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MONTANA STATE FUND
BOARD OF DIRECTORS MEETING
June 15, 2018

The Montana State Fund (MSF) Board of Directors meeting was held June 15, 2018 in the Board Room of Montana State Fund, 855 Front Street, Helena MT 59601.

Directors Attending

Lance Zanto, Helena
Jan VanRiper, Helena
Matt Mohr, Bozeman
Jim Molloy, Helena
Lynda Moss, Billings
Jack Owens, Missoula
Cliff Larsen, 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
Patti Grosfield, Internal Auditor
Sandy Leyva, IT
Shannon Copps, Director, ESPM
Peter Strauss, Compliance Officer
Rene Martello, Controller
Mike Worden, HR Specialist
Tammy Lynn, Safety Services Director
Erika Ayers, Select Team Leader

Others Attending

Representative Vince Ricci, Laurel
Bob Biskupiak, CSI
Sonia Powell, LAD
Bill Wheeler, ERD
Neville Kenning, Kenning Consulting
Jon Putnam, Montana Board of Investments
Pat Murdo, Leg. Services Division
Brenda Miller, Liberty Mutual
Russell Ehman, CSI
Marlys Rulon, Eide Bailly
Joseph Cullen, Montana Board of Investments
Brian Reed, Montana State Council of Professional Firefighters

I. Meeting Preliminaries

A. Call to Order

Lance Zanto, Chair, called the meeting to order at 8:34 am and thanked the Board and members of the audience for attending. He reminded attendees that the meetings are now recorded and requested that anyone with comments come to the podium and speak into the microphone. He recognized Representative Vince Ricci, Legislative Liaison from the Economic Affairs Interim Committee (EAIC), Bob Biskupiak, Deputy Insurance Commissioner from the Commissioner of Securities and Insurance (CSI) office and Bill Wheeler, from the Employment Relations Division (ERD). Chair Zanto shared with attendees that former MSF Board member Joe Brenneman had passed away recently and took a moment to recognize his fine service on the Board and expressed his appreciation for the work that Mr. Brenneman had done on behalf of MSF. He asked that attendees keep Mr. Brenneman's family and friends in their thoughts.

B. Approval of March 9, 2018 Board Meeting Minutes

Chair Zanto called for a motion to approve the March 9, 2018 minutes.

Chair Zanto made a motion to approve the March 9, 2018 minutes as presented. The motion was seconded by Jan Van Riper. Chair Zanto asked for any questions or comments from those present, seeing none, he called for the vote and the motion was unanimously approved.

II. Miscellaneous – Laurence Hubbard, President/CEO

A. Miscellaneous

President Hubbard welcomed and thanked the attendees. He reminded those in attendance that at the March Board meeting, the Board approved an eight percent average rate reduction for Montana businesses. He said that was a remarkable accomplishment and noted that there has not been a rate increase on Montana businesses from MSF since 2007. He added that Montana and MSF have enjoyed this trend and the Board has been able to accomplish continued rate reductions through excellence in claims management as well as stability in insurance premiums over the long term.

He provided an update on Senate Joint Resolution 27 (SJ27), the EAIC study of Montana State Fund and the structure of the workers' compensation system to determine what is most effective for Montana's business interests. He noted that of particular concern are the businesses and industries that have the most difficulty finding workers' compensation insurance in a competitive market. He said the committee met on April 27 and the committee goal, at that time, was to choose one of three options: elimination of MSF, mutualize or privatize MSF or to maintain the status quo with some adjustments. He noted there is a group of special interests that are eager to see MSF removed from the market and open only to private insurance companies. The effort to mutualize or privatize MSF is an effort to assure that MSF operates like an insurance company in a competitive environment; however, this approach does not address who will insure the small high-risk businesses.

President Hubbard said the committee was not able to come to a consensus as to the direction that should be taken and deferred any further decision or discussion until the July 9 meeting. The agenda for the July 9 EAIC meeting has no scheduled testimony by interested parties which mean any input from MSF or Board members would have to occur during the public comment portion of the meeting. He noted there are several documents on the EAIC website outlining the three options and the questions that the committee may want to ask or answer. He said he believed the committee is at a crossroads and must now determine what the mission of this study is. He said the committee must determine if their goal is to lower the cost of workers' compensation insurance or to find the most effective delivery system for Montana businesses, large and small. Does the proposed system include a non-profit state fund entity or a privatized entity; or is the goal of this study to increase competition in the marketplace? He noted that throughout his years of working in the workers' compensation insurance industry, there has been a very competitive workers' compensation environment in Montana with at least 27 companies that write over $1 million of workers' compensation premium in Montana, including MSF. How much more competition can Montana's workers' compensation market absorb? He also noted that the committee needs to consider the current financial strength and long-term health of MSF. He said MSF continues to pay record dividends to deserving customers who have demonstrated safe work habits and work places. The performance of MSF since the late 2000s has done a remarkable job at keeping rates stable for Montana businesses and improving workplace safety. He asked if the committee's goal should be to move MSF further away from state government. He noted that the legislature, years ago, wisely made the segregation between state government funding and MSF operating like an insurance company or domestic mutual because political management interfered with the operations of the workers' compensation program which resulted in a half-billion-dollar liability for the Old Fund and for the taxpayers of Montana.

He said the committee must consider how a legislative body can achieve the protection of the assets of MSF for use only to pay workers' compensation claims and administration of MSF. Though the language in the law now may seem clear enough, perhaps there are things that can be done to make it clearer so that MSF and the Board can go forward managing MSF in a financially sound manner. He said all the committee's goals are laudable; however, not all goals are of the same priority. The most important thing to achieve is ensuring the most effective system for Montana businesses and injured workers. He said the items such as increasing competition and moving State Fund further away from state government auspices, are ancillary and not the most important objective. He said when examining cost effectiveness, there is a tremendous amount of emphasis and attention paid to the Oregon rankings index study that is published every two years and ranks all 50 jurisdictions. He noted that Montana has consistently been in the higher quartile; however, the study is flawed. Though it is a reasonable proxy for how jurisdictions benefits are paid or what the cost is for those benefits comparatively ranked; it has nothing to do with the actual cost of the system to policyholders. The two key reasons why that is true is because the study does not normalize workers' compensation benefits from state to state; it simply takes the costs for indemnity and medical, averages them, makes some assumptions and then ranks the costs of premiums to support losses. It also does not take into account wage level variations. Montana is consistently in the lower quartile of average hourly wages and the Oregon study does not adjust for wage levels. He said if the average wage in Oregon is $18 per hour, and Montana is $15 per hour and each state has the same cost for benefits, the rate is going to be higher in the lower wage rate state. He said he thought the committee needed to be very cautious on how much credibility or weight is given when considering these studies. The most important thing when considering what to do is that the committee base their actions on what is fair for Montana businesses and workers. It would be nice to see policymakers get comfortable with the idea that Montana is not going to rely on the study ranking but rather benchmark against Montana's own standard. The benchmarks for Montana should ask if the actions being taken are decreasing accidents and the costs on average for claims, and are people getting back to work sooner.

President Hubbard took a moment to address Representative Vince Ricci, EAIC Legislative Liaison to MSF's Board of Directors, directly and stated that the elimination or sale of MSF is not in the best interest of businesses or the State of Montana. It is not cost effective and there has been no evidence that it is. It is actually high risk and uncertain and could be extremely disruptive for decades. He recommended the committee be very cautious about consideration of elimination. He said he believed the status quo is the most cost-effective system for Montana employers and small businesses and injured workers. He said he has been in this business for almost 30 years and has seen the Old Fund liabilities weigh a burden on MSF and the taxpayers of this state. He said he has been privileged to serve and help the legislature pass laws that made MSF function like an insurance company and those laws have worked very, very well. He said he believed if the committee did nothing more than maintain status quo, they would be doing the right thing.

He said mutualizing may be the opportunity to achieve some of those objectives in moving the state further away from MSF operations or vice versa. It may help the competitive environment; however, that too, is very uncertain. There are risks and short-term cost increases for Montana businesses due to premium taxes and Federal income tax. Some efficiencies might be gained but that is not the most important goal for the policymakers in this discussion.

President Hubbard said MSF is entering the third year of regulatory oversight by the Insurance Commissioner's Office. Rates must not be inadequate, excessive or unfairly discriminatory. That is the standard by which policymakers can take confidence and solace that someone is watching so that the consumers are not unfairly charged. There are ample protective measures in the law today to protect the competitive market in Montana. There needs to be nothing more done legislatively with regard to how MSF sets its rates. The MSF Board of Directors is publicly appointed by the Governor with at least four members drawn from MSF policyholders. MSF holds public meetings where stakeholders and the public weigh in and present their point of view when the Board is considering some of their most important responsibilities such as rate making and dividend declarations and determining the level of capital necessary to ensure the healthy long-term operations of MSF. This is the public forum for those discussions and this Board has been charged, by law, to grow MSF's financial strength to the point where it will never again be a burden on the tax payers of Montana.

He said he was hopeful that he would get an opportunity to speak to the SJ27 Committee and he planned to encourage them that the status quo is what is right for Montana, though it may not be right for other states. He added that regardless of the committee's action, he firmly believed that at the next legislative session, there will again be an effort to move MSF way out from state government or to eliminate MSF. He said he is hopeful that the committee will send a strong signal that they have reviewed the issue and that they do not believe these alternatives are in the best interest of Montana businesses, though there may be other options that could have merit. He said he would appreciate any guidance that the Board members could offer.

Chair Zanto called for comments.

Jim Molloy commented that it was obvious that Victory Insurance is out there with an agenda and is behind many of the legislative efforts that have been proposed regarding MSF, which is their right. Regardless, he said he had questions about Fair Montana and thought it was important on the record that whenever a representative of Fair Montana appears at a legislative hearing, that they fully disclose their source of funding. He said this is just one more example of hiding money - dark money - behind some good, attractive sounding name. He requested that when President Hubbard is in front of the committee, to assure that they understand that and make that point with them. He said they are entitled to fund a lobbying organization but to do it through a non profit is questionable in his mind.

Lance called for additional questions or comments. There were none. He added that he had attended the last committee meeting, though he did not testify. He attended to represent the Board and noted that whatever comes out of the July meeting, the Board and MSF will definitely want to make sure they are ahead of the ball. He said the Board will be kept apprised and he encouraged Board members to watch the meeting or attend if able.

Ms. VanRiper took a moment to express her strong support of Mr. Molloy's suggestion and thanked him for making it. She asked if President Hubbard would feel comfortable carrying out the request.

President Hubbard said he was absolutely comfortable asking the question and noted that he also thinks it is important that the committee knows who is testifying and who the party represents. He said in the spirit of how the legislature does its work, most organizations are very transparent about who their supporters and members are. He did say that he prefers not to name names with MSF's competitors; however, it is not a secret who is requesting the actions being proposed.

Chair Zanto called for questions; there were none.

B. Brand Refresh Update – Mary Boyle, Communications Manager

Ms. Boyle explained that from inception to roll out, the brand refresh project concentrated on employee input and employee focus. The 20-year-old MSF brand needed to be refreshed and Ms. Boyle began the process with executive-level buy in and information gathering through surveys and then completed eight sessions with employees to gather their input. After the sessions, an employee working group was appointed to work with Partners Creative in the development of a revised and redefined mission statement, vision statement and values. Once the executive level approval was granted, the working group developed a roll out and introduction plan for internal staff.

- The new mission statement: **We partner with employers and their employees to care for those injured on the job and we champion a culture of workplace safety for our fellow Montanans.** Employees felt that we cared about both the employer and the employees. The employee group felt that a strong reference to Montana was really important and that it was vital to say we are Montanans and we serve Montanans.
- The new vision statement: **To be an indispensable partner in achieving a safer, healthier and more prosperous Montana.** The group wanted to note that this vision does not just apply to MSF's customers but rather for all Montanans.
- The new values are:
  - do what's right,
  - deliver with heart,
  - focus on what matters,
  - succeed together,
  - find a better way, and
  - take the long view.

She said the principles were changed to values to match contemporary speech. The working group provided further definition of each value for a more thorough understanding of the impact and that offers the best approach to take to achieve the values. She said the logo was updated to have a more contemporary appearance by changing the font and the colors as well as emphasizing the size of the Montana part of the company name.

Ms. Boyle said a Brand book was created to distribute to employees for easy reference of who MSF is, why MSF is here and what the mission, visions and values mean to all employees. A video was developed by Partners Creative and will be used for future on-boarding of new employees. She reported that MSF employees have embraced this change and are carrying the message forward in their everyday tasks.

Chair Zanto called for questions. There were none.

Ms. Moss said she really appreciated this effort and added that she loved that the efforts came from the employees and is grounded in values and principles. She said she could envision this percolating throughout the whole MSF culture and believes it will be very important and beneficial as MSF moves forward in the next relationship with the Legislature and the challenges that MSF will face. She commended Ms. Boyle on this great project.

Ms. Boyle thanked her and said that she was fortunate enough to work with a great group of people on this project. She thanked the Executives for allowing staff to move this forward.

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

Ms. Grosfield provided an update on the Legislative Audit report that Board members had recently received. She noted that the report is not free to be publicly discussed until after the report has been presented publicly to the Legislative Audit Committee.

She presented the credentials for Eide Bailly, LLP and Marlys Rulon, Senior Manager to present the 2017 Statutory Financial Statements Audit Report.

i. Presentation of 2017 Statutory Financial Statements Audit Report – Marlys Rulon, Senior Manager, Eide Bailly

Ms. Rulon then presented a review of the audit report. She introduced the Eide Bailly service team that prepared MSF's audit. She said as the Senior Manager, she is responsible for face time with MSF and Dave Glennon, Lead Partner, is the audit insurance partner for MSF, a position that rotates every five years. Team members were Jason Lindstrom, Manager and Lauren Humphrey, Senior in Charge. She explained that the audit process began after the third quarter NAIC report was filed in November/December of 2017 with preliminary planning and procedures. Year-end field work was completed in February 2018 and the audit reporting was completed in March 2018 with on-going communication throughout the process.

Ms. Rulon said the audit was performed in accordance with auditing standards generally accepted in the United States. She clarified that the audit's purpose is to obtain reasonable, not absolute, assurance that the financial statements are free of material misstatement on a statutory principle basis. She said MSF had received an unmodified opinion on the statutory principle basis of accounting and then explained that due to the application of a different set of standards for the Generally Accepted Accounting Principles (GAAP) or governmental basis, MSF received an adverse opinion on that basis. She explained that the adverse audit opinion based on GAAP is not a bad report, it is simply standard boiler plate language used by an auditing firm when reporting on an insurance company using regulatory accounting.

She noted that this year's audit has an "Emphasis of Matter" note that alerts the reader that MSF has changed its manner of reporting the OPEB liability in its accounting. The OPEB liability will never be paid and is no longer required to be reported on the statutory financial statements or audit.

Ms. Rulon explained that a letter regarding the audit not uncovering any material weaknesses in the internal controls was issued to MSF and will be filed by MSF with CSI. She said there is also a lengthy audit qualification letter prescribed by NAIC from Eide Bailly to MSF assuring MSF that the auditing firm will comply with the NAIC's model audit rule and all work papers will be turned over to the state examiners. MSF also files that letter with CSI. She said the management letter is a communication from Eide Bailly to the management and the Board that lists a number of items that Eide Bailly must disclose to MSF. The management letter must include any significant items that occurred in the audit, the significant accounting measures and exposures, estimates related to any estimations or accruals and if there are any disagreements with management. She noted there were no disagreements with management during this audit.

Chair Zanto called for questions. There were none.

Ms. Rulon added her encouragement to the Board to look at the statement of cash flows to maintain on-going monitoring. She said in the top segment is cash from operations, the second part is investments acquired and investments sold, the third segment is miscellaneous. Typically, the cash provided from operations would be a positive number; however, this year Eide Bailly noted a $15 million negative balance due to the special assessment passed during the special legislative session in late 2017. She said Eide Bailly anticipates it will be negative again next year as the second $15 million is taken from MSF's investment income. The second segment shows that investments were sold to generate cash to fund MSF operations.

Chair Zanto thanked Ms. Rulon for the presentation.

ii. *Approval of Audited Calendar Year 2017 Statutory Financial Statements – Board Action*

Ms. Grosfield noted that the letters Ms. Rulon mentioned were in the packet of documents that were sent to the Board members. She thanked Eide Bailly and requested that the Board approve the completed statutory financial statement audit performed by Eide Bailly, LLP for Calendar Year ending December 31, 2017.

Mr. Larsen asked what documents were routinely sent to CSI?

Ms. Grosfield said all audited financial statements, all work papers, and all audited information that Eide Bailly has gathered are made available to CSI. She deferred to Rene Martello, Controller, for further clarification.

Mr. Larson refined his question to cover what was sent the past month and clarified that "historically there was whining from the Insurance Commissioner's office" that they did not get enough information from MSF.

Ms. Martello said every year the insurance department publishes a required filing document with the timeline of what must be filed by each insurance company that does business in Montana. She said June 1, 2018 was the deadline to file MSF's statutory audit statement and required letters. She added that though there are not necessarily monthly filing requirements, there are quarterly requirements. Some items that must be filed are executive compensations reports, compliance matters and rate filings.

Mr. Larson asked if additional information requests from CSI are handled casually or is there is a more formal process that is required from either side.

Ms. Martello said the relationship between staff at CSI and MSF is fairly casual and is typically handled through email or phone calls. She noted that the financial examination that CSI completed in 2017 was a very effective means for CSI to learn and understand the workings of MSF. A lot of information, including presentations and trainings were given to CSI staff to enhance their understanding of MSF. She said the relationship is casual and open.

Chair Zanto asked Bob Biskupiak, Deputy Insurance Commissioner, if he felt that CSI was getting everything they needed from MSF?

Mr. Biskupiak said yes, and added that if there are questions, there is no hesitancy by MSF staff to call the CSI office and discuss the issue with them. He said the reporting needs are very much a process driven by timelines and deadlines and for anything out of the ordinary, CSI and MSF engage in discussion.

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

Ms. Moss made a motion to approve the statutory-basis financial statements as audited by Eide Bailly for inclusion in the Calendar Year 2017 Annual Report, along with a reconciliation of the audited statutory policyholder equity as compared to GASB net position, subject to audit. Mr. Molloy 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. *Annual Business Plan – Shannon Copps, Director of Enterprise Strategy and Project Management*

Ms. Copps provided the key success measures for the 2018 Business Plan and the projections to date.

Key Success Measures

KSM	2018 BP	2018 Projected
Net Earned Premium	$162.4M	$160.5M
Loss Ratio	75.1%	75.4%
Expense Ratio	40.5%	40.5%
Investment Income	$40.7M	$49.0M
Net Operating Income (before dividend)	$10.7M	$18.6M

Achieve Enterprise Wide Initiatives

Ms. Copps said net earned premium is currently projected to be below projections and the loss ratio is slightly higher than projected. Expense ratio was at target; however, investment income and net operating income were quite a bit 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 that is not currently on track. She noted that due to the complexity and the volume of the work required to complete this project, the project team has determined that the original March 2019 completion date cannot be achieved. She said the project leadership is committed to resetting a high confidence go-live date and are working with the vendor to set that deadline. She added that Development Phase 1 includes several separate teams working concurrently in various capacities: data conversion or system integration, developing a policy center and a billing center, addressing rate tier process and documentation, building an account management portal and an agent gateway portal as well as an organizational change management program.

She said the Worksafe Champions and Growing a Safer Montana initiatives were on track and have been completed. Worksafe Champions educates employers with on-site safety practices and procedures. There are two ways to participate; the first is for a MSF Safety Management Consultant (SMC) to work on site with the policyholder. She said there are nine policyholders with a total of 75 employees, going through this program. The policyholders are currently working on the eight modules and making progress developing their safety action plans. The second way to participate in Worksafe Champions is for smaller employers and requires attendance at one of the regional workshops. There are 20 people from 14 different policyholders currently enrolled in workshops in Missoula, Helena, Miles City and Kalispell.

Ms. Copps said the Growing a Safer Montana project is on track and it expands MSF's efforts to reach young workers and invest in the safety future of Montana. She said 22 high school classes submitted requests for safety equipment grants; all were accepted. The instructor will select from a variety of personal protective equipment for their classes, up to $750. The equipment could include welding gloves, welding helmets, hard hats and eye protection, all branded with the MSF logo.

She said the second part of this project awards scholarships to students in college trade and occupational safety and health programs. The information packets are being developed and the scholarships will be awarded in the first quarter of 2019.

Chair Zanto called for questions. There were none.

E. *Policy/Billing Replacement Initiative (PBRI) – Julie Jenkinson, VP Insurance Operations*

Ms. Jenkinson said due to the PBRI project being the only project off-track, she offered her assurance that the project team went through a lengthy project planning process and built a very robust governance model. She said that planning process and governance model is doing exactly what the team wanted it to do, which is identifying the issues and the problems early on and providing a path to resolve them. She said MSF also hired an independent validation and verification partner, Sabot, that reports directly to President Hubbard with monthly reports on the project progress. She said Sabot also asserts that the project team is on target with their issue identification and mitigation responses to those.

She said though the planning and governance process are working she wanted to explain why the project is off-track. The team is two years into a multi-year project and the team has been working with the system integrator for nine months. She said the team had just begun its eighth sprint and clarified that a sprint is 30 days of development. She further explained that the original plan called for building the rating engine in Phase II; however, the team realized that work needed to be moved to Phase I. That changed the development sprints from 10 to 13 which expanded the amount of time necessary before implementation could occur. In addition, over the course of a multi-year project, there will be issues with resources and staffing changes for the vendor as well as for MSF. She said there have been some issues with identifying and securing Guidewire experts due to competing for the same talent and resources with other companies implementing the Guidewire platform. She said the team is working very productively together and is challenging one another and looking for the best customer experience and efficiencies.

She shared a review of the operational efficiencies or "Business Value Realization" that MSF will be gaining by implementing the new systems. The new system will allow for online quote submissions, reduce customer phone calls and eliminate manual processing whenever possible. She said the changes will free up employees to be able to spend more time with the customers that do prefer to do business via telephone.

Ms. Jenkinson then explained the organization change management program that has been instituted to educate employees on the new systems and the changes they will be experiencing once the project is completed and the system is implemented. This approach has been developed to educate employees from the beginning of the project rather than just springing the changes upon them during implementation.

Chair Zanto called for questions.

Ms. VanRiper asked if the reduction of customer phone calls and freeing up people's time to spend more time with the customer would mean implementing a frustrating phone system that would place our customers in a never-ending phone tree that encourages them to go on line and takes forever to get to an actual person.

Ms. Jenkinson said that is absolutely not the intention. The overall goal of this project is to enhance the customer experience and to create an ease of doing business with MSF by giving the customer the option of how they want to access their information is sole purpose of reducing phone calls. She clarified that staff expects telephone calls to reduce because many people prefer to handle their bills, banking, etc. on-line on their own time. She said this just allows additional options to MSF's customers and there is no intention of staff reduction or reducing staff's availability to our customers.

Chair Zanto asked Ms. Jenkinson to define what a customer is for MSF.

Ms. Jenkinson said there are internal and external customers and the terms customer and stakeholder are interchangeable. MSF's customers are everyone staff is talking to, including other MSF employees, agents, policyholders and injured employees.

Chair Zanto called for additional questions. There were none. He then cautioned that he had a healthy trust that MSF is holding the vendors accountable for what is expected of them.

Ms. Jenkinson assured the Board that management and the project team meet regularly with Sabot and the vendor to assure that gaps are being recognized, discussed and addressed.

President Hubbard introduced the PBRI Project Managers, Sandy Leyva and Erika Ayers. He commended the remarkable job they have been doing on a day to day basis running this project. He added that based on MSF's past-history of implementing a system development project, management and the team knew that this would be a major leap for MSF. He said past experience and research clearly indicate that the success of a project of this size also means the customer, MSF in this case, must be prepared to make the investment in personnel and resources. He said management and the team are fully invested and are working with the vendors to achieve success.

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.

Mr. Cullen shared the organizational chart of BOI and assured the Board that they employ a very capable staff to manage the MSF's assets. He said BOI's investment objective for MSF is to attain investment returns that assist MSF in meeting liabilities as well as maintaining stable, cost effective rates for workers' compensation insurance. To do so, they employ an investment philosophy that includes a long-term focus, an active management style, managing the downside risks and controlling costs.

He explained that MSF's portfolio is in different asset classes which are investment grade fixed income, bonds, equities and some real estate investments. He noted that the capital market assumption is that returns across most asset classes are expected to be lower over the next ten years. He said investments and capital markets have been through an extremely good period since 2009 and though there is no expectation of a recession continuing to see these strong investment returns will be a challenge going forward.

Mr. Cullen turned the presentation over to Mr. Putnam.

Mr. Putnam provided a brief review of the equities, core real estate and fixed income markets and explained recent fluctuations and changes that have been occurring. He 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 has added two additional core real estate managers to increase the diversification of real estate investments. He said the portfolio had solid performance over every time frame vs. the benchmark. He stated that the MSF investment pool continues to perform well; however, returns are expected to moderate over the next few years. He noted that BOI takes a long-term view of the portfolio with a focus on managing downside risk.

Chair Zanto called for questions.

Ms. Moss asked if there were a major disruption in the marketplace what would BOI's communication protocol be for notifying MSF?

Mr. Putnam said BOI has a very open line of communication with Mr. Barry, Ms. Martello, President Hubbard and various staff members at MSF and would not hesitate to reach out immediately if there were an issue of concern. He said BOI and MSF staff meet a couple of times a year and there are exchanges between both regularly. He added that since BOI tends to take a long term view the markets would have to drop fairly precipitously to require that kind of immediate response.

President Hubbard added that the investment policy has a range of targets that allow BOI to manage the portfolio as they see fit. If there is a disruption, they will be reacting for all of the portfolios they manage. In 2007, MSF's portfolio took $50 - $60 million in realized and unrealized combined losses and BOI was very responsive in addressing how best to manage that. He said the important item to concentrate on may be the medical inflation vis a vis MSF's assumptions in rate making and how to manage the effects of that to a long-term return in MSF's invested assets. He also noted that BOI does not have to take MSF's input regarding MSF's investments; however, because of the very cooperative arrangement expressed in the policy statement, BOI does accept and respond accordingly to MSF's input.

Chair Zanto called for additional questions; there were none. He thanked Mr. Cullen and Mr. Putnam for their time and presentation.

B. *Calendar Year 2018 First Quarter Financial Report, Rene Martello, Controller*

Ms. Martello provided the financial report for the first quarter of 2018. She said as of March 31, 2018, total admitted assets decreased by $ 20.2 million in comparison to the first quarter of 2017.

Bonds were up $36.9 million as a result of purchases of $86 million offset by sales of almost $50 million. Equity securities were down by $16.3 million due to the sale of $15 million completed in early January and unrealized losses of $1.3 million. She noted that as of May 2018, equity markets are in a better position compared to March which has resulted in unrealized gains of $2.1 million in the equity balance. The cash variance of $25.4 million is higher than expected due to the SB4 transfer to the fire suppression fund of $14.7 million. The other invested assets, which include the core real estate investments, experienced some sales in the first quarter which resulted in a $2.5 million decrease from end of year. She said total admitted assets for the first quarter 2018 indicated a $20.2 million decrease from 2017. Liabilities and policyholder equity are also down $20.2 million due to unpaid losses being up $1.8 million, which includes the first quarter loss estimate of $29.4 million and adverse development of $2.6 million and offsetting that with the claim payments made and reinsurance changes that total $30 million. The significant variance in "other liabilities" is due to an accrual and accounts payable for the SB4 transfer which resulted in an $18.1 million change. Policyholder equity reflects a decrease of $4.1 million.

She said the income statement reflected net earned premium to be approximately $6 million less than the prior year at $160 million due to the eight percent rate decrease going into effect on July 1, 2018. Losses, loss expenses and underwriting expenses incurred are all comparable to the end of year amount for 2017 and reflect a net underwriting loss of $25.6 million. She noted that the income statement reflects a projection of $18.6 million net income before any dividend declaration.

Ms. Martello said policyholder equity was projected to be $560 million by end of year; however, since the equity is contributed to by a number of factors, this is a difficult projection to pin down. She compared the current projections to the Annual Business Plan, highlighting the underwriting loss $25.6 million which was fairly comparable to the business plan. She said the most significant variance to the plan was in the net realized capital gains of $13 million and was thanks to BOI's early action to sell equities in January before the market reacted. She noted that combined ratio which is total expenses divided by net earned premium, saw increases in 2017 partially due to the asset transfer from SB4 and in 2018 due to asset transfer and PBRI project costs.

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

C. *Calendar Year 2018 First Quarter Budget Report*

Ms. Martello said total expenditures as of March 31, 2018 were projected to be slightly over budget at the end of the year if the indemnity claim benefit payments continued at the level experienced during the first quarter. She noted that that since the first quarter the claims payments have been under the average monthly spend and are offsetting the projection for the year. She explained that this projection is monitored closely to assure that if an amendment is needed to cover those benefit claim costs, the Board can be prepared to address that before the end of the year. She said operational expenses were offsetting the forecasted overage in benefit payments with a total expenditures variance of $66,635 for first quarter.

She said operational expenditures are projected to be $1.5 million under projection due to a 5.4 percent vacancy rate and the effects of SB3 which temporarily suspended the contribution to the state employee group health insurance. Operating expenses were under by $360,000 due to the consulting costs and commissions being under budget. The allocated loss adjustment expenses saw a larger variance at $764,381 due to coding changes from claim benefit payments to ALAE based on the requestor for the services, MSF vs. injured worker.

Ms. Martello provided a slide requested by the Board at the last Board meeting that would reflect MSF's expenses in the aggregate for MSF's safety related expenditures.

Safety Expenditures	2018 Budget	2017 Actuals
Safety Services Team	$1,560,414	$1,497,873
Communications	679,256	832,594
Facilities	195,460	137,456
Safety Workshops	132,997	124,610
WorkSafe Champions	106,811	70,932
Growing a Safer Montana	63,789	34,560
Brand (safety material updates)	29,278	n/a
ACE Grants	25,000	27,086
Total	**$2,793,005**	**$2,725,111**

She said the safety services team is made up of 14 staff members, 12 of which are Safety Management Consultants (SMC). She noted that the communications costs are for advertising campaigns completed by Partners Creative, safety campaigns such as "Work Hard, Be Safe", YouTube videos, TV and radio ads, and other publications related to safety. The facilities category is support of the fleet vehicles or car maintenance for the SMC's and field office leases in Billings, Kalispell, Missoula, Butte and Great Falls. The safety workshops are run out of the Operations Support Department to arrange trainings and meetings, facility rentals at the various locations across Montana for the Safety Workshops that are available for all Montanans, not just policyholders. The Worksafe Champions and Growing a Safer Montana projects are individually budgeted for and she noted that the budget for Growing a Safer Montana which provides safety equipment to high schools, was doubled for the 2018 budget year to allow the program to expand. The brand category called for the update of all the safety-related brochures and materials with the new brand, mission, vision and values. She said the ACE grants program awards matching funds to non-profits enabling them to address safety-related issues. She also noted that there are additional costs for the safety team as well, such as IT services, PCs and overhead costs; however, those were not reflected in the slide.

Chair Zanto called for questions.

Ms. Van Riper noted that the overage amount in the claims benefit payments was being driven by indemnity and asked if there is any means for MSF to control the payout schedule to control the need to ask the Board for an amendment.

Ms. Martello said there are choices in claim management; however, the law states MSF is obligated to pay these benefits, which includes indemnity settlements. She noted that there was a higher amount of indemnity settlements that occurred in the first quarter that caused that amount to be off.

Ms. VanRiper asked why MSF's budget has to be approved annually by the legislature.

President Hubbard said MSF's budget is not approved annually by the legislature. He explained that MSF is still a state agency under the enabling laws that created MSF. The laws that apply to state agencies apply to MSF unless expressly exempted. The Board's budget authority is not subject to legislative approval; however, because MSF is part of the consolidated annual financial reports of the State of Montana, all of MSF's financial transactions must go through SABHRS and be structured and authorized through that process. One process is a budget authorization document that requests that the Board approved budget be entered in SABHRS for MSF's use; however, if the account does not show that funds are available, the check could not be written. That is the reason an amendment may be necessary.

Ms. Moss thanked Ms. Martello for the safety expenditure slide and said she felt it was important to articulate and document the funds and the support that MSF provides to workforce safety throughout Montana.

Chair Zanto called for additional questions. There were none.

D. *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, 2018 for premium of policies with coverage effective between July 1, 2015 and June 30, 2016. She said this is consistent with the valuation dates used over the past ten years and allows for a reasonable period or lapse of time to accurately review the maturity of the losses on those policies.

Ms. Moss moved the Board approve management's recommendation to utilize June 30, 2018 as the date to value premium and incurred losses on new and renewal policies from July 1, 2015 through June 30, 2016 for potential dividend calculation purposes. Ms. VanRiper 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.

E. *Old Fund Variance Report – State Fiscal Year 2018 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 the third quarter summary. She noted that all Old Fund expenditures are funded from the General Fund as require by law. She said the Old Fund is projected to come in at $8.1 million or 2.4 percent less ($198,000) than the initial funding estimate. She said claim benefit payments are under by $27,000 which is a rather close projection and staff will maintain a close review of these expenditures to assure adequate funding is available. She said operational expenses include the administrative cost that is paid to MSF to manage the Old Fund, DOLI assessments and loss adjustments expenses. Overall, it is projected to be $170,000 under. Included in the initial estimate was the $722,000 for administrative costs; however, SB261 was triggered and MSF had to adjust services to remain under the cap of $625,000. Nurse and medical consulting services were cut back to meet the cost restriction. She explained that total expenditures were expected to be slightly under $600,000 due primarily to the SB3 temporary suspension of the group health insurance payments for MSF staff who administer the Old Fund.

Chair Zanto called for questions; there were none.

F. *Old Fund Funding Estimate – State Fiscal Year 2019*
Ms. Martello provided the FY19 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 FY19 are expected to increase minimally to $8.2 million from FY18 yet remains below the FY17 funding estimate of $8.6 million. This slight increase is due to settlement activity declining in FY18 as well as high medical costs occurring with the claims that remain. She said benefit costs are estimated to be $7.4 million for FY19. She said there are 898 claims in the Old Fund in 2011; and since that time have been 82 new claims, 364 reopened, 704 closed claims and 641 claims currently opened.

Mr. Larsen asked how there could be new claims in the Old Fund?

Ms. Martello said claims such as asbestos claims where the injury occurred prior to July 1, 1990 would be considered an Old Fund claim and paid out from that fund. She said it is very complicated to assess the policyholder and who the employer was at the time of injury.

She said the highest cost to the Old Fund is the medical costs, estimated to be $4.8 million for FY19. Indemnity was projected to be $1.4 million with settlements expected to slow in the future. She noted that operational expenses will hit $624,701, assessments are at the same rates and estimated to be $104,236 and ALAE is projected to be $135,348 for a total operational expense of $864,285.

She said the total Old Fund funding estimate is $8,230,929. She noted this will be provided to the Budget Office and entered into SABHRS for the spending authority to be drawn from the General Fund.

Chair Zanto called for additional questions. There were none.

Mr. Mohr made a motion the Board approve the executive staff recommendation of $8,230,929 for the FY19 Old Fund estimated benefit payments and administration costs for reporting to the State of Montana for funding from the general fund. Mr. Larsen 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 2018 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 18 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. 39-71-2317, MCA set the authority for the Board for setting of CEO Compensation. Statute 2-18-103 exempts the CEO from the state classification and compensation plan.

Up until FY2014, the compensation of the CEO had both base salary and variable compensation in the form of an incentive plan. The incentive plan was eliminated in 2014 and there is an impact from this on the competitiveness of the CEO's total compensation.

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. 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, their location is 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 position (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 2017.

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 11:49 am 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 Performance Review

A. *Introduction – Lance Zanto, Chair of the Board*
Chair Zanto reconvened the meeting at 1:42 p.m. and thanked the attendees for their patience while the Board conducted a performance analysis and salary review of President Hubbard during the Board's closed session.

B. *President/CEO's Annual Compensation*
Chair Zanto made a motion that the annual base compensation of Laurence Hubbard, President and CEO of Montana State Fund, be set by the Board at $350,000, effective March 3, 2018. Ms. Moss seconded the motion. Chair Zanto called for discussion; there was none. He called

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

C. Budget Amendment for the Calendar Year 2018
Chair Zanto made a motion that the budget for Calendar Year 2018 be amended to acknowledge the Board-approved adjustment to the President/CEO's base compensation. Ms. VanRiper seconded the motion. Chair Zanto called for further discussion; there was none. Chair Zanto called for discussion from the audience; there was none. He called for the vote and the motion passed unanimously.

VII. Old Business/New Business

Chair Zanto called for Old or New Business.

President Hubbard thanked the Board for their consideration and said it was a pleasure and an honor to serve this Board of Directors and to work with the fine MSF staff. He said he is looking forward to the challenges MSF will be facing in the future for many years to come.

Chair Zanto expressed, on behalf of the entire Board, their appreciation for President Hubbard's hard work.

Ms. VanRiper added that the Board feels honored to be on the Board of MSF and to be a Board of Directors for such a hard-working, dedicated and successful Executive Staff and CEO.

Chair Zanto called for further comments; there were none.

VIII. Public Comment

Chair Zanto called for public comment. There was none.

The meeting was adjourned at 1:46 pm. The next scheduled Board Meeting will be held on Thursday, September 20, 2018 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