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Strategic Business Plan

[July 1, 2010 through June 30, 2011]



UP TO THE CHALLENGE

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From the President . . .



I am pleased to present Montana State Fund's Fiscal Year 2011 Strategic Business Plan. I must also acknowledge it has been quite a challenging year. We've watched dramatic and disturbing events happen to our world and state economy; events that affect our company, employees and our customers. For example, we unfortunately continue to be challenged by our state's high injury rates to our fellow Montanans. Also, we have experienced rapidly declining payrolls – evidence of the toll the recession has taken on Montana businesses and workers, continued medical cost inflation, and operating expense pressure due to lower premium that strains our limited resources.

However, we are optimistic about Montana and our ability to both weather these challenges and support Montana businesses as they rise up from the economic downturn. Through it all, MSF has met our commitment as a stable and financially sound workers' compensation provider for Montana businesses and their employees. MSF has changed to new ways of doing business, becoming more efficient in managing claims, in working with our policyholders, in managing overall risk and in making this a good place to work.

There is reason for optimism. Despite high accident rates for Montana, the frequency of those accidents continues to decline due to improved awareness and focus on preventing injuries. Montana State Fund completed our new office building that will provide an efficient, safe and healthy work environment for many years to come. The national and state economy is beginning to show signs of a slow recovery, and with that will come more business as innovation drives Montana's fierce ability to not only survive, but to excel.

We continually gain knowledge about how data can be managed and tapped for more effective decisions and improved practices. We see more and better ways of delivering service to our customers and to the injured employee while continuing to lower costs. We innovate and modify toward better efficiencies in our operations for the benefit of our customers and for the benefit of all of our stakeholders. We will make necessary operational changes in the spirit of continuous improvement.

This Strategic Business Plan's initiatives are designed to help us toward these goals.

Workforce development efforts are essential for keeping valuable, highly skilled people and assisting them in development and growth, for planning succession and for recruiting the very best talent. This is even more important as higher numbers of retirement-eligible employees leave the workforce.

Customer service and education are the focus of other initiatives; making changes in service, more clarity in communications, improved data access and ease of use, and better service delivery that will continue to set Montana State Fund apart from our competition.

We will continue to reach out to Montana, increasing the recognition of the need for safety and helping policyholders and employees reduce the injury rate. In addition, meaningful and effective implementation of utilization and treatment guidelines has the potential to significantly reduce workers' compensation costs for Montana businesses.

Finally, this year we will initiate a review of risks we face as a business and examine the way we manage internal and external risk through effective planning, controls and improved governance practices. But one risk our state cannot afford is wishful short-term thinking. Montanans know that workers' compensation claims can last for decades. To ensure our ability to pay those claims MSF must remain fiscally responsible and conservative over the long term. Conservative business practices have enabled MSF to overcome economic downturns before and they will, again.

Montana State Fund is up to the challenge.

Sincerely,

A handwritten signature in black ink, appearing to read "L. A. Hubbard". The signature is fluid and cursive, written over a white background.

Laurence A. Hubbard
President/CEO

Executive Summary

Most Montana businesses felt the effects of the recent economic recession and Montana State Fund was no different. As Montana jobs and payroll decreased so too did MSF's premium. Our FY 2011 premium plan of \$153.9 million will mark the fourth straight year of declining premium and an extended decline unprecedented in our local experience. In addition, MSF's investment-generated income remains subject to the risks and instability of the equity and bond markets.

MSF's revenues are dependent on Montana's job and payroll recovery. We expect the road to be slow and halting at best. Although challenging for Montana businesses, recovery from the recession will happen, we are sure. Just as we weathered the financial crisis through prudent management, MSF will work through the lengthy recovery by maintaining our focus on expense and underwriting discipline, operational improvements and managing claims for the best outcomes.

We see FY 2011 as an opportunity for MSF to focus resources on strategic initiatives that build on our solid foundation of operating efficiencies and our commitment to continuous improvement.

Customer service is a continued focus this year. From innovative safety education programs to aligning our business to better serve Montana business, we are committed to meeting and exceeding the high service level expectations of our customers.

We know customer service starts with engaged and capable employees. With 54 percent of MSF employees eligible for early or full retirement in 2011 it is essential we find creative ways to retain our talent and to capture, document and share the vast amount of business knowledge represented in our long-term employees.

The high number of potential retirements is one risk MSF faces in the near future. But there are many other risks for MSF and we intend to focus this year on developing an Enterprise Risk Management structure to proactively address them.

And as you know, we continuously look for ways to improve in our largest risk areas – claim and medical management. This year we will implement medical treatment guidelines adopted by the Montana Department of Labor and Industry, enhance best practices and automate inefficient processes as we ensure claims are managed to the best possible outcomes.

Our strategic plan takes advantage of Montana State Fund employees' unique knowledge of the workers' compensation system and our superior customer service commitment. The FY 2011 plan recognizes the challenges we face as we continue to provide a stable and financially strong workers' compensation option for Montana businesses.

Our Enterprise-Wide Initiatives for FY 2011 are:

- 1) **Workforce** – Continue to enhance the MSF work environment allowing us to attract and retain high-performance employees. Provide opportunities for personal and professional development to strengthen and improve business and industry skills and to retain institutional knowledge.
- 2) **Customer Service** – Develop and foster a culture of safety within Montana businesses. Streamline and refine the systems and processes we use to enhance our service levels to our stakeholders.
- 3) **Infrastructure** – Incorporate a risk management process at Montana State Fund, creating a framework to identify and define our risk tolerance, limits and scope and to establish the processes to measure, model and manage risk.

Adapt claim handling workflows that enhance our ability to deliver a differentiated level of service to our customers and improve claim outcomes.

Strategic Framework

Mission – Montana State Fund is Montana’s insurance carrier of choice and industry leader in service.

Vision – Montana State Fund is committed to the health and economic prosperity of Montana through superior service, leadership and caring individuals working in an environment of teamwork, creativity and trust.

Guiding Principles

Integrity and Ethical Conduct

In the course of providing superior service to our policyholders, their injured employees and insurance producers, we conduct ourselves with honesty, consistency and transparency.

Customer Focus

Enhance and maintain a partnership with stakeholders in the true spirit of cooperation and collaboration. Enter into strategic partnerships where appropriate to enhance the service and products we provide our customers. Educate stakeholders on the economic and human impacts of the Montana workers’ compensation system.

Financial Strength

Set adequate rate levels to maintain financial strength and stability. Operate to ensure long-term viability and financial solvency.

Offer Quality and Competitive Insurance Products

Deliver high-quality products to Montana businesses at the lowest possible cost consistent with sound insurance principles. Foster and support a competitive insurance market in Montana. Function like a private insurer, offering a competitively priced product based upon actuarially sound rates, while still fulfilling our role as the guaranteed market.

Employee Growth and Development

Provide a performance-driven culture that is conducive to the growth and development of our employees. Promote a customer-focused, team-oriented, high-performance environment that empowers, challenges and rewards our employees.

Continuous Improvement

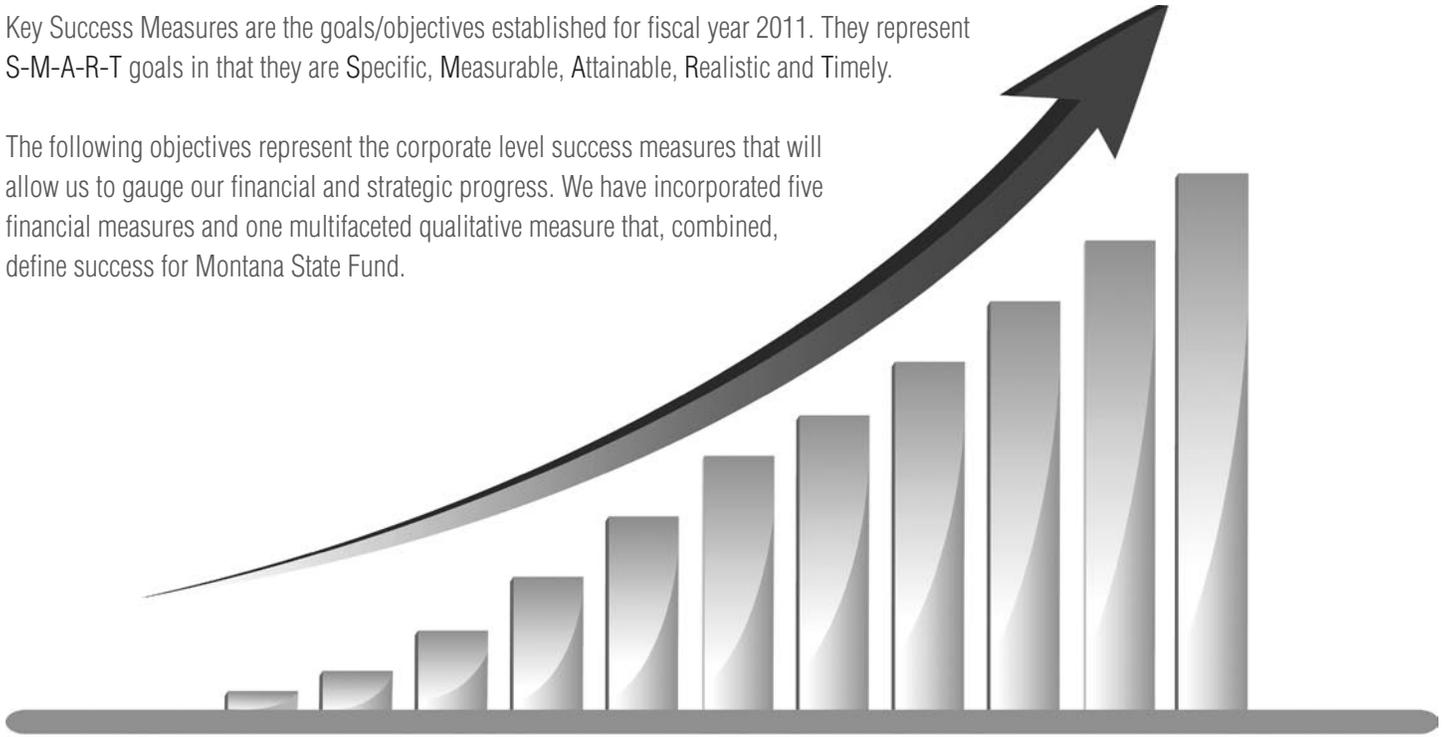
Dedicate ourselves to identify and implement new and better ways to efficiently and effectively operate and improve customer service.



FY 2011 Key Success Measures

Key Success Measures are the goals/objectives established for fiscal year 2011. They represent S-M-A-R-T goals in that they are Specific, Measurable, Attainable, Realistic and Timely.

The following objectives represent the corporate level success measures that will allow us to gauge our financial and strategic progress. We have incorporated five financial measures and one multifaceted qualitative measure that, combined, define success for Montana State Fund.



1. Achieve targeted FY Net Operating Income before dividend of \$23.9M
2. Achieve total Net Earned Premium of \$153.9M
3. Achieve Fiscal Year Loss Ratio of 83.6 percent
4. Maintain Expense Ratio of 27.8 percent or less
5. Achieve Investment Income of \$46.3M
6. Achieve Enterprise-Wide Initiatives



Enterprise-Wide Initiatives

Enterprise-wide initiatives are a critical element for the continued success of Montana State Fund. They are supported by a number of multifunctional efforts (most often initiative-based) comprised of actionable key performance indicators that are measurable, ensuring the accomplishment of our stated goals and objectives. In addition, they support our Mission, Vision and Guiding Principles.

1) Workforce

MSF continues its focus on workforce management and development. Our initiative is centered on employee talent development, retention and succession planning. MSF provides a challenging yet rewarding work experience that recognizes and rewards superior performance.

Key Performance Indicators

Talent Retention/Knowledge Transfer – Create generationally focused pilot programs to improve/enhance employee engagement and retention. These programs will develop and implement creative learning opportunities for high-performance employees, coupled with a mentoring program to bolster personal and professional development. Besides enhancing employee satisfaction, growth and recognition, these tactics are intended to mitigate the loss of critical Montana State Fund institutional, situational and proprietary business operations knowledge by pairing “subject matter experts” with potential backups/replacements to enhance knowledge transfer. In addition we will continue the succession planning/succession management and development program that was established in FY10.

Success Measures:

1. Complete focus group activities and implement Mentor/Mentee pilot of three members by February 2011 and Job Reassignment pilot by March 2011. Gain feedback and evaluations in fourth quarter.
2. Proceed with development plans identified in CEO succession planning in first quarter and ongoing.
3. Move to VP/Leadership phase of succession planning evaluations during first quarter of FY11 and initiate development plans in second quarter.



2) Customer Service

Clearly demonstrate and articulate who we are and our commitment to our policyholders, their employees and, ultimately, all Montanans. Develop and reinforce an unwavering commitment to a culture of safety among all Montana businesses. Continue to evaluate our operating processes and procedures to ensure that we are fulfilling our promise and providing service to our customers in the most efficient and effective manner possible.

Key Performance Indicators

Document Management System – As the first step in unbundling the architecture of our legacy policy application, implement a single source document generation package that will serve the needs of both our policy and claims applications. This initial step is part of an overall strategy to modernize our policy application.

External First Notice of Loss – Develop and implement a tool that makes it easier for Montana employers to report claims more promptly and thoroughly, thereby accelerating the resolution process.

Utilization and Treatment Guidelines – Effectively implement the Utilization and Treatment Guidelines adopted by the Department of Labor and Industry.

Reserve Rewrite – Improve ClaimCenter™ functionality through the development and implementation of a system enhancement that allows greater flexibility in the entering and subsequent adjusting of individual claim reserve levels.

Claim QA Review and Improvement – Conduct an independent review of current Montana State Fund Claims Best Practices Guides and our management of claim files relative to industry best practices.

WorkSafe Champions – Fully communicate, develop and nurture a culture of safety among Montana State Fund policyholders. Strengthen our partnerships with our policyholders and enlist their support to make Montana a safer work environment for all its citizens.

Success Measures:

1. Achieve fiscal year loss ratio at or below FY 2011 plan Key Success Measure.
2. Manage prior period development to less than \$5M.
3. Quarterly evaluation by Communications to develop a baseline of customer service perception.
4. Deliver projects on time and within approved budgets.

3) Infrastructure

Establish an enterprise-wide definition and common understanding of Montana State Fund's risk tolerance, how it impacts what we do, and what creative and cost-effective opportunities exist to minimize our exposure to potentially catastrophic actions or events.

Review and determine adjustments to service team alignments that allow us to most efficiently and effectively meet the needs of our policyholders and their injured employees.

Key Performance Indicators

Enterprise Risk Management – Research and establish a comprehensive enterprise-wide process for defining, recognizing, prioritizing, anticipating and communicating the risk environment in which Montana State Fund operates. This cultural refocusing throughout the organization will ensure consistency relative to risk and to the measures employed to control or mitigate overall risk.

Business Team Alignment – Review potential changes to our current organizational structure to ensure the most efficient and effective means of providing a differentiated level of customer service to our stakeholders. Particular attention will be focused on the claim handling process to enhance efficiency and improve claim outcomes.

Success Measures:

1. Provide a report with recommendations on financial and customer service improvements as a result of the review of business team alignment.
2. Decrease internal claim file transfers.
3. Train and educate MSF leadership by October 2010 on the concepts, processes and procedures involved in establishing the Enterprise Risk Management (ERM) program.
4. Establish the ERM Framework by May 2011 with the following steps.
 - a. Review current risk management environment.
 - b. Conduct gap analysis and develop recommendations.
 - c. Establish specific ERM framework that includes the goals and objectives of the program, the organization and governance methodology, and the measurements and reporting processes to monitor and track progress in meeting MSF risk objectives.
 - d. Develop ERM Road Map of Priorities for Implementation of the program in FY 2012.

Organizational Profile

The state of Montana originally established the predecessor to Montana State Fund (MSF) in 1915 to function as a competitive workers' compensation insurance carrier. Since then MSF has operated under a number of different forms, with its current structure resulting from legislative actions taken in 1990. At that time the legislature separated the workers' compensation regulatory function (originally established in the Montana Department of Labor and Industry) from the day-to-day insurance operations responsibilities (which were vested in a separate, new entity known as Montana State Fund). A seven-member Board of Directors, appointed by the governor, governs the operations of Montana State Fund. The Board is also responsible for appointing the president/CEO.

Montana State Fund is a self-sufficient, not-for-profit workers' compensation insurance carrier. Our statutory purpose is to act as a competitive insurance carrier, providing an available market and thereby guaranteeing coverage to all employers in Montana. We receive no taxpayer or general fund money, operating solely on the premium dollars paid by the insured employers and the net proceeds from our investments. We function like a private insurance carrier in a competitive marketplace and, as provided by law, perform all the functions and exercise all the powers of a private insurance carrier that are necessary, appropriate or convenient for the administration of the Montana State Fund.

MSF has undergone a number of changes since our creation in 1990. We have transitioned from a traditional organizational structure to one that is more adapted to the demands of the information age. A comprehensive corporate redesign in 2000 enhanced our operational flexibility with the addition of multifunctional teams that are aligned with specific groups of employers. This change resulted in a "flatter" organization that increased employee empowerment and allows us to work more closely with our policyholders and their injured employees. We continue to strive to improve efficiencies in all operational areas and have made a major investment in our safety management services as we work diligently with Montana employers in developing accident prevention programs. As our state's economic structure continues to evolve, we stand ready to fulfill our critical role as the guaranteed workers' compensation market for all Montana employers.

FINANCIAL PROJECTIONS

Projected Results of Operations

Montana State Fund

Statutory Basis (\$000)

OPERATING STATEMENT

| | ACTUAL 2009 | ESTIMATE 2010 | PLAN 2011 | PROJECTION | |
|---------------------------|----------------|------------------|--------------|------------|-----------|
| | | | | 2012 | 2013 |
| Premium Income | \$203,976 | \$165,825 | \$153,941 | \$159,010 | \$167,146 |
| Investment Income | 47,924 | 46,015 | 46,340 | 49,545 | 52,514 |
| Other Income | (19,571) | (5,209) | (4,971) | (5,696) | (6,507) |
| Total Losses and Expenses | 219,706 | 184,537 | 171,442 | 171,844 | 174,583 |
| Policyholder Dividend | (3,997) | (2,001) | TBD | TBD | TBD |
| Net Income | \$8,626 | \$20,093 | \$23,868 | \$31,015 | \$38,570 |

TBD - Future dividends to be determined by Board of Directors

| | | | | | |
|---------------------------------|---------|---------|---------|---------|---------|
| Premium to Surplus (X:1)* | 0.99 | 0.66 | 0.55 | 0.51 | 0.47 |
| Loss Reserves to Surplus (X:1)* | 3.97 | 3.30 | 3.05 | 2.77 | 2.48 |
| FY Combined Ratio | 107.71% | 111.28% | 111.37% | 108.07% | 104.45% |
| Dividend to Premium Ratio | 1.96% | 1.21% | TBD | TBD | TBD |
| Operating Ratio | 84.22% | 83.54% | 81.27% | 76.91% | 73.03% |

* Ratios prior to any dividend declaration

BALANCE SHEET

| | | | | | |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| Total Assets | \$1,284,083 | \$1,340,199 | \$1,393,735 | \$1,458,305 | \$1,535,102 |
| Unpaid Loss and LAE | \$813,305 | \$834,477 | \$849,359 | \$865,330 | \$883,331 |
| Other Liabilities | 269,746 | 254,871 | 266,304 | 280,356 | 295,834 |
| Total Liabilities | \$1,083,051 | \$1,089,348 | \$1,115,663 | \$1,145,686 | \$1,179,165 |
| Surplus | \$201,032 | \$250,851 | \$278,072 | \$312,619 | \$355,937 |
| Total Liabilities and Surplus | \$1,284,083 | \$1,340,199 | \$1,393,735 | \$1,458,305 | \$1,535,102 |



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