

**MONTANA STATE FUND
BOARD APPROVED FISCAL YEAR 2016 ANNUAL BUDGET
(Effective for period of July 1, 2015 to December 31, 2015)**

Montana State Fund (MSF) is a nonprofit, competitive workers' compensation insurance organization. Under state law, MSF provides Montana businesses with an option for workers' compensation and occupational disease insurance and also guarantees available coverage for all employers in Montana. During the 2015 Legislative Session, SB 123 passed with an effective date of January 1, 2016. As a result of this law change, MSF is subject to oversight and regulation by the State Auditor, Commissioner of Securities and Insurance (CSI) and is required to convert financial reporting processes to a calendar year basis.

Current law, 39-71-2363(2), MCA, requires delivery of the board approved budget to the governor and the legislature. Law also requires delivery of the estimated budget to the legislative fiscal analyst no later than October 1st of each year. A "Budget Change Document" (BCD) is submitted to establish the board approved annual budget or amendments on the State's budgeting and general ledger systems.

Please note, until January 1, 2016, MSF will follow the current law and then replace this budget with a new annual budget to cover the first calendar year. For compliance and comparability with prior years, this budget covers a full year from July 1, 2015 to June 30, 2016. However, management will return in December of this year to propose and request the board's approval of a new annual budget that covers the period of time from January 1, 2016 to December 31, 2016.

The Fiscal Year 2016 (FY16) Budget provides the funding to enable MSF to continue our role of providing a stable guaranteed workers' compensation market for Montana, implement our business plan initiatives, and effectively support business operations. The FY16 Budget (covering the period of July 1, 2015 to June 30, 2016) includes funding for all expenditures of MSF operations, as supported by policyholder premiums and investment income.

The following table summarizes the MSF FY16 Budget and comparative prior year data.

	<u>FY16 Budget</u>	<u>FY15 Projection</u>	<u>FY15 Budget as Amended</u>	<u>FY14</u>	<u>FY13</u>
FTE	306.00	304.00	304.00	304.00	289.00
Positions	308	306	305	305	291
Operational Expenditures	\$53,048,546	\$50,411,109	\$51,849,323	\$46,819,824	\$46,939,357
Benefit Payments	<u>\$125,271,222</u>	<u>\$117,405,377</u>	<u>\$117,595,106</u>	<u>105,934,616</u>	<u>111,690,340</u>
Total MSF	<u>\$178,319,768</u>	<u>\$167,816,486</u>	<u>\$169,444,429</u>	<u>\$152,754,440</u>	<u>\$158,629,697</u>

This budget includes the expenditures necessary to administer and manage Old Fund claims. These are claims for injuries that occurred prior to July 1, 1990. By law, MSF is reimbursed by the state General Fund up to \$1.25 million a year for Old Fund administration cost. However, we are estimating that only \$789,838 will be needed for FY16. The estimated amounts needed to pay Old Fund benefits and other costs paid by the general fund are outlined separately in the ‘Old Fund Fiscal Year 2016 Funding Estimate’.

This budget includes the financial resources to support the FY16 Annual Business Plan (ABP) initiatives and projects noted below.

FY16 Expenditures for the Annual Business Plan (ABP) and Enterprise Strategy and Project Management (ESPM) Projects

<u>Project Type</u>	<u>Project Description</u>	<u>FY16 Project Expenditure</u>
ABP	Calendar Year Conversion (SB123)	\$448,380
ABP	Policy & Billing System Replacement	209,156
ABP	Change Management & Communication (SB123)	109,664
ABP	Rates and Rate Filing (SB123)	101,200
ABP	Regulation (SB123)	<u>85,273</u>
	Subtotal	\$953,673
ESPM	Succession Planning	\$166,774
ESPM	Work Safe Champions	<u>157,000</u>
	Subtotal	\$323,774
	<u>Total ABP and ESPM Projects</u>	<u>\$1,277,447</u>

The Annual Business Plan Project for Regulation also has an associated new position for a Compliance Officer. The 1.00 FTE and \$119,793 personal services budget for this new position is included in the General Counsel’s budget. Including the budget for the Compliance Officer, the total FY16 budget for project expenditures is \$1,397,240.

I. Executive Summary – Statutory Operating Expense Ratio

The statutory operating expense ratio is a standard financial measurement for insurance organizations to analyze the cost of operations in relation to net earned premium and allows MSF to compare operational management to competitors and the industry. The statutory operating expense ratio encompasses accounting adjustments, such as depreciation and amortization expenses, that are not displayed in an expenditure driven budget.

Based on the items included in the budget and the estimated net earned premium, which includes a 5% rate reduction, we have estimated the FY16 statutory expense ratio to be 28.2%. The following table displays the statutory operating expenses, net earned premiums and the FY16 expense ratio with comparison to previous years.

Montana State Fund	FY16 Budget	FY15 Projection	FY15 Budget	FY14 Actuals	FY13 Actuals
Statutory Operating Expense	\$44,289,750	\$43,302,682	\$45,402,582	\$36,411,176	\$53,249,410
Net Earned Premiums	\$157,106,579	\$165,563,001	\$167,038,943	\$165,271,880	\$156,062,480
Statutory Operating Expense Ratio	28.2%	26.2%	27.2%	22.0%	34.1%

MSF's *operational expenditures* (personal services, operating expenses, equipment and intangible assets, and allocated loss adjustment expense) are \$53,048,546 for the fiscal year's budget, and *statutory operating expenses* are \$44,289,750. The statutory operating expense ratio excludes specific 'expenditures' and includes other 'expenses' based on Generally Accepted Accounting Principles (GAAP) and statutory accounting principles.

The statutory operating expense is divided by estimated net earned premium of \$157,106,579 to determine the FY16 estimated expense ratio of 28.2%.

The following table compares the MSF statutory operating expense ratio with the property and casualty insurance industry and other state funds based on 2013 data from 2014 A. M. Best's *Aggregates & Averages*.

A.M. Best's Total US PC Industry – (1,266 P&C Organizations)	A.M. Best's Work Comp Composite – (253 Organizations)	A.M. Best's Total US PC State Funds – (26 Organizations)	MSF FY13	MSF FY14	MSF Projected FY15	MSF Budget FY16
39.0%	35.9%	30.1%	34.1%	22.0%	26.2%	28.2%

II. Revenue

The premium revenue MSF generates in Montana's competitive workers' compensation insurance market, along with investment income, provides the funding for operational expenses; indemnity and medical claims reported by MSF policyholders; and contribution to equity, if necessary.

For FY16, MSF is projecting net earned premium of \$157,106,579. The estimate assumes:

- 25,911 policies written in FY16
- 5% manual rate reduction for policy year 2016
- Wage growth of 2.5%
- Premium retention rate at 91.1%
- New business written of \$11.9M

III. Total Expenditures

The total budget for FY16 expenditures is \$178,319,768 and is separated into four primary expenditure categories and displayed below with comparative expenditures from the year-end projection of FY15 and the approved FY15 budget. As used throughout this report, the FY15 Budget includes the \$8.0 million budget amendment for medical benefit payments approved by the Board on May 1, 2015.

Categories	FY16 Budget	FY15 Projection	FY15 Budget
MSF - Benefits and Claim Payments	\$125,271,222	\$117,405,377	\$117,595,106
Allocated Loss Adjustment Expenditures	3,424,640	2,959,758	2,712,955
Unallocated Loss Adjustment Expenditures	16,634,433	16,122,190	16,486,255
Underwriting Expenditures	32,989,473	31,329,161	32,650,113
Total MSF Expenditures	\$178,319,768	\$167,816,486	\$169,444,429

The total MSF budget of \$178.3 million is an increase of \$10.5 million or 6.3% from the FY15 projection of \$167.8 million. The FY16 budget for claim benefit payments to injured employees of \$125.3 million equates to 70.3% of the total budget. Claim benefit payments to injured employees increase by \$7.9 million or 6.7% as compared to the FY15 projection.

Operational expenditures comprise \$53.0 million or 29.7% of the FY16 budget. Operational expenditures increase by \$2.6 million or 5.2% as compared to the FY15 projection.

IV. Benefit Payments

The FY16 claim benefit payments budget of \$125.3 million is an increase of \$7.9 million or 6.7% from the FY15 projection of \$117.4 million. Medical benefit payments are estimated to increase by 9.4% and indemnity benefit payments are estimated to increase by 1.1% from amounts projected for FY15.

MSF expects claim benefit payments to increase above the projected FY15 level due to the implementation of a standardized process to settle claims in relation to HB334. This standardized settlement process started in December 2014. The increase in medical claim benefit payments for FY16 reflects a full fiscal year of expenditures under the standardized settlement process, as compared to only seven months being at this level in FY15.

Provisions in HB334 enabling undisputed medical settlement have accelerated benefit payments to injured employees in FY15 and are planned to continue into future years. The acceleration of the benefit payments is expected to reduce the ultimate claim liability of future years.

The budget includes the addition of a new accident year's claim payments to the estimate of payments on existing claim liabilities. The benefit payments budget does not include contingency funds related to court decisions.

The following table reflects the budgeted FY16 MSF benefit payments, projected FY15 benefit payments, and ten years of actual payments.

Fiscal Year	Net Earned Premium	Benefits as a Percent of NEP	Benefit Payments	Percent Change in Benefit Payments from Prior Year
FY16 Budget	\$157,106,579	79.7%	\$125,271,222	6.7%
FY15 Projection	\$165,563,001	70.9%	\$117,405,377	10.8%
FY14 Actual	\$165,271,880	64.1%	\$105,934,616	-5.2%
FY13 Actual	\$156,062,480	71.6%	\$111,690,340	0.8%
FY12 Actual	\$150,482,457	73.6%	\$110,752,851	-0.6%
FY11 Actual	\$173,605,442	64.2%	\$111,420,055	-9.4%
FY10 Actual	\$166,265,384	74.0%	\$123,003,870	0.4%
FY09 Actual	\$203,976,354	60.0%	\$122,460,166	-1.4%
FY08 Actual	\$230,965,307	53.7%	\$124,139,778	7.2%
FY07 Actual	\$238,202,708	48.6%	\$115,849,169	5.1%
FY06 Actual	\$211,892,198	52.0%	\$110,237,048	11.9%
FY05 Actual	\$189,378,858	52.0%	\$98,479,963	

The next table displays MSF and Other States Coverage (OSC) benefit payments separately as compared to the FY15 projected and FY14 actual expenditure levels below.

Benefit Payments	FY16 Budget	FY15 Projection	FY14 Actual	\$ Change FY16 from FY15 Proj.	% Change FY16 from FY15 Proj.
MSF	\$123,966,222	\$116,293,028	\$105,128,400	\$7,673,194	6.6%
OSC	1,305,000	1,112,349	806,216	192,651	17.3%
Total	\$125,271,222	\$117,405,377	\$105,934,616	\$7,865,845	6.7%

MSF – All Accident Years

\$123,966,222 is budgeted for MSF (no OSC) claim benefit payments to injured employees for the following benefit types:

- Indemnity - \$37.8 million or 30.5% of total benefits
- Medical - \$86.2 million or 69.5% of total benefits

The benefit estimates are based on analysis of the actual ‘Accident Year’ benefit payments for each fiscal year from 1991 through April 30, 2015. The more recent FY14 and FY15 benefit payments for all ‘Accident Years’ are weighted most heavily in the determination of the FY16 benefit payments. Consideration has been given to the acceleration of settlement activity in the latter half of FY15 and this settlement activity is expected to continue through 2016.

Benefit Payments*	Indemnity	Medical	Total
FY16 Budget	\$37,775,181	\$86,191,042	\$123,966,222
FY15 Projection	\$37,509,973	\$78,783,056	\$116,293,028
FY14	\$36,965,855	\$68,162,545	\$105,128,400
FY13	\$37,418,731	\$72,998,611	\$110,417,341
FY12	\$40,832,807	\$69,139,443	\$109,972,250
FY11	\$40,007,198	\$70,571,894	\$110,579,092
FY10	\$50,943,453	\$71,433,192	\$122,376,644

*No Other States Coverage program benefit payments are included in the data.

Other States Coverage (OSC)

The OSC program enables MSF policyholders with employees working in other states the ability to insure all their workers' compensation needs through MSF. MSF contracts with carriers licensed to provide workers' compensation insurance to our policyholders in other states.

OSC benefit payments are estimated to be \$1,305,000 and include:

- \$435,000 - Indemnity payments
- \$870,000 – Medical Payments

Including operational expenditures of \$943,000, the total budget for OSC expenditures is \$2,248,000. The operational expenditures are driven by contractual rates based on written premium. OSC written premium is estimated to be \$2.5 million in FY16 and funds the program. OSC operational expense are detail in latter sections of this report however the following table list expenditures and premium of the OSC program for FY16 and FY15.

<u>OSC Program</u>	<u>FY16 Budget</u>	<u>FY15 Projection</u>	<u>FY15 Budget</u>
Program management, fronting fees, letters of credit	\$493,000	\$416,635	\$417,666
Commissions	200,000	177,109	165,802
Premium Tax	105,000	92,045	87,046
ALAE	<u>145,000</u>	<u>91,045</u>	<u>67,357</u>
Operational Expenditures	\$943,000	\$777,771	\$737,872
Claim Benefit Payments	<u>\$1,305,000</u>	<u>\$1,112,349</u>	<u>\$1,279,785</u>
OSC Total Expenditures	\$2,248,000	\$1,890,120	\$2,017,657
OSC Written Premium	\$2,500,000	\$2,213,859	\$2,072,527

V. Operational Expenditures

Operational expenditures include personal services, operating expenses, equipment and intangible assets, and Allocated Loss Adjustment Expense (ALAE).

Operational Expenditures	FY16 Budget	FY15 Projection	FY15 Budget
FTE	306.00	304.00	304.00
Positions	308	306	305
Personal Services	\$27,389,875	\$25,614,837	\$26,608,599
Operating Expense	21,896,766	20,974,637	21,410,770
Equip & Int Assets	337,265	861,877	1,116,999
ALAE	3,424,640	2,959,758	2,712,955
Total MSF	\$53,048,546	\$50,411,109	\$51,849,323

MSF Staffing

MSF continually evaluates and re-aligns our staff to meet the changing work processes. The State Fund is approved for 306.00 FTE (full time equivalent) for FY16. This is an

increase of 2.00 FTE from FY15. Both the new positions, a Compliance Office and a Paralegal, are assigned to General Counsel.

The 306.00 FTE equate to 308 positions. In FY16, MSF will have 304 positions that are 1.00 FTE each, and four half-time positions listed as 0.50 FTE each.

The following table reflects MSF staffing by department.

MSF Department Staffing (FTE)	FY16 Budget	FY15	FY14	FY13
Corporate Support	34.00	34.00	33.00	33.50
Executive Offices	6.00	6.00	6.00	6.00
General Counsel	18.00	16.00	16.00	15.50
Human Resources	7.00	7.00	6.00	6.00
Information Technology	53.00	53.00	53.00	52.00
Operations	146.00	146.00	138.00	137.00
Operations Support	41.00	41.00	49.00	39.00
ABP Succession Project	1.00	1.00	3.00	n/a
MSF Total	306.00	304.00	304.00	289.00

The staffing changes between FY14 and FY15 in the Operations and Operations Support department were the result of the Operations Optimization project which involved moving some staff and teams to different areas in the company.

Personal Services

To support the necessary staff of 306.00 FTE, MSF has approved funding of \$27,389,875 for the FY16 personal services budget. A vacancy savings factor of 3.0% was applied to the personal services estimates of all MSF positions to reduce the budgeted amount.

MSF Total Personal Services Budget	FY16 Budget	FY15 Projection	FY15 Budget	FY16 Variance from FY15 Bud
Salaries	\$21,219,826	\$19,412,565	\$20,788,415	2.1%
Employee Benefits	7,005,487	6,202,272	6,633,984	5.6%
Vacancy Savings	(835,438)		(813,800)	2.7%
Total Personal Services	\$27,389,875	\$25,614,837	\$26,608,599	2.9%

The FY16 personal services budget increases by \$781,276 or 2.9% from the FY15 budget. With the addition to the increase of 2.00 FTE, salaries increase by 2.1% and employee taxes and benefits increase by 5.6%. The FY16 budget increase is \$1,775,038 or 6.9% when compared to the FY15 projection.

Salary budget items of \$21.2 million include regular salaries for 308 positions / 306.00 FTE, overtime, Personal Leave Program payouts, and planned retirement payouts. The salary budget items are outlined as follows.

Regular Salaries - \$20,895,052

The regular salaries account includes base salaries and merit based salary adjustments.

- \$20,388,864 for base salaries (no employee taxes or benefits) is calculated on the hourly wage for all active employees as of April 6, 2015. Vacant position budgets

were based on the compensation at mid-point for the position's salary band. FY16 will have 2,092 annual payroll hours for each FTE. Partial FTE salaries are prorated.

- \$506,188 for merit based salary adjustments (no employee taxes or benefits). The merit salary adjustments for employees are paid after the final FY15 performance reviews are completed. For the FY16 budget a merit adjustment of 3.0% was assumed to be effective September 12, 2015. No merit adjustment was budgeted for the President.

Overtime - \$22,943 – Supports additional workload coverage during the policy renewal periods. The budget provides for on-call and call-out compensation to support computer systems and infrastructure.

Personal Leave Program Payouts - \$143,722 – MSF's Personal Leave Program provides for the annual payment of excess unused personal leave balances to eligible participants in accordance with the program guidelines. The FY16 budget estimate is based on FY15 payments and review of leave balances of participants.

Retirement and Termination Payouts – \$158,108 - Includes funding for leave balance payouts of seven expected retirements and one possible termination in FY16. This amount is for the salary portion of the leave balances. The associated employee taxes and benefits for these retirement payouts are budgeted to those specific accounts.

Employee Taxes and Benefits - \$7,005,488

Employee Taxes and Benefits are payments / contributions MSF makes on behalf of our employees as a tax or as workers' compensation premium. The following lists employee tax and benefit categories, and the dollars budgeted.

- FICA / Medicare – 7.65% of applicable salary- \$1,574,800
 - ✓ The rate remains unchanged from FY15 however, the FICA salary cap increases from \$117,000 to \$123,600 effective 1/1/16.
- Retirement (PERS) – 8.37% of applicable salary - \$1,774,179 is the employer's contribution.
 - ✓ The PERS contribution rate increased 0.1% from the FY15 rate per law, 19-3-16(2)b, MCA
- Workers' Compensation Premium – average of approximately 0.852% of applicable salary - \$180,984
 - ✓ The average rate for FY16 is a reduction from the FY15 budgeted average rate of 1.04%
- State Unemployment Tax (SUT) – 0.15% - \$32,701
 - ✓ MSF's employer contribution rate for SUT was revised in May 2015 to 0.15% for FY16 from the 0.45% FY15 rate.
- Group Insurance - \$3,442,824
 - ✓ The FY16 annual employer contribution for group insurance is \$11,178 per eligible employee. This is an annual increase of \$1,020 or 10% per eligible employee from the FY15 contribution of \$10,158. In FY16, MSF will have a

maximum of 308 employees eligible for the group insurance contribution and the increase drives \$281,820 in additional expense.

Vacancy Savings - \$835,438

Vacancy savings is a reduction of 3% that has been applied to the calculated salaries and employee taxes and benefits on all MSF positions. This is the same rate used in the FY15 budget.

All MFS positions are budgeted to be filled all year. However, turnover occurs. Exactly which positions will be vacated during the fiscal year cannot be determined but at an aggregate level we can determine a reasonable estimate on vacancies and an appropriate budget reduction.

Actual vacancy savings will vary by department and departments that do not experience staff turnover will likely be over budget in personal services. Conversely, departments that experience higher staff turnover than expected will be under budget in personal services categories. In aggregate, MSF estimates 3% vacancy savings.

Operating Expenses

The MSF budget for Operating Expenses is \$21,896,766 and includes funding in the following categories:

Category	FY16 Budget	FY15 Projection	FY16 Variance from FY15 Proj	FY15 Budget
Other Services	\$16,334,991	\$15,756,624	3.7%	\$15,868,947
Supplies & Materials	615,643	642,923	-4.2%	654,226
Communications	1,269,039	1,082,345	17.2%	1,156,164
Travel	297,317	245,138	21.3%	293,213
Rent	362,274	438,981	-17.5%	367,818
Utilities	224,000	215,531	3.9%	223,500
Repairs & Maintenance	1,376,356	1,497,328	-8.1%	1,610,196
Other Expenses	1,417,145	1,095,768	29.3%	1,236,706
Total Operating Expenses	\$21,896,766	\$20,974,637	4.4%	\$21,410,770

Other Services - \$16,334,991 is budgeted and is comprised of the following sub-categories

- **Consulting and Professional Services - \$3,043,243** – This is an increase of \$583,500 or 23.7% from the FY15 projection of \$2,459,743. The following table compromises 87% of the total Consulting and Professional Services budget. The expenditures are necessary to complete Annual Business Plan initiatives and other operational aspects of MSF business.

Consulting and Professional Services

FY16 Budget	Department	Item / Description
\$865,815	Operations	NCCI Membership Fee Agreement and transaction based charges (membership required by law)
\$716,073	ABP / ESPM	Annual Business Plan and Enterprise Strategy & Project Management projects
\$493,000	Operations	Other States Coverage program costs
\$346,500	Executive	Actuarial services
\$214,430	Executive	Promotional and Communication

- ✓ **National Council on Compensation Insurance (NCCI)** – \$865,815 – This is an increase of \$78,550 or 10.0% from the FY15 projection of \$787,265. The budget reflects the following:
 - The current contract with NCCI that became effective January 1, 2015.
 - The NCCI Membership Fee is primarily based on percentages that vary by core service, of net direct written premiums from FY14. The FY14 net direct written premium used to calculate the membership fee was \$172,253,649. Total FY16 budget for the NCCI ‘Affiliation Licenses and Services’ is \$498,315.
 - Other fees are associated with the services provided by NCCI, such as eMods, unit statistical reporting, proof of coverage, and additional data. MSF is charged a transaction fee when receiving or providing data to NCCI. These fees are budgeted to be \$367,500.

- ✓ **ABP and ESPM Projects** - \$716,073 – Consulting and professional services portion of ABP and ESPM projects:
 - \$200,000 – Policy and Billing System Replacement - ABP
 - \$183,000 – Calendar Year Conversion – ABP
 - \$101,200 – Rates and Rate Filing – ABP
 - \$56,873 – Regulation – ABP
 - \$125,000 – WorkSafe Champions – ESPM
 - \$50,000 – Succession Planning - ESPM

- ✓ **Other States Coverage (OSC)** – \$493,000 - The budget is based on total estimated OSC premium of \$2,500,000 for FY16.
 - \$248,750 - Per OSC contract with Zurich, MSF pays 9.95% of the written premium as ‘fronting fees’ – expense of writing policies.
 - \$152,250 - Contracts provide for 10.5% of incurred losses, estimated to be \$1.45 million, as unallocated loss adjustment expense for expenses not attributable to a specific claim. This is the cost of providing claims adjusting and supervision services required to support the classes of business reinsured under our agreement.
 - \$92,000 - A letter of credit is required of MSF per contract.

- ✓ **Independent Actuary** - \$346,500 – The Board is required by law to use the services of an independent actuary when estimating losses, dividends, and other areas of business. This budget will fund actuarial services to consult on rate level, loss cost multipliers, loss reserves, and, equity and dividend analysis. The FY15 expense for actuarial services is projected to be \$371,500.

- ✓ **Promotional Campaign and Communications Development** - \$214,430 – This is for the consulting services to create MSF advertising campaigns, producing the advertising products, customer documents, photography shoots and administration and assistance on communication projects. This is separated from the cost of air time or other means of advertising.

- ✓ **Other Consulting and Professional Services Items** - \$401,425
 - \$100,000 – consulting or other services for business support deemed appropriate by the President
 - \$75,000 – outsourced insurance computing services for support of claim analytics
 - \$54,920 – compensation consulting, position reviews, merit adjustment planning, and peer group surveys
 - \$37,372 – Medical Director expense for training providers and MSF staff
 - \$37,016 – Department of Justice (DoJ) expense related to policy investigations and prosecutions. The total DoJ agreement funding is \$370,164 with 90% allocated to claimant and provider investigations and prosecutions and 10% directed to policy investigations and prosecutions based on cases currently assigned to DoJ and historical expense.
 - \$33,917 – national fraud indexing service (ISO) to check new claims for prior fraudulent activities and Medicare Set Aside reporting.
 - \$30,000 – consultants to assist IT with the ‘Core Provisioning’, a rule-based system used to set up employees to access and work in the many applications used to conduct business at MSF. Core Provisioning will help preserve corporate knowledge in anticipation of staff approaching retirement.
 - \$24,000 – Development and facilitation of executive training programs
 - \$9,200 - Board member stipends and other miscellaneous services

- **Insurance and Bonds** - \$406,247 – this is a \$108,691 or 36.5% increase from the FY15 expense of \$297,556. All MSF insurance is provided through the state’s division of Risk Management and Tort Claims of the Department of Administration. The state is self-insured. This is a cost charged to MSF based on the Governor’s Office of Budget and Program Planning’s (OBPP) ‘Fixed Cost’ report and an increase appropriated during the 2015 Legislative Session based on increased losses reported by other agencies.

- **Legal Fees and Court Costs** - \$100,000 - this is an increase of \$42,471 or 73.8% from the FY15 projection of \$57,529. The budget will fund employers’ liability coverage opinions, bankruptcy issues and other cases.

- **Warrant Writing** - \$43,484 – this is an increase of \$3,119 or 7.7% from the FY15 projection of \$40,365. MSF’s medical bill processor issues checks for all medical related expenses but MSF relies on the state to issue all other warrants. The estimate is based on the OBPP Fixed Cost report and prior year expenditures.
- **State Human Resources Information System (Payroll) Service Fee** - \$60,424 – this is an increase of \$793 or 1.3% from the FY15 projection of \$59,631. The budget is based on OBPP Fixed Cost and will be charged to MSF for services of the State’s Central Payroll and SABHRS Human Resource module.
- **Policyholder Payroll Audits** - \$888,934 – this is an increase of \$71,284 or 8.7% from the FY15 projection of \$817,651. For FY16, MSF plans to continue using external audit services to perform policyholder payroll audits. These audits may be conducted in the field or as a telephone audit. Payroll audits are a significant means to verify payrolls and ensure appropriate classifications are used, as well as creating additional opportunities to educate policyholders on MSF processes for reporting payroll.
- **Financial and Legislative Audits** - \$215,272 – this is an increase of \$112,189 or 108.8% from the FY15 projection of \$103,083.
 - \$70,272 is for the Financial Compliance audit performed by the Legislative Audit Division (LAD) of the MSF governmental financial statements. This includes \$10,000 for an independent actuarial review (contracted by LAD) of MSF rates and reserves as required under current law.
 - \$62,000 is for an independent accounting firm to audit our annual statutory financial statements.
 - \$21,000 is for an audit of the Vocational Rehabilitation contract. The contract is due to renew 7/1/16 and this audit will provide insight to evaluate vendor and MSF adherence to the current contract and quality of work being performed.
 - \$62,000 is budgeted with the Calendar Year Conversion project for additional expense associated with audit of the ‘short year’ (July 1 through December 31, 2015).
- **Consultants – Training** - \$194,163 – this is an increase of \$108,403 or 126.4% from the FY15 projection of \$85,760. The budget will enable MSF to bring trainers on-site and provide for a larger number of employees to participate in the training rather than sending a limited number of employees to external locations.
 - \$114,163 - continuing professional development for executive and leadership staff along with consultants to provide training seminars on insurance curriculum
 - \$50,000 – Carl Van conducting on-site training for ‘Awesome Adjuster’, ‘Negotiation Skills’, ‘Time management’, and ‘Consistency in Estimating’
 - \$25,000 – insurance licensing training for Customer Service Specialists as required by SB123 and is budgeted in the Regulation project
 - \$5,000 – professional customer services trainer to present at annual Customer Service Representative and Customer Service Specialist conference

- **Commissions** - \$10,785,488 – this is a decrease of \$486,566 or 4.3% from the FY15 projection of \$11,272,054 which includes base, incentive, and Other States Coverage commissions. Commissions are directly and proportionately related to gross premiums, percentage of MSF policyholders represented by agents, and the commission rates paid on a policy. The payment of commissions supports service and distribution capabilities with our agent partners.

Base Commissions:

In aggregate, MSF estimates FY16 gross earned premiums (excludes OSC premium) to be \$166,484,604 with agents representing approximately 71.7% of this amount. The average base commission rate is 7.6%. The FY16 budget is \$9,092,499 for base commission and the FY15 projection is \$9,559,078.

Incentive Commissions:

Incentive commissions are determined after reviewing profitability and retention of an agency's overall book of MSF-represented accounts. The average agent incentive commission rate is expected to be 1.25% though not all agents may qualify for the incentive commission. \$1,492,989 is budgeted for the FY15 agent incentive commission and the FY15 projection is \$1,535,867.

Other States Coverage (OSC) Commissions:

\$200,000 is budgeted for commissions associated with OSC policies and the FY15 projection is \$177,109. The total FY16 revenue estimated for OSC is \$2.5 million. The average commission is 8%.

- **SABHRS Administrative Costs** - \$77,535 – this is an increase of \$12,680 or 19.6% from the FY15 projection of \$64,855. This is paid to the Department of Administration and is MSF's portion of the expense for maintaining the state's accounting system, SABHRS. This expense is from OBPP's Fixed Cost report which uses a ratio of 'financial journal lines' by user as the basis for distributing the cost of SABHRS financial modules cost. Expenditures of \$100,000 are also included in the Calendar Year Conversion project to cover SABHRS system changes necessary for implementation of SB123.
- **Temporary Services** - \$54,080 – this is a decrease of \$48,977 or 47.5% from the FY15 projection of \$103,057. MSF uses temporary staff to fill in for vacancies as business needs require. The two areas of temporary services items are:
 - ✓ \$50,000 – to enable the hiring of temporary claims examiners to maintain service levels during periods of claim examiner position vacancies.
 - ✓ \$4,080 – Facilities will require temporary custodial services to cover staff personal leave and position vacancies.
- **Miscellaneous Information System Services - Non-DOA** - \$69,355 – this is a decrease of \$5,260 or 7.0% from the FY15 projection of \$74,615.
 - ✓ \$67,860 - Disaster recovery services
 - ✓ \$1,020 – Montana Integrated System to Improve Customer Service (MISTICS) – Department of Labor and Industry's unemployment insurance system used in

- ✓ determining workers' compensation eligibility
 - ✓ \$475 – Public Access to Court Electronic Records (PACER) system for bankruptcy research and International Risk Management Institute (IRMI) on line subscription
- **Records Storage** – \$29,039 – this is an increase of \$4,771 or 19.7% from the FY15 projection of \$24,268.
 - ✓ \$10,596 – Off-site storage of back-up tapes with State Records Management
 - ✓ \$10,200 – Microfiche retrieval of older MSF and Old Fund claim data for the Strategic Claims team
 - ✓ \$8,243 – All other finance, legal, and claim information retrieval from data archived with State Records Management.
- **Printing** - \$128,119 – this is an increase of \$13,299 or 11.6% from the FY15 projection of \$114,819. This includes internal forms, envelopes, safety workshop materials, and a variety of small printing jobs for brochures, business cards, envelopes, and other informational materials.
- **Services provided by the State Information Technology Services Division (SITSD) of the Department of Administration** - \$532,954 – this is an increase of \$99,742 or 23.0% from the FY15 projection of \$433,213.

SITSD, in conjunction with OBPP, has determined the rates and expenses to be charged to MSF for services in the FY16 and FY17 Biennium. MSF reviews processes and charges regularly and continually seeks the most efficient means to provide staff network support/services and to avoid the use of unnecessary or duplicative ITSD network services to minimize expense.

The budgets by SITSD category are as follows:

- ✓ \$205,030 – enterprise services
- ✓ \$161,436 – network services
- ✓ \$101,735 – asset broker
- ✓ \$38,904 – long distance – MSF estimated charges to use SITSD long distance provider, per State contract
- ✓ \$14,988 – storage, server, and application hosting
- ✓ \$10,212 – e-mail
- ✓ \$649 – voice services

Supplies and Materials

- **Educational Supplies** - \$28,717 – this is an increase of \$7,171 or 33.3% from the FY15 projection of \$21,546. The budget provides for purchase of materials used in courses for MSF staff training and safety workshops.
- **Gasoline** - \$40,330 – this is an increase of \$4,939 or 14.0% from the FY15 projection of \$35,390. The budget estimate was based on \$2.73 per gallon (MSF is exempt from gas tax) for gasoline, an estimate of 26.9 miles per gallon on average, and an estimate of 12,970 gallons of gasoline being purchased.

- **Minor Office Equipment** - \$41,429 - this is a decrease of \$25,377 or 38.0% from the FY15 projection of \$66,807. The FY16 budget includes:
 - ✓ \$18,060 – replacement of 30 office chairs
 - ✓ \$23,369 – for ergonomic sit/stand workstations, headset replacements, monitors, paper cutter, scanner, keyboards, and other items

- **Computer Hardware** – \$129,694 – this is an increase of \$8,154 or 6.7% from the FY15 projection of \$121,540. The FY16 budget includes:
 - ✓ \$118,390 – PC and printer replacement – replacement cycle plans for approximately 20% of MSF desktop computers and printers to be replaced each year.
 - ✓ \$11,304 – all other minor hardware which includes: Cisco switches in the Data Center, mobile ‘Hot Spots’, media projectors, and monitors

- **Minor Software** - \$60,672 – this is a decrease of \$26,527 or 30.4% from the FY15 projection of \$87,199. Software to be purchased in FY16 includes:
 - ✓ \$55,500 – for Information Technology software including:
 - \$27,000 – Oracle database licensing for disaster recovery environment at State of Montana Data Center
 - \$12,000 – PowerKeeper system to manage passwords and database accounts
 - \$6,000 – WildPackets Enterprise licenses to replace Cisco Network Analysis module
 - \$5,500 – ShoreTel development and quality assurance environment licenses
 - \$5,000 – Websense system to filter and block high risk websites
 - ✓ \$3,875 – Insurance industry annual statement preparation and electronic filing software
 - ✓ \$1,297 – Dragon Naturally Speaking and other software

- **General Office Supplies** - \$165,778 – this is a decrease of \$6,310 or 3.7% from the FY15 projection of \$172,087. This budget includes paper, toner, and a wide variety of minor office supplies.

- **All Other Supplies and Materials Categories** - \$47,288 - includes budget for:
 - ✓ \$23,575 – promotional aids to enhance safety and other program awareness
 - ✓ \$18,425 – books and reference materials – primarily specialized desk manuals
 - ✓ \$2,948 – safety supplies, equipment, and clothing
 - ✓ \$2,340 – diesel fuel for back-up generator

Communications

- **Postage** - \$441,404 – this is an increase of \$13,049 or 3.0% from the FY15 projection of \$428,356. The budget includes:
 - ✓ \$282,000 - print mail service fees
 - ✓ \$153,000 - meter postage
 - ✓ \$6,404 – all other – meter scale updates, PO Box rental, field staff postage, and stamps

- **Advertising** (excluding recruitment / employment advertising) - \$525,338 – this is an increase of \$127,478 or 32.0% from the FY15 projection of \$397,860. The FY16 budget is for advertising placement and includes funding for three broad based advertising campaigns: 100 Year Celebration of Workers’ Compensation System; No Jack Young Workers; and, Return to Work. There will also be multiple smaller scale advertising placements.
- **All Non-SITSD Telephone Categories** - \$101,308 – this is an overall increase of \$10,059 or 11.0% from the FY15 projection of \$91,249. This expense covers cell phones, tablets, long-distance, and ‘800’ line services. The budget is based on FY15 usage and rates expected in FY16.

Travel

- \$297,317 – this is an increase of \$52,179 or 21.3% from the FY15 projection of \$245,138. The FY16 budget supports:
 - ✓ \$120,769 - Travel by safety management consultants, claims examiners, and underwriters to visit customers, attend, and provide safety seminars and agent advisory meetings
 - ✓ \$161,350 – MSF staff attending training or industry conferences at off-site locations
 - ✓ \$15,198 - Travel associated with Annual Business Plan and ESPM projects

Rent

- \$362,274 – this is a decrease of \$76,707 or 17.5% from the FY15 projection of \$438,981. MSF has three areas of rent expense:
 - ✓ \$289,800 – annual parking fees for 350 spaces – this is budgeted based on \$69 per month per space. The FY15 projection is \$364,809 and included a one-time payment of \$85,175 to align the billing and payment process of the Helena Parking Commission with their establishment of annual parking rates.
 - ✓ \$56,507 – rent for five field offices: Billings, Great Falls, Missoula, Kalispell, and Butte and is a 1.1% increase from the FY15 projection of \$55,898
 - ✓ \$15,967 – photocopy equipment rental agreement including field offices and is a 12.6% decrease from the FY15 projection of \$18,274

Utilities

- \$224,000 – this is an increase of \$8,469 or 3.9% from the FY15 projection of \$215,531. This is for electricity, natural gas, water and sewage services for the building. The increase is to fund utility costs that may occur with additional use due to weather fluctuations.

Repairs and Maintenance

- \$1,376,356 – this is a decrease of \$120,971 or 8.1% from the FY15 projection of \$1,497,328.
 - ✓ \$1,141,379 - IT maintenance agreements for application software and hardware such as servers, routers and associated peripherals, and spare parts for minor

- computer repairs. FY15 projection is \$1,313,214.
- ✓ \$82,020 - Facilities maintenance agreements including: heating, ventilation and air conditioning (HVAC); security; landscaping; window cleaning; elevator; fire system; vehicle and boiler inspections and maintenance; and other items. FY15 projection is \$95,770.
- ✓ \$48,587 – replacement of obsolete mail inserting machine and minor field office printer expense (\$150).
- ✓ \$40,797 - Document Processing budget for maintenance on scanning and mail room equipment. FY15 projection is \$31,610 which includes a refund of \$7,761 on replaced Insertamax.
- ✓ \$27,584 – ballast replacements in lighting features, air handling pre-filter replacements, washer and dryer unit, and dedicated DSL line for building automation system.
- ✓ \$25,989 – repairs and maintenance on MSF owned and operated fleet of 24 vehicles. Expenses include tires, oil changes and other regular engine maintenance.
- ✓ \$10,000 – replacement parts for monitors, computers, hard drives, memory, mice, keyboards, and printer maintenance kits. All computers and printers purchased with the move into the new building went off warranty in FY15.

Other Expenses

- **Dues** - \$60,729 – this is an increase of \$1,402 or 2.4% from the FY15 projection of \$59,327. This expense is for membership dues with professional business organizations such as the Montana Chamber of Commerce (\$36,370) and other local chambers, Montana Society of CPAs, American Association of State Compensation Insurance Funds, and the Society for Human Resource Management.
- **Subscriptions** - \$401,179 – this is an increase of \$166,343 or 70.8% from the FY15 projection of \$234,836. This includes budget of:
 - ✓ \$194,805 – Calendar Year Conversion project software subscriptions:
 - \$150,000 – investment support tool to value and report investments in the format required for regulatory reporting
 - \$36,800 – Host Analytics financial consolidation solution
 - \$8,005 – National Association of Insurance Commissioners (NAIC) Auto valuation service, Securities Valuation Office (SVO) manual, and market conduct disk.
 - ✓ \$45,386 – Host Analytics budget planning solution
 - ✓ \$38,400 - On-line access to Human Resource Management System (Greenlight, Wingspan, RedCarpet, and OpenHire)
 - ✓ \$28,900 - Linked In
 - ✓ \$18,000 - Career Builder
 - ✓ \$17,000 - SNL Financial
 - ✓ \$8,000 – Lexis Nexis
 - ✓ \$50,688 - a variety of desk manuals and career specific periodicals such as medical and occupational disability guides and on-line access.

- **Taxes and Assessments** - \$113,293 – this is an increase of \$14,489 or 14.7% from the FY15 projection of \$98,804. This budget is comprised of:
 - ✓ \$105,000 - OSC premium taxes paid for insuring MSF policyholder’s operations in other states where workers’ compensation premium taxes are assessed. For FY16 the OSC premiums are estimated to be \$2,500,000 and the taxes and surcharges are estimated to be 4.2%. The projected FY15 expense is \$92,982 on \$2,213,859 of premiums.
 - ✓ \$3,430 – Reinsurance excise tax
 - ✓ \$2,963 - Property assessment on the building
 - ✓ \$1,900 – Application for Certificate of Authority from Commissioner of Securities and Insurance included in the Regulation project

- **Education and Training and Professional Development Center** - \$234,271 – this is an increase of \$82,925 or 54.8% from the FY15 projection of \$151,346. Training is needed to ensure MSF employees are knowledgeable in best practices associated with supervision, claim management, safety management and underwriting of risk. The new and most significant budget item, \$49,938, is for the training and insurance producer licensing of MSF staff as required in SB123.

- **Rewards** - \$43,784 – this is an increase of \$7,507 or 20.7% from the FY15 projection of \$36,277. This is for employee of the month/year awards, employee referral incentives, certification awards, IDEA awards, and retirement recognition.

- **Tuition Reimbursement** – \$29,338 – this is a minor increase from the FY15 projection of \$28,667. For FY16, the maximum amount of annual tuition reimbursement per employee is \$4,000. Nine employees are expected to participate in the tuition reimbursement program in FY16. Reimbursements are based on MSF’s pre-approval, successful course completion, and actual cost.

- **Meetings and Conference Cost** - \$145,287 – this is an increase of \$57,016 or 64.36% from the FY15 projection of \$88,271. The budget provides for meeting rooms and equipment for MSF-sponsored meetings within our building and at locations throughout the state.
 - ✓ Safety management workshops in locations throughout Montana
 - ✓ Agent training workshops
 - ✓ Customer service representative conference
 - ✓ Marketing events
 - ✓ Medical Conference

- **Recruitment Expenses** - \$200,000 – this is an increase of \$36,967 or 22.7% from the FY15 projection of \$163,033. The FY16 budget is based on expected job candidate expenses and relocation expenses of thirteen eligible new employees.

Each recruiting action has the potential to require different levels of expense to complete the recruitment process. The budget is based on prior year expenditures for individual recruiting actions and expanding utilization of less costly web-based recruiting services in comparison to recruiting agencies.

Recruitment expenses are comprised of the following accounts:

- ✓ Relocation – Taxable – \$19,613
- ✓ Relocation – Non-Taxable – \$74,187
- ✓ Recruiting – Non-Advertising - \$1,200
- ✓ Job Candidate Expense – recruitment services and candidate travel expenses – \$105,000

➤ **Charitable Contributions / Scholarships** - \$51,300 – this is a decrease of \$2,893 or 5.3% from the FY15 projection of \$54,193. The total funds budgeted for FY16 charitable contributions are roughly 0.03% of estimated FY16 net earned premium. Charitable Contributions are budgeted as follows:

- ✓ \$27,300 – Scholarship program – Scholarships of up to \$1,000 per semester are provided to dependents or spouses of MSF-insured employees who died in work-related accidents. MSF estimates 13 scholarships (2 semesters each) will be awarded in FY16 for a total budget of \$26,000. Each scholarship is estimated to be \$2,000 with an additional \$100 administrative fee each. The budget is based on prior year participation.
- ✓ \$13,000 - ACE (Assisting Charitable Endeavors) Grants program - The grants are awarded by a committee of MSF employees based on applications submitted by ‘not-for-profit’ organizations throughout the state.
- ✓ \$11,000 – Support of Leadership Montana and ‘Festival of Trees’

➤ **Fee Collection Expense** - \$47,342 – this is a decrease of \$10,003 or 17.4% from the FY15 projection of \$57,345. MSF contracts with two collection agencies and uses the services of the Montana Department of Revenue. The fees vary based on success with collections, amount sent to collection, and whether litigation is involved. The decrease from FY15 is due to decreases in premium and lower amounts expected to be sent to collections.

➤ **State Wide Indirect Cost** - \$51,668 – this is an increase of \$12,044 or 30.4% from the FY15 projection of \$39,624. The State Wide Indirect Cost (also known as the State Wide Cost Application Plan or SWCAP) is an allocation determined by the Office of Budget and Program Planning as a means to allocate costs incurred by agencies whose functions support all state entities.

Equipment and Intangible Assets

The total FY16 budget for equipment is \$337,265. This is a decrease of \$524,612 or 60.9% from the FY15 projection of \$861,877.

Equipment - \$337,265

- **Multi-User Computers** - \$249,000
 - ✓ \$177,000 – for server, storage, and switches for the disaster recovery environment at the State of Montana Data Center.
 - ✓ \$38,000 - Replacement of one Oracle database sever
 - ✓ \$20,000 – Websense appliance / application for system to filter and block high risk websites
 - ✓ \$14,000 – WildPackets Enterprise servers to replace the Cisco Network Analysis module

- **Autos & Trucks** - \$88,265 - four vehicles to replace four high mileage vehicles as recommended by the Fleet Manager. Vehicles being replaced have reached the mileage specified in MSF's Fleet Management Policy as the replacement threshold. MSF will replace three sedans at a cost of \$21,890 each and one SUV for \$22,595 in FY16.

Allocated Loss Adjustment Expense (ALAE)

ALAE are costs directly associated with managing a specific claim, such as independent medical examination to analyze a prescribed treatment of an injured employee.

\$3,424,640 is budgeted for ALAE and is an increase of \$464,882 or 15.7% from the FY15 projection of \$2,959,758.

- \$1,229,618 – The budget is an increase of \$90,066 or 7.9% from the FY15 projection of \$1,139,552. Medical invoice processing is budgeted based on estimated medical benefits to be paid, invoices to be processed in FY16 and the applicable contracted cost per bill.

FY15 MSF actual expenditures (as of April 30) for medical invoice processing were \$951,090 or 2.5% of the estimated \$38.4 million medical benefit payments processed. The FY16 budget estimated the expense to be 2.5% of the estimated \$49.3 million in medical payments processed.

- \$911,405 – All legal expense categories - this is an increase of \$249,405 or 37.6% from the FY15 projection of \$662,149.
 - ✓ \$640,857 – State Fund legal contract for services of external counsel and expense of the Medicare Set Asides which have significantly increased during FY15 as settlement activity increased – FY15 projection is \$418,243.
 - ✓ \$79,349 – Legal Fee Claimant Attorney and for costs associated with claimant attorneys - FY15 projection is \$91,649
 - ✓ \$175,000 – Employer's Liability Insured Defense Cost - FY15 projection is \$135,669
 - ✓ \$16,200 – photocopy expense – FY15 projection is \$16,587
- \$792,905 - Investigations – This is an increase of \$38,516 or 5.1% from the FY15 projection of \$754,389. The private investigation activity is budgeted at \$459,757 a \$10,068 increase from FY15 projection. The Department of Justice Fraud investigation and prosecution agreement budget is \$333,148, an increase of \$28,448 from the FY15 projection.
- \$316,895 – Medical Consultants – this is an increase of \$33,035 or 11.6% from the FY15 projection of \$283,860. The budget increase is due to an expectation of greater reliance on medical consults to offset the staff expertise and knowledge lost to retirements. The budget enables MSF staff to consult with medical professionals to provide expertise when managing complex medical issues.
- \$173,816 – Contract Examiners - this is an increase of \$54,009 or 45.1% from the FY15 projection of \$119,808.

- ✓ \$145,000 – Examiners associated with Other States Coverage claims
- ✓ \$25,216 – Examiners for MSF in-house claims
- ✓ \$3,600 – Life expectancy reviews

Costs not included in the Proposed Budget

The FY16 budget includes all known and expected costs for the fiscal period July 1, 2015 through June 30, 2016. The budget does not include:

- Merit salary adjustment for the President - this is separate Board actions that may be taken if the Board deems appropriate;
- Court decisions which may significantly and adversely impact the State Fund - no such decisions are currently anticipated.

The FY16 Budget is prefaced on MSF's net earned premium projection of \$157.1 million. Should premium significantly increase or decrease from the estimate, appropriate budget increases or decreases may be presented to the Board for further review.