuse to fill the script. The bill requires that the pharmacy then must steer the patient to another pharmacy that will fill the script.

House Bill 283 requires all entities of the state to report grant information. For MSF, the ACE Grant program that grants charitable endeavors with a safety focus and MSF scholarship programs will have to be reported to the Legislative Finance Committee. The first report is due October 1, 2017.

House Bill 370 states that no one can prevent someone from recording a public meeting visually or in an audio recording; however, the person conducting the meeting can control the process so the act of recording is not disruptive to the meeting.

Senate Bill 261 affects MSF as it pertains to the Old Fund responsibilities. This bill contains triggers that state if the general revenue for 2017 and 2018 does not meet projections, the costs associated with administering the Old Fund will be cut in half. The General Fund revenue must result in $2.2 billion. If that projection is not met, a trigger kicks in and eliminates half of the spending authority to administer the Old Fund. Currently there is a $1.25 million spending authority to administer the Old Fund. This bill will cut that amount to $625,000 in 2017. In 2018 the trigger is raised to $2.348 billion. Current projections from the Governor's office indicate that the revenue is expected to be approximately $50 million below the $2.2 billion level. That can change depending on how the revenue streams come in. Our current expenditures would be reduced by about $150,000 short. MSF is statutorily prohibited from expending any New Fund monies to pay for Old Fund obligations.

Ms. Moss asked what the process would be for determining where less support will be provided due to the funding shortage. She specified that her concern was how this change would affect what she believes is MSF's first purpose, which is supporting injured workers.

Mr. Braun responded that continued support of injured workers is also MSF's primary goal. He noted that this bill does not affect the benefits that are paid, it does impact MSF's ability to adjust claims. Staff is already trying to scale back the consulting actuaries' work with regard to the Old Fund in anticipation of this shortage. Staff is working toward the goal of addressing the shortage with a goal of not short changing the injured workers.

Chair Zanto called for questions. There were none.

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

i. Approval of Audited Calendar Year 2016 Statutory Financial Statements

Ms. Grosfield provided an update on the statutory financial statement audit performed by Eide Bailly, LLP for Calendar Year ending December 31, 2016. She noted that Board Members received copies when the report was first issued and David Glennon, Lead Audit Partner from Eide Bailly had met with the Board Members earlier in the year. She said that for 15 ½ years MSF voluntarily prepared, and annually had audited, MSF statutory basis financial statements. Following the passage of legislation moving MSF under regulation by CSI the statutory audits became mandatory for MSF effective January 1, 2016 and this audit reflects the first full year under that regulation. Statutory audits are completed using an insurance basis of accounting which follows the NAIC practices and procedures manual adopted by CSI. She explained that Eide Bailly issued two opinions: the first 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 second opinion was issued on MSF's presentation in accordance with Generally Accepted Accounting Principles (GAAP) which resulted in an adverse opinion. She explained that the adverse opinion is expected because the two opinions are based on two distinctly different accounting principles. The statutory accounting basis is typically more conservative than GAAP. She noted that MSF does receive unqualified audit opinions on MSF's GAAP GASB financial statements from the Legislative Audit Division (LAD). It is necessary to reconcile between the statutory financial statements and the GASB or governmental net position and Ms. Grosfield provided an overview of the differences. She added that 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 and the audit report contained no audit recommendations for improvement. Four letters are included with the audit – two that are sent to SAO and two that are sent to the Board.

Ms. Grosfield requested the Board approve the Calendar Year 2016 statutory audit completed by Eide Bailly, LLP.

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

Mr. Mihelish made a motion to approve the statutory-basis financial statements as audited by Eide Bailly for inclusion in the Calendar Year 2016 Annual Report, along with a reconciliation of the audited statutory policyholder equity as compared to GASB net position, subject to audit. Ms. Moss seconded the motion. Chair Zanto called for discussion from the Board and the public; seeing none, he called for the vote and the motion passed unanimously.

President Hubbard indicated he would share his copy of the audit with interested Board members for review during the break in the meeting.

Ms. Grosfield continued her report. She stated that the email received by Board members from the Legislative Audit Division (LAD) was in reference to the audit they are completing at this time. She said examiners from LAD have been completing the field work for several months and have set the opinion date at June 8, 2017. This audit will be presented to the Legislative Audit Committee (LAC) later in 2017. Once presented to the committee, staff will be at liberty to share more information about the audit; however, she did say it seems to be a very clean audit at this point.

ii. Approval of 2017 Internal Audit Plan
Ms. Grosfield explained that historically the Internal Auditor has drawn up an audit plan for the upcoming year which was then approved by the President/CEO. The Internal Auditor reported the audit status to the Board of Directors at meetings throughout the year. Best practices indicate that the Board, acting as the Audit Committee, should provide the internal audit plan approval. She noted that she reports administratively and functionally to the President/CEO and functionally to the Board of Directors. She presented the proposed internal audit schedule for Calendar Year 2017 and noted that there was also an opportunity for Board members to request audits. She asked the Board to approve the 2017 Internal Audit Plan.

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

Chair Zanto made a motion that the Board approve the 2017 Internal Audit Plan as presented. Ms. VanRiper and Mr. Owens 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.

Ms. Moss commented that as the study bill proposed by the legislature moves forward, she was hopeful that information is provided that really illustrates the amount of oversight that MSF experiences to show that there are various perspectives that review MSF's operations.

D. *Annual Business Plan – Shannon Copps, Director of Enterprise Strategy and Project Management*
Ms. Copps provided the key success measures for the 2017 Business Plan and the projections to date.

Key Success Measures

KSM	2017 BP	2017 Projected
Net Earned Premium	$167.0M	$165.9M
Fiscal Year Loss Ratio	79.0%	75.5%
Expense Ratio	30.3%	29.7%
Investment Income	$48.1M	$49.4M
Net Operating Income (before dividend)	$28.3M	$36.6M
Achieve Enterprise Wide Initiatives		

Ms. Copps said net earned premium is currently projected to be slightly below projections; however, the loss ratio and expense ratio are projected to be better than planned. She said investment income is behaving as expected, while net operating income is behaving $8.3 million better than expected.

Chair Zanto called for questions; there were none.

Ms. Copps said the three Enterprise-Wide Initiatives are all focused in the Customer Service category and include the Policy and Billing System Replacement, Worksafe Champions and

Growing a Safer Montana. She said the Policy and Billing System Replacement project is a multi-year project currently on track and the RFP evaluation work has been the focus for the last few months. The scoring team included three sponsors and two project managers and they received seven written proposals. Those were narrowed to the top three contenders who then returned to provide live demonstrations. The proposed costs were then applied to the final score.

The Worksafe Champions project has been an important cornerstone for MSF's safety services for the past eight years. The intent is to change the safety culture of Montana by educating policyholders to identify the safety challenges at their workplace and focusing their efforts on reducing those risks. There are to two options to participate; one is an on-site training of several modules from one of MSF's Safety Management Consultants. The second option is a regional workshop which is optimal for smaller employers with less employee resources to dedicate to this process.

The Growing a Safer Montana project is designed to reach young workers, specifically high-school-aged students. This project will award safety kits which contain personal protective equipment to high school industry classes. The kits include safety glasses and hearing protection along with a packet of safety information. The first year's roll out was small and targeted schools in South Central Montana. Upon completion of the application evaluation process, eight kits were awarded to high school classes in Helena, Boulder, Three Forks, Belgrade, Livingston and Manhattan. The second aspect of this project to is to provide scholarships to college students in trade and occupational safety health programs who promote and embody the safety commitment.

President Hubbard requested that Tammy Lynn, MSF's Safety Services Director provide the items that are to be included in the kits to the Board members.

Chair Zanto called for questions. There were none.

E. *Policy/Billing Replacement Initiative (PBRI) – Julie Jenkinson, VP Insurance Operations*
President Hubbard noted that the policy/billing and replacement initiative was begun two years ago and has culminated, as a result of due diligence and research, into the proposal that Ms. Jenkinson would be presenting. He commended staff for the thoughtfulness of their approach on this project. Last year the Board authorized the retention of an Independent Verification and Validation (IV&V) consultant and Sabot Consulting was awarded that RFP. He introduced Chris Eaves, the President/CEO of Sabot and said the Board had received a letter from Mr. Eaves summarizing the activities they have observed to date. Sabot observed that the process followed thus far has been appropriate and utilizes industry best practices. Sabot found no major issues with the procurement process and overall the project is well positioned to enter into the contracting stage. Following Ms. Jenkinson's presentation, management will be asking the Board to support this project moving forward.

Ms. Jenkinson provided an overview of the process developed and used by the team assembled to research and evaluate available products that would serve MSF's purposes. She said the software platform and system integrator that management will be recommending will allow customers to interact with MSF in a more on-line fashion and at their convenience, increasing MSF's efficiency and value to the customer overall. She outlined the foundational tenets and principles the team developed to determine which product would best meet MSF's customer's needs.

She noted that a Guidewire software platform had been chosen and then described the process used to review and evaluate the competing vendors who would integrate the system for MSF.

She stated that the proposed product provided several business values currently not available such as real-time policy data availability, on-line application submission, electronic submission and management of customer audit information. She said electronic submission and management of construction credit applications will be more efficient for MSF's policyholders and provide real time access to available information and on-line application submittal and systematic coverage reinstatements. She noted that currently, lapsed policies are processed manually which annually generates 100,500 manual work activities. The new system will reduce targeted work activities by approximately 4,200 hours of manual labor. She also said that MSF currently reinstates 1,500 policies per year.

Ms. Moss asked if it will be possible to provide the newly proposed real-time services beyond MSF's standard operating hours and if MSF has considered expanding its operating hours.

Ms. Jenkinson said MSF has not made the determination to provide 24 hour service; however, it is researching and reviewing options to provide personnel coverage for expanded hours or a live-chat system.

Ms. Moss noted that a positive aspect of the Montana business climate is that due to the majority of businesses being small, customers are typically able to speak with a person regarding questions or concerns. She also said she believed MSF being based in Montana is a positive for customers.

Ms. VanRiper asked if people will still be able to contact a live person during business hours if they are not interested in the on-line application submission and asked that the new system still make the direct phone contact the main means of communication.

Ms. Jenkinson said MSF wants to remain the carrier with the personal touch and intends to carry that principle forward with the new system.

Mr. Hubbard clarified that this system is expected to make MSF more efficient without taking away the direct customer contact that is so vital for the large number of MSF's smaller policyholders.

Ms. Jenkinson said the PBRI team, upon completion of the RFP process, is recommending a Guidewire platform with HCL as the system integrator. She said Guidewire met all of the core functionality out of the box without additional customization being needed. She said the Claim Center system, another Guidewire software system that was implemented at MSF in 2006, is very adaptable and responsive when MSF needs to make changes or address regulatory changes and the Guidewire billing/policyholder system will be as well. She said HCL is a certified Guidewire provider and has developed a specific approach to work with MSF collaboratively to implement this new system. She noted that HCL staffers are considered experts in data conversion and implemented a data conversion for Canada's largest workers' compensation carrier where 342 million records were reconciled with zero unexplained differences. HCL typically prefers to integrate the system on their own; however, has committed to working with a blended governance model for MSF. The project is scheduled to begin in August 2017 and projected to be completed for utilization in January 2019 making it available for use for new and renewal policies in July 2019. She stated the estimated cost for completion of this project is $19.9 million with the first year's estimated cost coming in at $6 million with $1.46 million that year and each year after for the usage of the software. The Guidewire software will be licensed to MSF with a five-year contract and that is based on MSF's expected premium of $165 million.

Chair Zanto asked if the costs for this system would be amortized over time or how that would be handled. Ms. Jenkinson and President Hubbard asked Mr. Barry to respond to this question.

While Mr. Barry was moving to the podium, Ms. Van Riper sought clarification on whether this proposal was based on new money or existing costs that would be going away.

Ms. Jenkinson and Mr. Hubbard clarified that the current system is a 20-year-old legacy system so the costs would all be new.

Mr. Mihelish asked what percentage of the expense budget the additional $1.4 million per year will be after the initial costs of implementation are paid out.

Mr. Barry said MSF's current operating budget is approximately $61 million so the $1.4 million would not be a significant increase. Mr. Barry then responded to Chair Zanto's question regarding accounting of this expense. He stated that the $19.9 million is partially the cost of the system and partially on-going costs. The cost of the system, which is approximately $13.6 million, will not all be expensed in one year. During development of the system, these costs will be placed into a construction work-in-process capital asset account. That will not be amortized until the system has been implemented. There will be two phases to the system so the actual costs or cash flow are spread out over a period of three years. Once implemented, the costs accumulated in the work-in-process capital asset account will be amortized over an estimated five-year period. In statutory accounting, software systems are considered a non-admitted asset, which means these costs will not impact MSF's surplus. The initial investment, over time, is a cash flow hit because once implemented this item becomes an expense. He stated that estimated amortizations beginning in 2019 are $3 million, 2020 are $4.4 million, 2021 are $4.6 million and 2022 are $1.5 million and a minimal number in 2023 to fully amortize the costs. He stressed that these estimates could change depending on actual costs; however, based on the current model, the impact to the expense ratio which is currently just under 30 percent, would place the expense ratio slightly under 35 percent. He said the cost of this project could affect future dividend declarations; however, the modeling projections do not include any rate or premium changes in the future.

Ms. Jenkinson completed her presentation with a discussion of the risk mitigation plan the PBRI team has developed. She also introduced Sandy Leyva, Lead Project Manager and Erika Ayers, Business Lead Project Manager of the PBRI team and her co-sponsors, Sam Heigh, Vice President, Operations Support and Al Parisian, CIO. She also mentioned Chris Eaves and Darren Chiappinelli of Sabot Consulting.

Chair Zanto requested a motion to easier facilitate further discussion.

Ms. Moss made a motion the Board authorize management to accept the proposal by HCL to implement a Guidewire software solution for the policy and billing system replacement and to enter into the appropriate contracts that are necessary to effectuate the HCL proposal. Ms. Van Riper seconded the motion. Chair Zanto called for questions or discussion.

Ms. Moss said she saw this as an intangible prospect for MSF to recruit new employees to respond to increased customer expectations of greater use of technology.

Mr. Mihelish said he complimented the PBRI team for pursuing this project as it is very necessary. He noted that agents are a key MSF customer and MSF must invest in leading the way to continue to compete in the workers' compensation market.

President Hubbard assured the Board that the staff at MSF and specifically the project team have the experience and ability to implement this project and deliver MSF's vision and mission to be an industry leader in service to all customers.
Mr. Miltenberger also commended the PBRI team on a job well done. He commented that at past meetings he had commented about the advantages of business process outsourcing and whether that would be preferable to implementing a new system. He noted that his question on that regard had been answered and he supports the implementation project so that MSF can remain competitive going forward. He added a challenge to management to expand MSF's hours of operation which he believed could be handled by simply addressing scheduling through staffing.

Ms. Jenkinson said she has already begun this conversation with the Human Resources Department to address the customer's request for expanded hours and also staff requests for more flexibility, particularly by the younger generation.

Mr. Miltenberger also asked if MSF had done recent financial due diligence on HCL and Guidewire.

Ms. Jenkinson responded that the PBRI team as well as the Finance Department completed a financial review of both companies.

Mr. Miltenberger encouraged management to use attrition of retiring staff to make this project more affordable.

Mr. Owens asked if MSF's cost were comparable to other sister funds that are also having to upgrade systems and complete this process.

Ms. Jenkinson said based on the PBRI team's research, the costs are comparable. She noted that the Guidewire platform also provides a more stable pricing structure which protects MSF from further costs in the future if changes are requested.

Ms. VanRiper echoed the kudos to the project team and commented on this excellent presentation as well as the previous presentations on this proposal to the Board. She then asked how MSF will know what the customer's experience is and be inclusive of a broad range of customers.

Ms. Jenkinson said the team has engaged with a number of customer groups including the state agencies as a policyholder and the Agency Partnership Committee (APC). She added that the team will utilize tools that HCL provides to continue to measure the satisfaction level for customers and staff as the project progresses.

President Hubbard added that MSF conducted a policyholder survey and an injured-worker survey in the early 2000s through Ipso Reid. Upon implementation of this project it would likely be a good time to conduct two more surveys to gather statistically valid input on customer satisfaction with this project.

Chair Zanto called for questions from the audience.

Mr. Biskupiak commented that in his current position as Deputy Insurance Commissioner, their guiding principle is the consumers of Montana and he sees the implementation of this project as a move in the right direction. He noted that prior to his current position, he served on the APC and this topic was of key interest to the committee. They continuously requested ways to bring efficiencies into the distribution system as well as to address better customer responsiveness. He

asked if this project would address the agents' concerns about reducing the amount of paper sent out for each policy and if with this new system it would be mobile capable.
Ms. Jenkinson noted that APC and agents have been requesting electronic document delivery for some time. She said that MSF moved to electronic document delivery beginning just shortly after Mr. Biskupiak accepted his new position. She said MSF still sends a hard copy of some of the documentation based on the legal department's recommendation; however, the agents have access to the documents electronically. She said mobile capability is something management will continue to evaluate; however, that was not a requirement included in the RFP, just a wish-list item for MSF's customers.

Mr. Biskupiak added that he recently attend an NAIC meeting in Kansas City and the theme of the meeting was innovation. He said what is coming down the road in the insurance industry is mind blowing and the mobile capability will become a must in the future.

Mr. Hubbard thanked Mr. Biskupiak for his input and also noted that the transition plan approved by CSI contains a regulatory expectation that MSF address the support of domestic workers' per capita monitoring within the new billing and policy system. MSF's old system could not meet this functional requirement, the new system will include this capability.

Mr. Mihelish commented that his work within the banking system and a recent survey revealed that a larger number of customers than expected prefer the phone and customer service centers to complete their banking business. Prior to the survey, they assumed that most people were gravitating to on-line rather than brick and mortar. He said it is important that MSF remember that personal-touch aspect of customer service.

Chair Zanto said he agreed with other Board member comments on the importance of remembering the personal touch with regard to customer service. He thanked the team for their hard work.

Ms. Jenkinson thanked the Board on behalf of the project team for their support up to this point.

Chair Zanto called for additional questions from the Board and the public; seeing none, he called for the vote and the motion passed unanimously.

III. Corporate Support – Rene Martello, Controller

A. *Board of Investments Update – Joseph Cullen, Chief Investment Officer and Jon Putnam, Director of Fixed Income*
Ms. Martello introduced Joseph Cullen, Chief Investment Officer and Jon Putnam, Director of Fixed Income from the Board of Investments (BOI) to provide an investment update. She noted they last addressed the Board in May 2016 and this year there were no changes to the Investment Policy statement which was provided to Board Members in their packets.

Mr. Cullen stated that legislation passed during the 2017 session created no significant changes in how BOI manages investments for MSF or how MSF's portfolio will be invested. The only real change is the rotation in of two new board members appointed, two reappointed board members and one yet to be appointed board position.

He reported that BOI is currently fully staffed; Jon Putnam was promoted over the past year to be the Director of Fixed Income and Mike Pettit was hired as the Director of Investment Operations which is a new role at BOI.

He reported that equities have done extremely well lately and are up about nine percent year to date and about 16 percent over the last year which was not the expected projection. He also added that there is not a lot of volatility in the market; however, there will be down markets through multi-year periods and MSF's portfolio is well positioned for that. He said the core real estate investments have done extremely well. He added that investors are beginning to express concern that there will be another big cycle change in real estate; however, BOI does not have the concern that real estate is going to run into significant trouble. He said the growth will slow and the returns will be muted; however, the concerns over the leverage issues of 2007 and the over-supply of the 80s and 90s are not at play at this time. He also noted that fixed income, which is the majority of MSF's assets, is holding steady. He provided an overview of the current market conditions and factors affecting outcomes and investment strategies.

Chair Zanto called for questions.

Mr. Miltenberger asked if MSF's funds are heavily invested in the retail/mall real estate ventures which is a market that has been hurt by on-line shopping.

Mr. Cullen said the BOI's approach has been to diversify the real estate investments within all of the portfolios they handle though there is some exposure to retail real estate assets. He clarified that internet sales have drawn business away from the traditional malls; however, the exposure for MSF is directed toward a different type of retail classification such as stand-alone retail stores.

Mr. Putnam said MSF's asset allocation is within all approved ranges and then provided an overview of some of the transactions that have been completed this year to manage MSF's investment exposures in various markets. He noted that BOI is in the process of adding an additional core real estate manager to increase the diversification of real estate investments. The portfolio's actual performance has been better than expected over every reporting time frame. He said the portfolio has also benefited from active management on the fixed income side. He stated that the MSF investment pool continues to perform well, low interest rates continue and most asset valuations are above the long-term averages but the economic environment remains constructive.

President Hubbard asked what forecasting methods BOI implements to stress test MSF's portfolio or other portfolios and/or if different approaches are applied based on the portfolio.

Mr. Putnam said they do not spend a lot of time forecasting what the market will do; however, they do spend a lot of time looking at what the market expects the environment to be going forward. He said there are tools with their Bloomberg system, an investment-related system for bond portfolios, that contains a number of research tools, such as the World Interest Rate Probability (WARP) screen. This screen provides a probable forecast based on people's positions in the market and current interest rates as well as possible Fed actions.

Mr. Hubbard asked how MSF's asset investment policy statements differ from other investment approaches such as for the retirement investment assets.

Mr. Putnam said MSF has a different set of liabilities than the pension fund. The pension fund has much more equity centric investments, such as private equity. In terms of the overall structure of many of our policy statements, they are very similar. BOI tries to keep the policy statements in the same vein so they are very similar. He said there are different assets in MSF's investment structure appropriate for MSF's liabilities; however, he did not believe that broadly the things BOI does for MSF would be any different for the pension fund or the trust fund.

Mr. Cullen said the investment process is very significant and must continually address who the investment is being managed for and what their liabilities are. It is important to address what is needed by the investment portfolio and what might happen if investment returns were strongly negative over a short period of time. The biggest difference is that pension assets are equity centric and MSF's portfolio is fixed-income centric. He added that there are a fair number of differences which are based on the objectives and liabilities of each portfolio.

President Hubbard said that was the point he was trying to illustrate to the Board, that just reading the newspaper will not educate someone on the pension fund investment expectations or actual results and then allow them to extrapolate what the MSF Board can expect out of MSF's investment portfolio.

Mr. Cullen said the approach for BOI in managing MSF's portfolio is to maintain the stability of income which will help assure that MSF's financial objectives, over a long period of time, are strong and successful.

Ms. Moss asked if peer sister state fund's investments are monitored and used to help guide MSF's possible actions though their asset management may be under very different statutory requirements.

Mr. Cullen said BOI does spend some, though not a significant amount of time, monitoring other state funds because they prefer to spend more time determining the actual needs of MSF and what must be done to maintain that portfolio. He said he and Mr. Putnam had recently spent time learning how other insurance assets are managed and what approaches they were taking. He said BOI is largely aligned with those approaches but there are other areas that don't line up such as areas where more conservative approaches are being taken than what BOI is currently taking and there are some with a more aggressive fixed-income structure.

President Hubbard said that MSF does monitor what other funds are doing through financial data collection reports.

Ms. Moss asked what due diligence is followed with regard to investment transactions.

Mr. Cullen said they do not spend a lot of time trying to predict everything that is going to happen from an absolute return standpoint. He said they concentrate on risk and the returns being paid on the risks that are being taken. He added that a number of people would be involved, Mr. Putnam, himself and a few other people to assure that execution of the approach goes smoothly.

Ms. Moss thanked BOI for reporting and said she has always advocated the need for the Board to strengthen their relationships and communications.

Mr. Cullen said if there is anything the Board has in mind to further strengthen the relationship and communications, BOI would be happy to do so.

Mr. Miltenberger asked if MSF's minimum allocation towards fixed income is set statutorily and what that amount was.

Mr. Hubbard said it is not statutorily set; however, MSF has an established Investment Policy Statement with BOI on how the assets will be allocated with some minimums and maximums which is subject to their good advice on those requirements. A minimum of 75 percent of MSF's assets are to be invested in fixed-income securities.

Mr. Miltenberger said he thought, given the duration that we would anticipate holding our assets, 75 percent invested in fixed income seemed a little high for an insurance company though not strikingly high and he asked if BOI had given consideration to reducing that amount to 65 or 70 percent.

Mr. Cullen said the type of insurance business and the expectation of how the liabilities are going to be paid out as well as the risk-based reserves needing to be held against that really determine what the appropriate amount to hold may be. He said he did not believe that 75 percent fixed income was overly high relative to what other insurance companies invest. He said the level is strategic and liability driven and now is probably not the time to make that change due to solid performance of real estate investments in the non-fixed income or the equity. He added that currently, from a purely asset management context and a market context, he did not think it was the appropriate time to lower the weighting of fixed income and increase the weighting of equity.

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

B. *Financial Condition Exam – State Auditor's Office*

Ms. Martello provided additional information regarding Ms. Moss's question about looking at other state funds for investment comparisons. She said MSF evaluates other state funds' allocations while remaining mindful that other states' investments may be taxable. She also said that since the regulation of MSF has changed to Title 33, Chapter 12 specifies the type of investments as well as how much can be held in certain areas.

Ms. Martello introduced two examiners from CSI: Russell Ehman, Assistant Chief Examiner and Kari Leonard, Captive Insurance Examiner, who are members of the exam team that will be reviewing MSF. She reported that CSI issued a notice of a financial condition examination of MSF on May 9, 2017 and requested planning information. The examination planning questionnaires covering organizational, personnel, financial and IT operations were due to the examination staff by June 2, 2017 and were completed by MSF staff and submitted timely. The financial condition examiners will be on-site for approximately a week beginning June 19, 2017 and then spend an additional eight weeks off-site completing their report.

She said the exam team also includes: INS Services, Inc. which assigns both contracted financial and technical examiner resources; CSI's contracted external actuary, Dan Reppert, FCAS, of Financial Risk Analysts, LLC who will provide actuarial support for the exam; and three CSI examiners responsible for supervising, monitoring and participating in the contracted examination work. The MSF team will be comprised of the financial reporting analyst, the internal auditor, the compliance officer, the internal actuary, the legal department, employees from IT and the Executive team and perhaps one or two Board members.

She said CSI will manage the contract and examination information gathered from MSF and when completed will invoice MSF for the exam costs. A rather extensive summary was completed and submitted to CSI and included a governance overview, makeup of the Board and contact information, strategic planning practices, organizational charts, key consultants that MSF uses, employee job performance evaluation process, list of internal audits, code of conduct and the process used to distribute and collect that, budget and planning controls, financial reporting, investment management practices, liquidity and how MSF keeps up with legal and regulatory requirements. She added that there was also an IT planning questionnaire which was coordinated and completed by Shannon Copps and included disaster recovery, IT security, data confidentiality, systems being used, etc.

Ms. Martello said she expects there will be findings of improvements that can be implemented; however, MSF's history of clean financial audits and cautious approach to establishing good business controls and transparency to the Board have her feeling confident MSF will fare well in this exam. She said the entire process will take approximately eight weeks and the results will be shared with the Board once received.

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

C. *Calendar year 2017 First Quarter Financial Report*
Ms. Martello reported that the first quarter 2017 filing with CSI was completed on May 15th and the 2016 audited financial report and letters were submitted by June 1, as required.

She said that the first quarter of 2017 saw investment income increases of $15.9 million in bonds and $10.3 million in equity securities. Decreases occurred in cash and short term investments as well as security lending collateral assets for a total of approximately $29 million. She said it is common for the securities category to fluctuate due to the amount that BOI has "on loan"; however there is an offsetting liability so there is no net impact. She said unpaid liabilities saw an increase of $3 million for the year which is a reflection of adding another current year loss estimate.

She noted that net earned premium was $39.4 million for the first quarter and after expenses, it resulted in an underwriting loss of $4.7 million which is projected to be $8.6 million for the year. The underwriting loss is the result of lower net earned premium and more expense pressure due to increased projects. Net income came in at $13.2 million for the first quarter and is projected to be $36.6 million. Policyholder equity is $541 million which means for every dollar of equity there is $1.64 of reserves. Ms. Martello provided the board with a closer look at operating expenses and the combined ratio.

Chair Zanto called for questions. There were none.

D. *Calendar Year 2017 First Quarter Budget Report*
Ms. Martello said MSF variances for 2017 projections are based on actual expenditures of the first quarter and result in total MSF expenditures to be under by $4.9 million. She said total claim benefit payments are currently $4.8 million under budget due to a lower level of indemnity payments than was expected. She said though medical benefits are over due to a medical bill backlog that did not catch up until the first quarter of 2017, that activity is expected to calm down and match more closely with projections as the year progresses. Operationally, personal services, ALAE and CSI personal services were projected to be slightly over budget; however, overall operating expenses are slightly under the first quarter projection.

Chair Zanto called for questions. There were none.

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, 2017 for policies with coverage effective between July 1, 2014 and June 30, 2015.

Chair Zanto moved the Board approve management's recommendation to utilize June 30, 2017 as the date to value premium and incurred losses on new and renewal policies from July 1, 2014 through June 30, 2015 for potential dividend calculation purposes. Mr. Mihelish 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 2017 Third Quarter*

Ms. Martello reminded the Board that the Old Fund still functions on a Fiscal Year basis from July 1 to June 30 and this report would be a third quarter summary. She said the Old Fund is projected to expend six percent less than the initial funding estimate by $592,876. Claim benefit payments are under by $545,414 due primarily to indemnity payments being down $430,000.

She said as of March 31 there were 671 open claims in the Old Fund and 93.7 percent of claim benefits are expected to be spent in the fiscal year. Operating expenses which include MSF's administration costs such as administrative allocation, legal cost allocation, warrant writing, DOLI assessment and allocated loss adjustment expenses were $47,462 or 4.2 percent under the initial estimate.

Chair Zanto reminded the Board that SB261 will affect these projections in the future.

Chair Zanto called for additional questions; there were none.

G. *Old Fund Funding Estimate – State Fiscal Year 2018 –* ***Board Action***

Ms. Martello provided the FY18 funding estimate which, once approved, will be provided to the Governor's Budget Office and the Department of Administration to establish the spending authority on the state's accounting system for the next fiscal year.

She said Old Fund claim benefit payments for FY18 are expected to decrease from prior year payments which was the expected continuing trend since the Old Fund was established. This is a reflection of claim evaluations and settlement activity that occurred in FY16 and FY17. The overall projection of the Old Fund claim benefits liability for 2018 is $7.3 million and operational expenses will be $1 million. The majority of Old Fund claims have been reviewed for potential settlement opportunities and appropriate actions were taken.

Ms. Martello said as expected, indemnity and medical claim activities are expected to decline from FY17 levels; however claim settlement opportunities are also declining. With administrative costs the Old Fund projection for 2018 is $8.3 million. Legislation passed in 2017, Senate Bill 261, established a trigger that could limit the Old Fund administration costs to no more than $625,000. Management is determining possible reductions of administrative services to address the shortfall such as reducing nurse case management services, claims management support, legal and quality assurance services and actuarial, data analysis and reporting. She stressed that the shortfall would not affect benefit payments, only administrative costs. She said initial projections indicate that the trigger is likely to be met and staff will know more in the August time frame for reporting to the Board at the September meeting.

Chair Zanto called for questions.

Mr. Miltenberger asked if the non-personnel expenses to the Old Fund were billed at fully costed overhead amounts.

Ms. Martello replied that MSF marginalizes the costs through a process that assumes that MSF's key business focus is management of MSF claims and current policyholder interests. To determine the administrative services costs for the Old Fund, all of the applicable administrative costs are reduced by half. Another step reviews what portion of the benefit payments are Old Fund related to New Fund and that creates an additional decrease. There are also a number of departments; marketing, underwriting and operations, that do not manage any portion of the Old Fund so are not included in the cost of administration services. The allocation process is reviewed often and re-evaluated to determine the appropriate pricing.

Chair Zanto called for questions.

Mr. Mohr made a motion the Board approve the executive staff recommendation of $8,302,709 for the FY18 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; seeing none, he called for the vote and the motion passed unanimously.

IV. President/CEO Calendar Year 2016 Performance Review and Determination of Calendar Year 2017 Performance Goals

A. Compensation Update – Neville Kenning, Kenning Consulting

Mr. Kenning said the President/CEO performance review is a good governance practice that the Board adopted 17 years ago to provide analysis for the Board's consideration. This process includes utilizing an independent compensation consultant to provide comparative market data and present analysis and recommendations. That provides the Board with the context and information to consider President/CEO compensation and make a sound and defensible decision. He noted that due to the change in MSF's fiscal year, there was no review of the President/CEO's compensation during 2016 so the last review was completed in September 2015.

He provided an in-depth review of the comparison he completed regarding varying similar state funds as well as private-industry insurance companies. The data collected relies heavily on the number of responses received and allows Kenning Consulting to build a visual of the industry pay for similar positions throughout the country. The MSF President/CEO position is the second lowest paid in the demographic group and has one of the longest tenures of the demographic comparison group. He also explained that MSF has discontinued the incentive program; however, the use of incentive plans continues to be a common practice for comparative AASCIF organizations. Organizations that have a targeted incentive opportunity have an increased leverage to recruit top executives. He provided a comparison to the private sector based on the Property and Casualty Insurers' executive salary survey which allows him to cut data by size and direct premium written thus comparing a size-to-size insurance company. Typically, because of the company size, they are located in less prominent cities which provides a geographic neutralizer as well.

Mr. Kenning told the Board there were a number of factors to be considered in the President/CEO compensation review:

- Current pay relative to relevant comparator markets
- Mix of fixed and variable compensation (to the extent to which variable compensation does not exist can have an influence on the level of base salary set)
- Time in positon (specifically the experience and organizational knowledge that brings)
- Investment in retention versus the cost of replacement
- The business and political environment and the need for "political pragmatism"

- Performance of the incumbent against the performance objectives and measures for the period under review.

He said the MSF Board does have a formal performance management process in place that takes into consideration the President/CEO's performance as the primary driver of the assessment.

Chair Zanto called for discussion and comments from the audience; there were none.

B. *Introduction – Notice of Closure of Meeting – Lance Zanto, Chair of the Board*
Chair Zanto asked President Hubbard if he wished to waive his right of privacy to his individual performance review for Calendar Year 2016.

President Hubbard said he did not wish to waive his right to privacy; however, he would waive his right if the Board wished to consult with Neville Kenning, Rick Duane, VP Human Resources and/or Kevin Braun, General Counsel.

Chair Zanto announced the closure of the meeting at 12:45 pm and stated that it would be reopened after the discussion of the President/CEO's individual performance review.

V. President/CEO Performance Review

A. *Call to Order*

B. *President/CEO's Performance Review*
Mr. Kenning took the minutes and upon completion of the closed meeting, provided the completed copy to Mr. Duane.

VI. President/CEO Determination of Calendar Year 2017 Performance Goals and Compensation

A. *Introduction – Lance Zanto – Chair of the Board*
Chair Zanto called the meeting back to order at 3:46 p.m.

B. *Calendar Year 2017 Performance Goals of President/CEO*
Upon reopening the meeting, the first order of business was to formally adopt the President/CEO Performance Goals for 2017.

Chair Zanto made a motion to approve the President/CEO's Calendar Year 2017 Performance Goals as presented.

President Hubbard clarified that a draft of the goals was submitted to the Board for their consideration to which the Board added a couple of items. The goals have not been presented in a public forum in the past and following that established procedure were not presented at this meeting.

Ms. Moss seconded the motion. Chair Zanto called for discussion or comments; seeing none, he called for the vote. The motion passed unanimously.

C. *President/CEO's Annual Compensation*
Chair Zanto made a motion that the annual base compensation of Laurence Hubbard, President/CEO of Montana State Fund be set by the board at $342,000 effective March 4, 2017. Ms. VanRiper seconded the motion. Chair Zanto called for discussion from the Board and the public. Seeing none, he called for the vote and the motion passed unanimously.

D. *Budget Amendment for the Calendar Year 2017*

Chair Zanto called for a motion for the budget amendment.

Mr. Mihelish made a motion that the budget for Calendar Year 2017 be amended to include the Board-approved increase to the President/CEO's base compensation. Ms. Moss seconded. Chair Zanto called for discussion and questions from the Board and the public; there were none. He called for the vote and the motion passed unanimously.

VII. Old Business/New Business

Chair Zanto called for Old or New Business.
Chair Zanto noted that President Hubbard had requested MSF's Safety Services Director, Tammy Lynn to provide the safety glasses kits being awarded to a number of high schools throughout Montana to the Board members.

Ms. Jenkinson added that the items presented will be included in specialized packing with the MSF logo. She said all of the high schools being awarded these kits have invited MSF representatives to visit them on-site and be part of their safety program, which was the key element of this project.

Chair Zanto thanked MSF's staff and safety team for their efforts in supporting the promotion of the safety message in this project and other projects and delivery methods that MSF is currently using.

Chair Zanto called for additional Old Business or New Business; there was none.

VIII. Public Comment

Chair Zanto called for public comment. There was none.

The meeting was adjourned at 3:50 pm. The next scheduled Board Meeting will be held on Friday, September 15, 2017 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