

2012 Annual Report

[Launching a decade of safety] [Letter from the President] [2012 Financials]

LEADERSHIP



From our President

Many observers know 2012 was a historic time for Montana's workers' compensation system.

With the passage of House Bill 334, Montana State Fund began the process of reducing rates for our policyholders up to 20 percent in anticipation of significant reductions in the future cost of workers' compensation claims – primarily in medical claims. We invested in the

reform efforts by adding new medical resources to improve claim handling and outcomes. At the same time, we continued to provide high-quality safety education and training for all Montanans, and our WorkSafe Champions initiative continues to show promise in reducing accident frequency for participating employers. In addition we upgraded our technologies to ensure our organization runs more effectively and efficiently, delivering excellent customer service.

Beyond our exceptional customer service Montana State Fund continued to manage a financially sound organization. Many people do not understand that as a workers' compensation insurance company we must have strong reserves and equity (surplus) to ensure we can pay the benefits due to our state's injured employees. Workers' compensation is a long-tailed line of insurance; meaning the life of any claim can go on for decades, so the ultimate cost of claims is not known for many years. With that in mind, we must be

vigilant to set aside appropriate monies to cover the growing cost of medical care and we must always be aware that a major disaster could wipe us out if we do not plan cautiously for the future. Add to that our statewide economy with historically low investment returns and it is easy to see why substantial equity is needed to keep costs relatively stable for Montana business. However, it is also true that when we have met our financial responsibilities needed for prudent business operations we are able to return some of the equity/surplus in the form of dividends to our Montana policyholders that have shown a commitment to safety and cost containment.

In 2012, 21,000 of our customers shared a \$6 million total dividend. While annual dividends are not a guarantee, since 1993 we have been able to reward a total of \$64 million to our customers. We are proud of this track record and salute Montana's employers and employees who have made a strong commitment to reduce injuries and embrace workplace safety.

Finally, I would like to thank our dedicated Board of Directors. I have been honored to work with each of them. Their support of our day-to-day business operations and professional service has made it a pleasure to lead such a compassionate and thriving organization.

Sincerely,

Laurence A. Hubbard
President/CEO



Chairman's Letter

I am pleased to present our 2012 Annual Report. Montana State Fund's success depends on our ability to help Montana businesses improve workplace safety for employees, to compensate injured employees consistent with Montana law, and to help injured employees get back to work with the best possible outcomes. We offer our

policyholders the highest quality insurance product at the lowest reasonable cost. Our dedicated staff significantly advanced these goals in fiscal year 2012.

Montana State Fund's innovative Worksafe Champions program graduated another class of safety-minded people who work for employers around the state. Results to date show lower accident frequency and claim costs for the people who participated in Worksafe Champions. In addition, by initiating proactive claims management protocols, developing useful return to work programs and continuing safety focused education training, MSF made noteworthy strides to reduce the negative impacts of workplace injuries. We helped injured employees get healthy and back to work sooner, and provided superior service to employer policyholders. As part of our

commitment to injured workers, we are also reaching out to them to discuss ways we can do even better.

The implementation of House Bill 334 was a significant undertaking for MSF in 2012. That legislation lowered premium rates for our policyholders by changing benefits for injured workers. MSF is committed to effective implementation of HB 334 and improving medical management and injured worker outcomes.

I appreciate the engaged, energetic participation and support of the Board of Directors in assisting MSF to meet its mission and vision as Montana's insurance carrier of choice. I am especially grateful to outgoing board members Jane DeBruycker, Ken Johnson, James Swanson and Tom Heisler who have graciously volunteered significant personal time and effort to serve the people of Montana as members of this Board for eight years apiece. It has been a pleasure to work with you.

In closing, for almost 100 years Montana State Fund has led the way to provide workers' compensation insurance coverage to Montana business owners and their employees. We look forward to carrying on this tradition for years to come.

Sincerely,

Elizabeth Best, Chair

Executive Team

Left to right: Peter Strauss, Vice President, Insurance Operations Support; Al Parisian, Chief Information Officer; Laurence Hubbard, President/CEO; Rick Duane, Vice President, Human Resources; Nancy Butler, General Counsel; Mark Barry, Vice President, Corporate Support; Dick Root, Vice President, Insurance Operations



Board of Directors



Elizabeth Best, Chair
Great Falls



Joe Brenneman
Kalispell



Jane DeBruycker
Dutton



Wayne Dykstra
Billings



Thomas Heisler
Great Falls



Laurence Hubbard
Ex-Officio, Helena



Ken Johnson
Missoula



James Swanson
Glendive

YEAR IN REVIEW

2012 HIGHLIGHTS

- Our safety services team hosted 103 safety workshops or trainings throughout the state.
- Last year 1637 policyholders were visited by twelve of our safety management consultants.
- WorkSafe Champions, our 12-month intensive safety education curriculum, graduated 47 Montana workers. Since the program's inception in 2009, a total of 227 WorkSafe Champion graduates have continued to spread a message safety at their workplace.
- Through our speaker's bureau program, MSF staff delivered a variety of workers' compensation related presentations at 126 events.
- MSF staff conducted 14 presentations at the two SafetyFest's held in fiscal year 2012.
- Over 100 medical providers and workers' compensation professionals from across Montana attended our eleventh annual medical education conference, Psychological Issues in Workers' Compensation.
- MSF board of directors authorized a \$6 million dividend that was dividend among 21,000 qualifying policyholders. Since 1999, MSF has awarded \$64 million in general dividend payments as a reward for workplace safety.
- We redesigned our public website montanastatefund.com. The new look and functionality helps our customers find the resources they need in a more timely manner.
- The efforts of the Special Investigations Unit to uncover fraudulent claims saved more than \$1.6 million in FY12. Since the program's inception in 1993, MSF has recovered \$54.5 million in savings from fraudulent claims and employer misconduct.
- MSF employees contributed \$27,326.16 to the State Employee Charitable Giving Campaign. MSF is often one of the highest state agency contributors.
- Our ACE (Assisting Charitable Endeavors) program awarded 9 worthy projects \$9,955.50 in grant monies. ACE makes matching funds available to qualifying Montana nonprofit organizations that contribute to safety and community well-being in our state.
- Our scholarship program awarded a total of \$35,500 in scholarships to 19 individuals in 2012. The scholarship assists children and spouses of workers who were fatally injured in a work-related accident. While nothing can replace the untimely loss of a loved one, our scholarship program provides an additional benefit for those who are most affected by significant loss.
- The American Association of State Compensation Insurance Funds (AASCIF) awarded MSF with three communications awards. The accolades were for Perspectives, our electronic quarterly policyholder newsletter; our Return to Work TV and radio ads; and our safety focused website safetmt.com.



2012 found our staff implementing the new requirements of House Bill 334. The passage of this bill introduced changes of historic proportions to Montana's workers' compensation system. In light of the changes we began a multi-year plan to address specific medical needs of claims by adding new medical staff and building stronger relationships with our statewide medical providers. Our employees continued to receive applicable education and training to provide exemplary customer service for our policyholders and injured employees. And our message of safety was delivered across the map by our safety management consultants who offered Montana business owners and their employees' valuable safety training. In addition, we built upon our successful WorkSafe Champions program and produced a powerful statewide Return to Work media campaign.

YEAR IN REVIEW

In 2012, we implemented an average 20% decrease in policyholder premiums. We added medical staff to provide optimum claims management. Our new return to work media campaign educated employers across the state on the virtues of this proactive program. And, we continued our efforts to join forces with other public and private organizations to spread a message of safety across Montana. These are just a few of the stories and accomplishments from the past year.



2012 FINDS LOWER PREMIUM RATES

The passage of House Bill 334 in 2011 legislative session, introduced significant premium rate relief for our policyholders. The new law took effect July 1, 2011.

What HB334 Has Meant for Our Policyholders?

In 2010, Montana's workers' compensation rates were the highest in the nation, according to a biennial study conducted by the Oregon Department of Consumer and Business Services. But by 2012, Montana's standing among the other fifty states and the District of Columbia had improved, falling to number eight.

With the enactment of HB334 rates are now 25% lower than in 2010. This legislation moved Montana's position down closer to the middle

of the pack. While Montana's rates are still 33% above the median (or the middle – Georgia and New Mexico in a tie), this is a significant improvement from 2010 when Montana's rates were found to be 63% above the median.

While these provisions have been in place for a little over a 1 year it is too soon to tell how effective the changes will be on reducing losses and reducing the costs of workers' compensation. However, we are confident that the rate decreases will help Montana's business owners reduce their operating costs allowing expansion, salary and benefit increases, and in some cases helping them keep their doors open, strengthening the overall Montana economy

Claim and Medical Management

An Rx for Containing Medical Costs

It is our job as a workers' compensation insurer to ensure that injured employees receive appropriate medical care for optimum results. But as we are all well aware, the cost of providing this care has skyrocketed. Montana State Fund has grappled with this issue and has taken steps over the past few years to improve how we manage claims and contain these medical costs. In 2012 we continued to build upon our efficiencies with increased training and education for our claims examiners and we hired more medical staff to assist with our claims.

In December 2012 we hired our first medical director, neurosurgeon Dr. Paul Gorsuch. With his expertise, Dr. Gorsuch will continue to train our claims and medical management staff on appropriate treatment for injuries. Also, he will meet regularly with medical providers to discuss the medical trends we see—with their goal always to promote optimal outcomes for our injured employees.

In addition to the medical director, we created a new provider relations specialist position. Michele Fairclough, a veteran MSF claims examiner with over 22 years experience, took on this role. In this position she directly communicates with providers and their office staffs about the information we need to efficiently handle claims. Her knowledge of workers' compensation insurance will be invaluable when providers have questions about the new state-mandated medical utilization guidelines providers must adhere to and the finer points of the workers' comp system.

Overall, we are confident that our improvements in claim management and provider communication will translate into lower overall costs for our policyholders and guarantee that our injured employees have timely access to appropriate medical care provided by medical professionals most competent to address their particular injuries.

A Guide to Healing

In 2009 the Montana Legislature directed the Department of Labor and Industry (DOLI) to study the use of medical utilization and treatment guidelines and their effectiveness in other workers' compensation jurisdictions. Part of this process involved DOLI establishing a stakeholder group consisting of numerous Montana medical providers. This group met several times in 2009-2010 to study the various guidelines available and select a guideline to be used for Montana.



On July 1, 2011, DOLI mandated the use of the Montana Utilization and Treatment Guidelines by medical providers in the treatment of injured employees. This is the first time guidelines had been required for the treatment of workers' compensation injuries in Montana.

At Montana State Fund our employees began to use the guidelines to assess the appropriateness of ongoing care for our injured employees. Our goal in using the Montana guidelines is to ensure the injured employee receives the right care at the right time by the right provider. We believe this will facilitate faster healing and earlier return to work which will result in better outcomes for injured employees and policyholders.

Work Heals: Return to Work Works

You don't get injured employees healed to get back to work. You get them back to work to get them healed. That's precisely the message we continued to communicate to Montana's employers and injured employees through our Return to Work (RTW) education efforts in 2012.

Creating an effective RTW program speeds recovery, improves workers' self-esteem and can reduce premium costs for policyholders. RTW is a tool that employers use to manage a workplace injury and, if necessary, temporarily modify the injured employee's position or job description to accommodate the physical restrictions identified by the medical provider.

Resources

One way MSF communicated the benefits of RTW to employers and employees was through our statewide Work Heals media campaign. The message aired on television and radio, was posted on billboards and appeared as print advertisements in a number of trade publications.

In addition, we built a dedicated RTW section on our safety website safemt.com to help employers shape their own RTW programs. We also offered a free Return to Work kit to anyone who was interested in receiving one.



Creating a Culture of Safety: SafetyfestMT

Montana's high workplace injury rates was the impetus for our staff to join forces with other public and private groups to create and implement SafetyFestMT for all Montana employers.

SafetyFestMT was created to provide high-quality safety training for Montana's workers at little or no cost. Since the first SafetyFest in Helena 2010, these free, weeklong, high-quality safety conferences have helped hundreds of Montana's employers and employees improve on-the-job safety.

By June 2012 there had been a total of five successful SafetyFests in Helena, Billings, Great Falls, Glasgow and Missoula. In that time MSF provided financial assistance and our staff facilitated a number of workshops.

At MSF, we believe it is our job to partner with public and private entities across the state to change the culture of safety one business at a time. We owe it to the people of Montana to ensure we lower workplaces injuries and provide high quality safety education every day.



PUBLIC EDUCATION

A company's investment in a safe, productive workplace is no accident. Because unsafe behavior contributes to more than 90% of all injuries, it's essential that businesses commit themselves to promoting the development of a safety culture throughout their organization. To that end Montana State Fund creates and disseminates a wide range of information resources and media campaigns to help Montana's employers and employees make safety a priority.



Outreach

Expressing our safety message to our policyholders, injured employees, insurance agents and the public is key to our organization's success. We accomplish this through our electronic newsletters, websites, informational brochures and trade show events.



www.safemt.com

**In case of injury:
GRAB N GO KIT**
An essential part of our Return to Work Benefit Program

EMPLOYEE INSTRUCTIONS:

The documents in this kit are designed to facilitate care of our employee in the event of a workplace injury. Please review the documents with your medical provider at your initial visit and return all completed documents to _____ immediately.

- Letter to Medical Provider – Our employees are our most valuable resource and whenever possible we provide medically appropriate alternative work for injured employees while they heal. This brief letter explains our Return to Work Benefit Program.
- Medical Status Form – To be completed by the treating physician at the initial visit and each follow-up if necessary.
- Job Description/Analysis – For the medical provider to review the physical requirements of your regular job.
- First Report of Injury (FROI) – The injured employee and employer are required to complete the FROI for this incident and immediately return it to Montana State Fund.
- Incident Investigation Report – To be completed by the employer. Initiate an investigation into the root causes of this incident to identify preventative measures.

Thank you for cooperating with our efforts to maintain a safe, healthy and productive work environment for our employees. Please contact _____ at _____ if you have any questions or concerns regarding our Return to Work benefit program.



www.safemt.com

**WORKING TOGETHER
TO BEAT FRAUD**

With your help, we can reduce fraud and save you money.



Feeling useful feels good.

Work Heals. That's why Montana State Fund is dedicated to working with employees, employers and physicians to get injured employees back on the job as soon as medically possible. Our Return to Work programs include modified duties, physician-approved task sheets and processes for reporting. Ask your insurance agent about Return to Work programs or visit www.safemt.com.


MONTANA STATEFUND
www.safemt.com
RETURN TO WORK PROGRAMS



www.safemt.com

**WHEREVER
YOU WORK,
SAFETY STARTS HERE.**

FREE SERVICES AND RESOURCES FOR OUR POLICYHOLDERS:

- SAFETY MANAGEMENT CONSULTANTS
- INDUSTRY SPECIFIC ONLINE REFERENCES AND TOOLS
- WORKSAFE CHAMPION CERTIFICATION PROGRAM
- STATEWIDE WORKSHOPS

**WORK HARD.
BE SAFE.**


MONTANA STATEFUND
www.safemt.com

**OUR PEOPLE.
AT YOUR SERVICE.**

Policyholder Information
Policy Year
2012


MONTANA STATEFUND

Report of Management

The management of Montana State Fund (MSF) is responsible for the financial statements and all other information presented in this Annual Report. MSF maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded against loss and that transactions are executed and recorded in accordance with management's authorization. This system encompasses the organizational structure and corporate governance practices, selection and training of personnel, communication and enforcement of policies and procedures, monitoring, and ongoing internal and external audit programs. Internal controls are continually reviewed and evaluated by management.

The financial statements are presented for our fiscal years ending June 30, 2012 and 2011 and include amounts based on the best estimates and judgments of management. These financial results are presented on a statutory basis (NAIC), which is consistent with insurance industry financial statement presentation. MSF governs, operates and completes its financial reporting as an insurance company domiciled in the State of Montana, and its financial statements are presented on the basis of accounting practices prescribed or permitted by the Montana State Auditor, Commissioner of Securities and Insurance. Evaluating the financial results of MSF in comparison to other insurers aids in assessing and maintaining the financial security and stability of MSF as a workers' compensation insurer. The statements included in this Annual Report should not be considered complete audited financial

statements. The statements presented are representative of audited financial statements as audited by independent public accounting firm Eide Bailly, LLP for the years ending June 30, 2012 and 2011. Unqualified opinions were issued on MSF's statutory financial statements for the years audited. After approval, the complete audited financial statements including the accompanying notes are available on the MSF website. In addition, MSF is a component unit of the State of Montana. As required in law, the Legislative Audit Division (LAD) of the State of Montana conducts independent audits of financial statements of MSF presented in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). For the financial periods ending June 30, 2012 and 2011, MSF also received unqualified audit opinions from the LAD. The audited governmental financial statements and the related audit opinions are issued under separate cover. A copy of the full governmental financial statements are available on the State of Montana Legislative Audit Division website. The presentation of the statutory financial statements in this report differs from the governmental presentation basis. A financial reconciliation of equity between the audited GASB financial statements and the audited statutory financial statements is included in this report.

A COMPARISON OF STATUTORY ACCOUNTING ENDING EQUITY TO GASB NET ASSETS

For the Year Ended June 30, 2012

Statutory policyholder equity (NAIC)	\$317,667,748
Add:	
Non-admitted assets	7,361,765
Change in investment value of bonds to fair market value	85,644,729
Change in allowance for doubtful accounts	(2,867,648)
Provision for Reinsurance recorded for statutory	55,265
Change in net income between Statutory and GAAP for:	
Deferred acquisition costs	4,071,134
Rounding differences	(3)
GASB net assets	\$411,932,990

QUICK FACTS AS OF JUNE 30, 2012

Total net earned premium	\$150,482,457
Number of policies serviced	27,923
Total number of claims processed	10,028
Investment income earned	\$49,432,329
Net income after dividends	\$23,802,085
Policyholders dividend	\$6,001,168
Loss and LAE reserves	\$889,940,574
Statutory equity	\$317,667,748
Reserves to Equity Ratio (after dividend)	2.80
Premium to Equity Ratio (after dividend)	0.47

FINANCIALS

As part of the corporate governance practices of MSF, the following is the list of the top five compensated executives/employees in the organization as well as their compensation for the fiscal year.

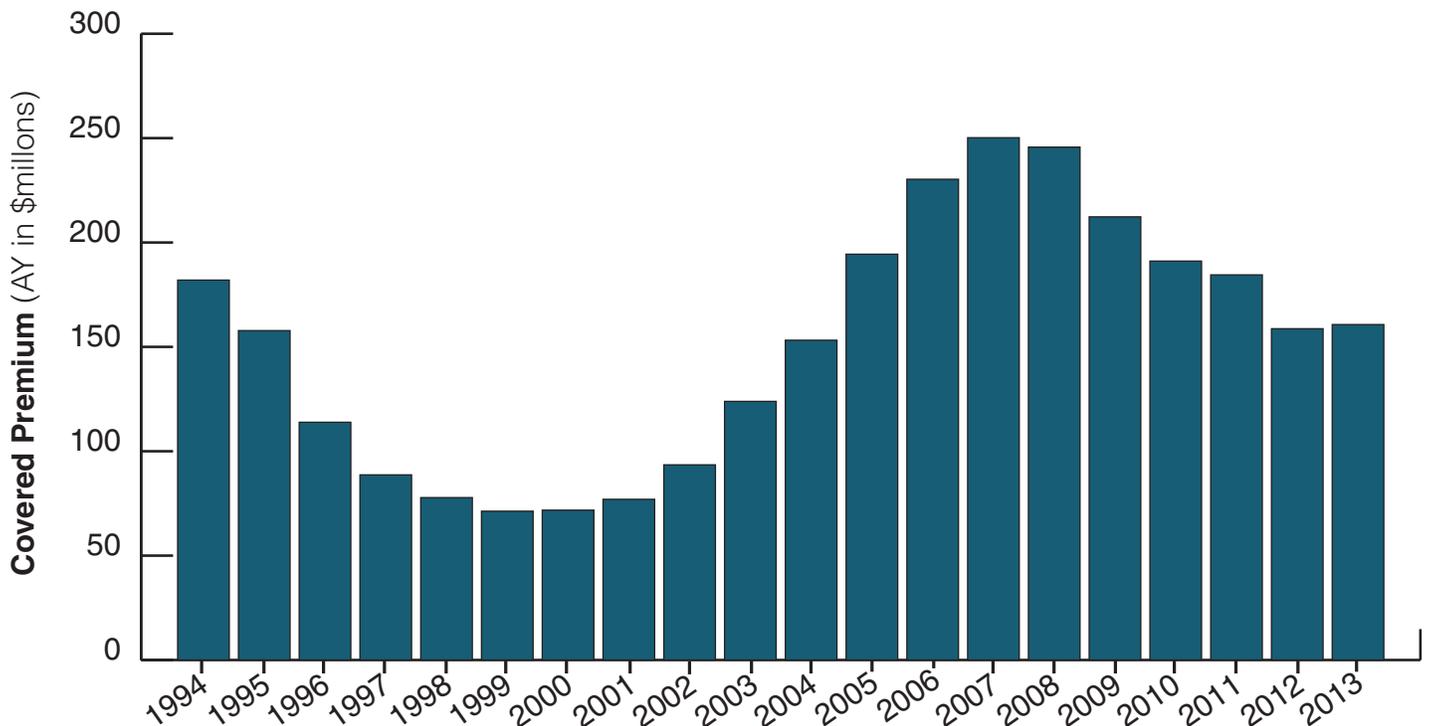
Name	Position	Base Salary	Incentive	Other Compensation*
Laurence Hubbard	President/CEO	\$261,047	\$0	\$20,154
Al Parisian	Chief Information Officer	\$182,719	\$0	\$1,763
Mark Barry	VP Corporate Support	\$157,920	\$0	\$3,204
Nancy Butler	General Counsel	\$157,920	\$0	\$3,204
Richard Root	VP Operations	\$151,062	\$0	\$4,963

* Other compensation is for earned excess annual leave payouts.

MSF COVERED PREMIUM

MSF Gross Earned Premium

MSF premium declined from approximately \$182 million (gross earned premium) in 1994 to \$71 million in 1999. Since 1999, gross earned premium has significantly risen as market conditions changed and MSF gained market share. Rates also increased during this period to cover the increasing cost of claims. MSF premium has fallen since 2007 due to rate reductions and faltering wage and employment conditions in Montana. The MSF will have an estimated \$156 million in gross earned premium in 2013 (estimate subject to change as the year progresses).

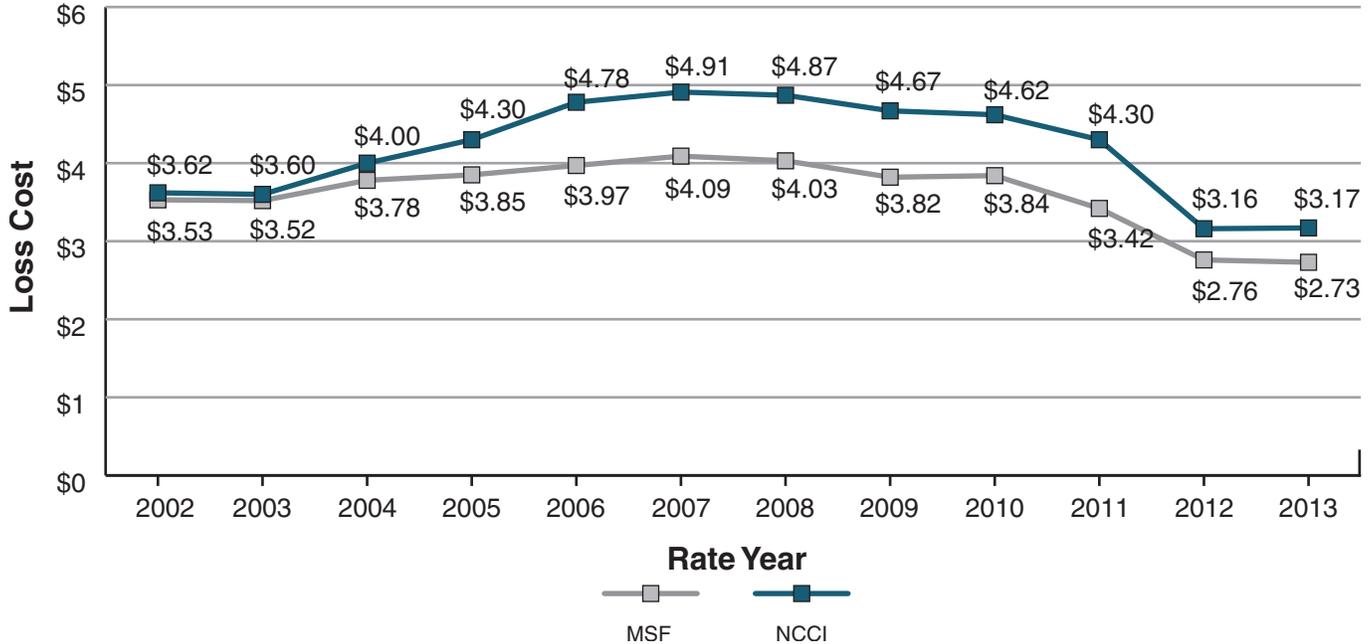


Based on exposure within 7/1-6/30 accident year AY 2013 is estimated based on current active policies to-date from Insurance intelligence as of 12/31/2012.

FINANCIALS

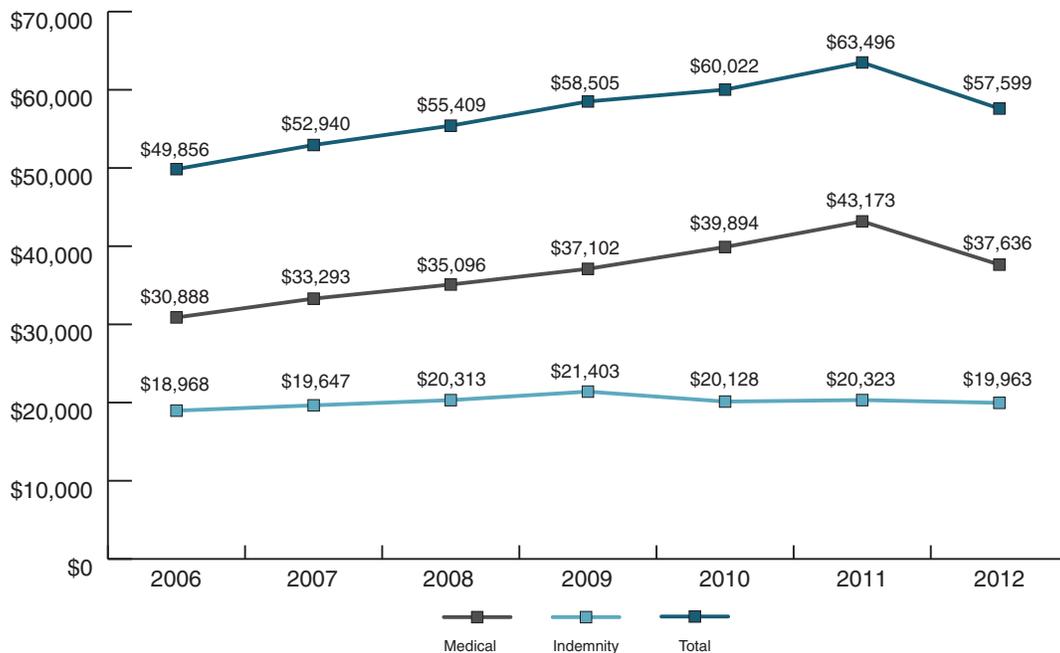
MSF VS NCCI LOSS COSTS

"Loss Costs" refers to the amount estimated to cover the cost of workers compensation benefits and claim administration. Loss costs represent approximately 80% of MSF premium rates. In a competitive rating state like Montana, carriers use the NCCI loss cost as the starting point in establishing their rates but may adjust the level for the book of business they write. For the past 10 years, MSF has charged an average of 15% less than NCCI loss costs. MSF's independent consulting actuary has determined that MSF does not need to charge as much as estimated by NCCI.



AVERAGE COST PER WAGE-LOSS CLAIM

The average wage-loss claim costs about \$60,000, although the most catastrophic of claims can cost several millions of dollars. About 67% of workers compensation claim costs are for medical services, which is a fast growing driver of Montana claim costs. Wage replacement (indemnity) costs are rising by an average of 1%-2% per year, consistent with the rise in general wage levels. However, workers compensation medical costs are rising 6%-7% per year. The average cost per claim dropped for 2012 due to benefit reforms enacted in HB334.



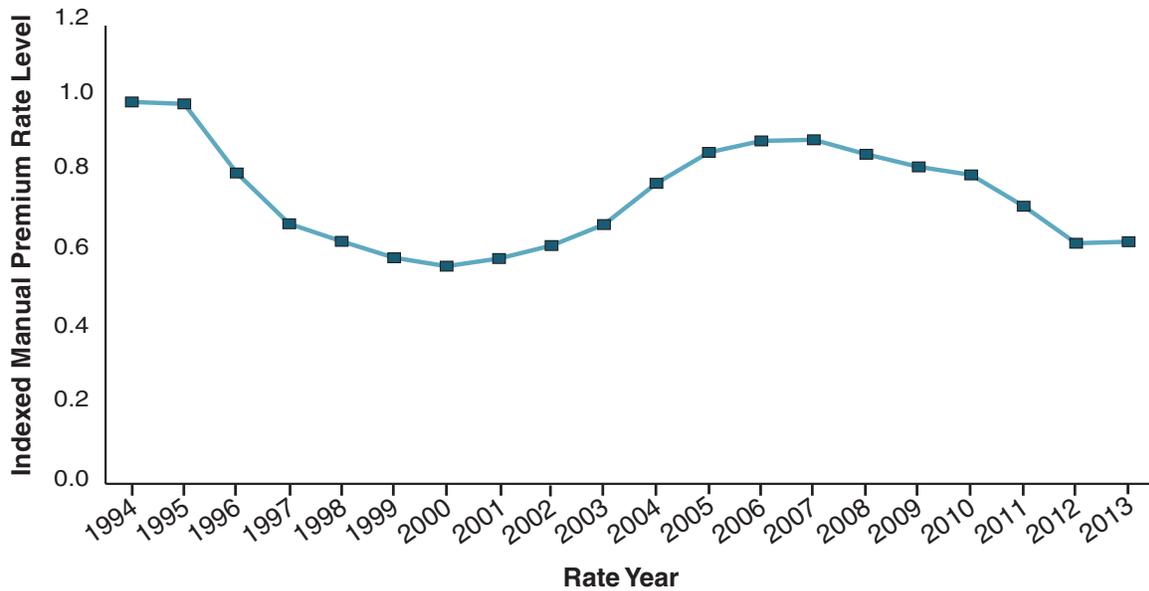
AY Severity Trend: Based on TowersWatson Central Estimate Ultimate Losses (6/30/2012 Reserve Report) Wage Loss Claims Only.

FINANCIALS

MSF RATE LEVEL

Manual Rates (average of MSF rate tiers)

MSF manual rate levels decreased 38% from 1994 to 2000 due to improved conditions in the workers' compensation arena including lower medical inflation, declining claim frequency, and statutory benefit changes enacted in 1995. MSF manual rate levels rose 36% through 2007 due to increasing medical costs and statutory and judicial benefit expansions. Net rate levels decreased 26% since 2007, in large measure due to legislative benefit level decreases in HB 334. MSF 2012 rates were 37% below 1994 rates.



Note: Manual Rate Change from 6/30/2012 TowersWatson Reserve Report. Net Credits for GEP from PY Premium.123 as of 12/30/2012.

MSF BOOK BY ACCOUNT SIZE

MSF predominantly serves small employers in Montana. However, the premium volume from larger employers enables MSF to maintain lower and more stable rates as well as a high level of customer service for all policyholders.

