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FILED

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OFFICE OF
WORKER'S COMPENSATION JUDGE
HELENA, MONTANA

IN THE WORKERS' COMPENSATION COURT OF THE STATE OF MONTANA

CATHERINE E. SATTERLEE, et al., Petitioners, v. LUMBERMAN'S MUTUAL CASUALTY COMPANY, et al., Respondents/Insurers.	WCC No. 2003-0840 **THIRD AFFIDAVIT OF DANIEL GENGLER**

STATE OF MONTANA)
: ss.
County of Lewis and Clark)

DANIEL GENGLER, being first duly sworn upon his oath, deposes and says:

1. I am currently the Internal Actuary for the Montana State Fund ("MSF"). I have been employed with MSF since August 21, 1995.

2. As the Internal Actuary, I am responsible for and have personal knowledge of MSF's policies and procedures regarding ratemaking, surplus, and dividends. I also

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have personal knowledge of MSF's financial condition and am familiar with the financial impact the recent common fund cases may have on MSF's viability. I am also familiar with the implementation efforts and costs associated with the common fund cases. I prepared and executed affidavits dated August 9, 2005, and October 5, 2005, that have been filed with the Court.

3. The affidavits I previously filed with the Court are accurate and based upon reproducible data and calculation consistent with generally accepted actuarial principles. The purpose of the present affidavit is to factually respond to assertions presented by Petitioners' counsel in their brief and the latest affidavit of the CPA hired by them.

A. Present Value Discount

4. Petitioners claim that MSF estimates are exaggerated because the MSF did not express cost estimates at present value. It is noted that the additional average cost per permanent total (PT) claim is not disputed nor is the number of affected claims. All that is in dispute with regard to the cost estimates is whether the representation of cost should be offset for future investment income earned on funds held in reserve while the additional liabilities become due and payable.

5. Present value discount in an insurance context means that the full nominal value of incurred liabilities need not be 100% funded at the time such liabilities are incurred because the funds will earn sufficient investment income to make up the difference by the time the liabilities are actually paid. For example, lifetime PT benefits on claims incurred from today forward are estimated to cost approximately $25 million per year (at business volumes currently insured by the MSF). However, we would not necessarily need to charge our policyholders the full additional $25 million because, depending on a risk analysis of expected payout patterns and investment rates, we could charge our policyholders roughly half the $25 million. That amount collected and invested today would earn enough in compounded investment income by the time lifetime PT benefits on those claims became due and payable to cover the full $25 million cost.

6. Petitioners are confusing two different questions:

1) How much more will benefits cost as a result of lifetime PT benefits?

versus

2) How much would be needed to fund the additional liabilities created by lifetime PT benefits?

Previous MSF filings have accurately characterized the impact of lifetime PT benefits on benefit costs and acknowledged the impact of investment income on funding requirements as appropriate. In particular, MSF disputes the relevance of a present value discount for characterizing the cost impact of retroactive applicability of lifetime PT benefits.

7. With regard to the prospective cost impact, MSF estimates that benefit costs would increase by about 15%. That fact appears to be uncontroverted. However, premium rates charged to customers would probably be roughly half that amount. We have previously noted (Aff. Gengler ¶ 7 (Apr. 11, 2006)) that increases to premium rates for the prospective costs would likely be offset for future investment income. The discount is appropriate with respect to the impact of prospective benefit costs on premium rates.

8. However, a present value discount is neither relevant nor meaningful for characterizing retrospective costs in this particular situation for two reasons:

a. Consistent with best practice in the industry, MSF does not discount its claim liabilities. It is less risky for an insurance company to state its liabilities on an undiscounted basis, particularly for a long-tailed line of insurance such as workers' compensation, because a present value discount is essentially counting money we do not yet have. Therefore, with respect to MSF financial statements, the retrospective cost estimates we previously attested to for the new fund (midpoint estimate of $161 million through 2005) would, in fact, be the impact on our financial statements.

b. The present value discount is merely an academic abstraction unless the funds are available to invest and earn return. It has no real meaning from a business perspective unless the funds to support the additional retrospective liabilities are in hand. That is not the case in this situation.

9. While MSF liabilities are stated on an undiscounted basis, the financial statements for the Old Fund (claims incurred prior to July 1, 1990 which are managed by MSF and constitute General Fund liabilities) are discounted as required by statute. This discounting practice is inconsistent with best practices in the insurance industry and is the result of the unique circumstance of the Old Fund liabilities having been assumed by the State General Fund. Petitioners imply that the discount applicable to PT claims from 2005 would be applicable to claims from all other prior years. However, an applicable present value discount on the cost of lifetime PT benefits for the Old Fund would be less than that applicable to recently incurred claims. For example, some of the retrospective cost for claims going back as far as 1982 would be immediately due and payable with no opportunity, even if funds were available, to earn investment income. Furthermore, for the remaining liabilities on past claims, the time available to earn investment income before the liabilities are payable is much shorter than for claims incurred more recently. For example, claimants associated with PT claims incurred in 1989 are, on average, already at retirement age. But in any event, with no additional funds available to support the additional liabilities, any discount would be illusory and the impact to the financial position of the Old Fund is, in reality, 100% of estimated benefit cost. As previously verified, the Old Fund already has an unfunded liability. It

appears the 2005 Montana Legislature would contribute additional general fund monies only on a strictly cash flow basis.

B. Male vs Female Life Tables

10. Petitioners erroneously claim that the MSF cost estimates are based on life expectancy tables for females only. In fact, the life expectancy assumptions used by MSF in our cost estimates was based on a weighted average between male and female life expectancy tables. We assumed that 67% of PT claimants are male and 33% are female based on the approximate gender split we find in MSF claim data. The life expectancy tables used were from the U.S. Center for Health Statistics as of November 2004 (Tables 2-Male & 3-Female: www.cdc.gov/nchs/data/dvs/lt2001.pdf).

C. Settled Claims

11. Of all PT claims incurred from 1982 through 2005, 57% were deemed to have been settled for purposes of deriving MSF cost estimates. MSF cost estimates exclude settled claims for purposes of estimating retrospective costs.

12. No such settlement exclusion is applied to prospective cost estimates because it is not reasonable to assume that anyone would settle their PT claim for less than lifetime benefits if the law changed and lifetime benefits were available. Going forward, the additional cost of lifetime benefits would be applicable to all claims whether eventually settled or not.

D. MSF Cost Estimates Insufficiently Based in Fact

13. Petitioners assert that because non-settled PT claims incurred in the past are not definitively identifiable in MSF data systems, the MSF cost estimates do not have a sufficient factual basis.

14. A definitive identification of all specific claimants affected by retroactive applicability of lifetime PT benefits would require an intensive manual investigation of records. An explanation of the propriety of the review and resultant calculations is set out in my Second Affidavit and not repeated here because the facts set out remain applicable.

E. Adequacy of Surplus to Absorb Costs of Lifetime PT Benefits

15. Petitioners imply that as long as the retrospective costs of lifetime PT benefits are less than the current MSF equity (surplus), no economic harm would result to the MSF.

16. The projected FY2006 year end equity as presented to the MSF Board of Directors in June 2006 is $170.4 million. However, a court ruling effective today establishing lifetime PT benefits would add additional unfunded claim liabilities for 2006

and 2007, about $50 million for these two years, bringing total unfunded claim liabilities for lifetime PT benefits for the MSF to about $210 million (midpoint estimate). Even assuming the lower optimistic range of MSF estimates, the retrospective costs of lifetime PT benefits at this point in time would exceed available equity. All funds now deemed "surplus" would be reserved for the additional claim liabilities. Claim liabilities would exceed the financial assets of MSF and an unfunded liability would exist.

17. Even if the retrospective costs of lifetime PT benefits were less than current equity, the financial viability of the MSF would be substantially impaired (*see* MSF Statement of Uncontroverted Facts ¶¶ 3-10). Insurance companies need to maintain adequate surplus as "insurance for insurance" or pay an equivalent amount plus risk premium to obtain reinsurance from another entity in order to hedge against the inherent uncertainty that reserves will be insufficient to meet contractual claim obligations. MSF is required by statute to have at least 25% of earned premium in surplus (about $55-$60 million at today's business volumes). Standards developed by the National Association of Insurance Commissioners, known as risk-based capital tests, were applied to MSF by our consulting actuary this past year and presented to the MSF Board of Directors in March, 2006. At a surplus of $95 million, the MSF would reach the "company action level," where an insurance company must present a plan to the insurance commissioner stating how the company will either reduce its risk profile or raise additional capital. This action level would equate to the "risk based capital requirements" referred to in Montana Code Annotated § 39-71-2330.

18. An insurance company with insufficient surplus relative to their incurred liabilities and other risk factors would be shut down and taken into receivership. Even if not totally eliminated, a significant depletion of MSF's surplus creates an unacceptable risk that the claim liabilities of the MSF will become a general liability of the state with consequent burden to Montana taxpayers. This risk was amply demonstrated by the need for the legislature to enact a general payroll tax to fund workers' compensation claim liabilities for the Old Fund.

F. <u>MSF Dividend Program</u>

19. Petitioners imply that the existence of a dividend program is evidence that MSF can absorb the retroactive cost impact of lifetime PT benefits.

20. A dividend program is not simply a means to ameliorate excess surplus. It is integral to MSF's strategy of creating effective incentives for insured employers to minimize the incidence and severity of workplace injuries consistent with Montana public policy and legislative direction. This strategy is only effective when a dividend program is highly consistent over a long period of time.

21. MSF surplus has been determined by our consulting actuary to be adequate but below levels at which the MSF would be considered financially strong if it were to undergo scrutiny by a rating agency. Our consulting actuary has advised that

modest dividends are prudent only to the extent that MSF can make consistent progress towards its target surplus position over a multi-year timeframe.

22. Suspension of the MSF dividend program would be highly insufficient to fund the costs of retroactive lifetime PT benefits. On the other hand, the retroactive costs of lifetime PT benefits would force MSF to indefinitely suspend its dividend program.

G. Independent Cost Estimate

23. As noted at ¶ 15 of my Second Affidavit, claim personnel performed an analysis of estimated benefit costs associated with a modification of the law allowing for lifetime PT benefits totally independent from our actuarial analysis. Those estimates covered the same time periods we considered. They were conducted utilizing a process and factors that understated such considerations as life expectancy, development of claims to PT status, and benefit rates of claimants. This independent understated analysis placed the overall benefit cost of lifetime PT benefits at \$235,401,077.59, attributing \$92,673,391.50 to the Old Fund. The approach and calculations provide support for the "highly likely range" of estimates presented in our previous filings which utilized more detailed assumptions.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

DATED this 18 day of August, 2006.

Daniel Gengler

DANIEL GENGLER

STATE OF MONTANA)
: ss.
County of Lewis & Clark)

Subscribed to and sworn to before me on the 18th day of August, 2006, by DANIEL GENGLER.

Kathleen G Gowen

(Type or print name) Kathleen G. Gowen
NOTARY PUBLIC FOR THE STATE OF MONTANA
residing at Helena, Montana
My commission expires: April 1, 2010

KATHLEEN G. GOWEN
NOTARY PUBLIC for the
State of Montana
Residing at Helena, Montana
My Commission Expires
April 1, 2010

KATHLEEN G. GOWEN NOTARIAL SEAL STATE OF MONTANA

CERTIFICATE OF MAILING

I, the undersigned, of GARLINGTON, LOHN & ROBINSON, PLLP, Attorneys for Respondent/Insurer, Montana State Fund, hereby certify that on this 21st day of August, 2006, I mailed a copy, of the foregoing **THIRD AFFIDAVIT OF DANIEL GENGLER**, postage prepaid, to the following persons:

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August 21, 2006

Patricia Kessner, Clerk
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Helena, MT 59624-0537

RE: Satterlee, et al v. Montana State Fund, et al.
WCC No. 2003-840

Dear Ms. Kessner:

Enclosed for filing please find State Fund's Response to Satterlee's Motion for an Order Allowing Discovery, as well as the Third Affidavit of Daniel Gengler. Thank you for your assistance in this matter, and if there are any questions or concerns, please do not hesitate to contact us.

Very truly yours,

GARLINGTON, LOHN & ROBINSON, PLLP

Bradley J. Luck

BJL:jla
Enclosures
c: Mr. James G. Hunt (w/enc.)
Mr. Michael P. Heringer (w/enc.)
Mr. Larry W. Jones (w/enc.)
Mr. Bryce R. Floch (w/enc.)
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