Statutory Financial Statements
December 31, 2019 and 2018

Montana
State Fund

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CPAs & BUSINESS ADVISORS

**Independent Auditor's Report**

To the Board of Directors
Montana State Fund
Helena, Montana

**Report on the Statutory Financial Statements**
We have audited the accompanying statutory financial statements of Montana State Fund (MSF), a component unit of the State of Montana, which comprise the statutory statements of admitted assets, liabilities, and policyholders' equity as of December 31, 2019 and 2018, and the related statutory statements of income and changes in policyholders' equity, and cash flows for the years then ended, and the related notes to the statutory financial statements.

**Management's Responsibility for the Statutory Financial Statements**
Management is responsible for the preparation and fair presentation of these statutory financial statements in accordance with the accounting practices prescribed or permitted by the Insurance Department of the Montana State Auditor's Office. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of statutory financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**
Our responsibility is to express an opinion on these statutory financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statutory financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statutory financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the statutory financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the statutory financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the statutory financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

**Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles**
As described in Note 1 to the statutory financial statements, the statutory financial statements are prepared using accounting practices prescribed or permitted by the Insurance Department of the Montana State Auditor's Office, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The effects on the statutory financial statements of the variances between the statutory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.


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**Adverse Opinion on U.S. Generally Accepted Accounting Principles**
In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the statutory financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of Montana State Fund as of December 31, 2019 and 2018, or the results of its income or its cash flows for the years ended December 31, 2019 and 2018.

**Opinion on Regulatory Basis of Accounting**
In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and policyholders' equity of Montana State Fund as of December 31, 2019 and 2018, and the results of its operations, changes in policyholders' equity and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Eide Bailly LLP

Fargo, North Dakota
March 11, 2020

| | 2019 | 2018 |
|---|---|---|
| **Admitted Assets** | | |
| **Cash and Invested Assets** | | |
| Bonds | $ 1,183,992,996 | $ 1,166,461,195 |
| Equity securities | 180,895,162 | 153,602,559 |
| Real estate occupied by the Company | 23,993,134 | 24,524,019 |
| Cash and cash equivalents | 69,121,234 | 22,693,392 |
| Other invested assets | 82,678,575 | 95,728,561 |
| Receivables for securities | — | 9,000,000 |
| Securities lending collateral assets | 5,861,488 | 102,000 |
| Total cash and invested assets | 1,546,542,589 | 1,472,111,726 |
| **Other Admitted Assets** | | |
| Investment income due and accrued | 8,609,084 | 9,071,920 |
| Receivables, net | | |
| Uncollected premiums | 7,502,300 | 9,608,332 |
| Deferred premiums booked but not yet due | 60,193,388 | 62,364,509 |
| Accrued retrospective premiums | 139,500 | 35,100 |
| Amounts recoverable from reinsurers | 62,360 | — |
| Funds deposited with reinsured companies | 258,310 | 278,310 |
| Reinsurance funds withheld | 56,753,488 | 48,385,574 |
| Electronic data processing equipment and software | 1,358,807 | 1,273,348 |
| Aggregate write-ins for other-than-invested assets | — | 864,466 |
| Total other admitted assets | 134,877,237 | 131,881,559 |
| Total admitted assets | $ 1,681,419,826 | $ 1,603,993,285 |
| **Liabilities and Policyholders' Equity** | | |
| **Liabilities** | | |
| Unpaid losses | $ 835,071,433 | $ 824,766,337 |
| Unpaid loss adjustment expenses | 121,522,210 | 116,871,358 |
| Commissions payable | 3,696,928 | 4,584,543 |
| Other expenses payable | 14,614,646 | 27,029,360 |
| Unearned premium | 60,542,803 | 63,931,327 |
| Advance premium | 356,011 | — |
| Dividend declared and unpaid | — | 130,469 |
| Ceded reinsurance premium payable | 80,795 | — |
| Funds held by Company under reinsurance treaties | 56,753,488 | 48,385,574 |
| Amounts retained for account of others | 1,109,572 | 3,394,839 |
| Remittances and items not allocated | 15 | 1,233,826 |
| Payable to affiliates | 82,656 | 99,613 |
| Payable for securities | 30,493,382 | — |
| Securities lending liability | 5,861,488 | 102,000 |
| Retrospective premiums payable | 569,119 | 989,000 |
| Total liabilities | 1,130,754,546 | 1,091,518,246 |
| **Policyholders' Equity** | | |
| Policyholders' equity | 550,665,280 | 512,475,039 |
| Total liabilities and policyholders' equity | $ 1,681,419,826 | $ 1,603,993,285 |

| | 2019 | 2018 |
|---|---|---|
| Net Premium Earned | $ 156,871,129 | $ 161,258,975 |
| Operating Expenses | | |
| Losses incurred | 110,705,800 | 117,107,380 |
| Loss expenses incurred | 25,890,985 | 21,416,826 |
| Underwriting expenses incurred | 37,930,364 | 52,123,955 |
| Contingent commission income | (8,367,914) | (9,652,596) |
| Net underwriting gain (loss) | (9,288,106) | (19,736,590) |
| Net investment income earned | 38,580,359 | 36,541,567 |
| Net realized capital gains (losses) | 16,209,809 | 20,802,787 |
| Receivable balances charged off, net of recoveries of $709,315 and $1,185,550, respectively | (1,090,709) | (376,661) |
| Other expenses | (2,489,957) | (3,207,942) |
| Net Income (Loss) Before Dividends | 41,921,396 | 34,023,161 |
| Policyholder Dividends | (30,006,671) | (39,997,664) |
| Net Income (Loss) After Dividends | $ 11,914,725 | $ (5,974,503) |
| Changes in Policyholders' Equity | | |
| Balance, Beginning of Year | $ 512,475,039 | $ 554,701,083 |
| Net income (loss) | 11,914,725 | (5,974,503) |
| Net unrealized gains (losses) on investments | 28,572,582 | (29,174,552) |
| Change in non-admitted assets | (2,297,066) | (7,076,989) |
| Balance, End of Year | $ 550,665,280 | $ 512,475,039 |

| | 2019 | 2018 |
|---|---|---|
| Cash from Operations | | |
| Premiums collected, net of reinsurance | $ 158,570,508 | $ 161,425,329 |
| Net investment income | 38,957,372 | 36,634,932 |
| Miscellaneous expense | (3,580,666) | (3,584,603) |
| | 193,947,214 | 194,475,658 |
| Benefit and loss related payments | (108,810,978) | (70,471,638) |
| Loss adjustments and underwriting expenses paid | (64,104,912) | (61,766,744) |
| Dividends paid to policyholders | (30,137,140) | (41,253,490) |
| | (203,053,030) | (173,491,872) |
| Net Cash from (used for) Operations | (9,105,816) | 20,983,786 |
| Cash from Investments | | |
| Proceeds from investments sold, matured, or repaid | | |
| Bonds | 341,331,735 | 222,998,637 |
| Equity securities | 15,000,000 | 25,000,000 |
| Other invested assets | 11,218,893 | 24,575,924 |
| Gain or loss on cash, cash equivalents, and short-term investments | 12,693 | (3,009) |
| Securities lending collateral | 39,493,382 | 20,896,735 |
| Total investment proceeds | 407,056,703 | 293,468,287 |
| Cost of investments acquired | | |
| Bonds | (353,927,960) | (248,418,488) |
| Equity securities | (10,680) | (5,366) |
| Other invested assets | — | (20,000,000) |
| Securities lending collateral | (5,759,488) | (9,000,000) |
| Total investments acquired | (359,698,128) | (277,423,854) |
| Net Cash from Investments | 47,358,575 | 16,044,433 |
| Cash from Financing and Other Sources | | |
| Cash provided or (applied) | | |
| Other sources | 8,175,083 | (64,733,128) |
| Net Cash from (used for) Financing and Other Sources | 8,175,083 | (64,733,128) |
| Net Increase (Decrease) in Cash and Short-Term Investments | 46,427,842 | (27,704,909) |
| Cash and Short-Term Investments - Beginning of Year | 22,693,392 | 50,398,301 |
| Cash and Short-Term Investments - End of Year | $ 69,121,234 | $ 22,693,392 |

## Note 1 - Nature of Operations and Significant Accounting Policies

### Nature of Operations

The Montana State Fund (MSF or the Company) is a nonprofit, independent public corporation established under Title 39, Chapter 71 of the Montana Code Annotated (MCA). MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is governed by a seven member Board of Directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF as fully and completely as the governing body of a private mutual insurance carrier. MSF is allocated to the State of Montana, Department of Administration for administrative purposes only, and is reported as a component unit in the State's Comprehensive Annual Financial Reports. MSF is exempt from federal or state income and premium taxes.

MSF functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of MSF are separate and distinct from assets, debts, and obligations of the State of Montana. State law requires MSF to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. MSF governs, operates, and completes its financial reporting as an insurance company domiciled in the State of Montana and is required to file its annual statement and audited financial report with the Insurance Department (MDOI) of the Montana State Auditor's Office (SAO).

During the 1990 Montana Special Legislative Session, legislation passed establishing separate liabilities, funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as MSF. This report reflects only the operations of MSF. MSF administers and manages the remaining claims of the Old Fund. The State of Montana pays MSF an administrative fee and provides the funding for the Old Fund benefit payments.

### Basis of Presentation

The accompanying financial statements of MSF have been prepared in conformity with accounting practices prescribed and permitted by the MDOI (Statutory Accounting Principles or SAP), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP). Certain amounts in the notes to the financial statements have been rounded to the nearest thousand or million and such amounts are annotated with a "K" or "M", respectively.

The MDOI recognizes only statutory accounting practices prescribed or permitted by the State of Montana for determining and reporting the financial condition and results of operations of an insurance company. The National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures* manual (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the State of Montana.

<u>Differences of NAIC SAP from Generally Accepted Accounting Principles</u>

Statutory accounting practices vary in some respects from U.S. generally accepted accounting principles (GAAP). Such significant differences include the following:

a. Investments in bonds with an NAIC rating of 1 or 2 are carried at NAIC determined value or amortized cost, whereas bonds with an NAIC rating of 3 through 6 are assigned specific year-end values by the NAIC and are written down to Securities Valuation Office (SVO) assigned values (if less than amortized cost) by charging statutory equity. Under GAAP, bonds are classified into three categories: held to maturity, available for sale, or trading. Bonds held to maturity are stated at amortized cost; bonds available for sale are stated at fair value and the resulting unrealized gains or losses, net of applicable income taxes, are charged or credited to equity; and bonds held for trading are reported at fair value and the resulting unrealized gains or losses are reported in earnings. The fair value of investments on a statutory basis is determined by the SVO, whereas for GAAP, the fair value of investments is determined based on the expected exit price.

For loan-backed and structured securities, if the Company determines that they intend to sell a security or no longer have the ability and intent to retain the investment for a period of time sufficient to recover the amortized cost, that security shall be written down to fair value. For statutory purposes, if the Company subsequently changes its assertion, and now believes it does not intend to sell the security and has the ability and intent to retain the investment for a period of time sufficient to recover the amortized cost, that security will continue to be carried at the lower of cost or market with any future decreases in fair value charged through operations until the security is disposed. For GAAP purposes, once the Company alters its assertion, that security's amortized cost basis will not be decreased for future reductions in fair value unless an other-than-temporary impairment is determined to have occurred.

Also, for GAAP purposes, other-than-temporary impairment losses related to debt securities are bifurcated between credit and non-credit with only the credit component charged to earnings, whereas for statutory purposes, the total other-than-temporary impairment loss is reported in earnings.

b. Assets having economic value other than those that can be used to fulfill policyholder obligations are categorized as "nonadmitted assets" and are not permitted to be included in the statutory financial statements of admitted assets, liabilities, and policyholders' equity, whereas for GAAP, these assets are recognized in the balance sheet, subject to any valuation allowances. Assets reported under NAIC SAP as "non-admitted" are excluded through a charge against unassigned policyholders' equity. Included with non-admitted assets are furniture, certain equipment and software, prepaid expenses and certain receivables that do not meet statutory criteria for admitted assets.

c. Receivables over 90 days outstanding are not admitted to the statutory financial statements and charged against statutory policyholders' equity, whereas, for GAAP, the Company assesses the collectability of premiums receivable and any charge for uncertain collection is made to the income statement.

d. The statutory statement of admitted assets, liabilities, and policyholders' equity is presented net of the effects of reinsurance, whereas, for GAAP, the balance sheet is presented gross of the effects of reinsurance.

e. Cash, cash equivalents, and short-term investments in the statement of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents include cash balances and investments with initial maturities of three months or less.

f. Commissions allowed by reinsurers on business ceded are reported as income when received rather than being deferred and, to the extent recoverable, amortized over the life of the policy, as required under GAAP.

g. Governmental pension accounting standards (GASB 68) require recognition of an allocation of the state's unfunded retirement plan liability at the agency level. Under SAP, the recording of a portion of the unfunded liability is not required for a reporting entity who participates in a plan sponsored by another entity, but is not directly liable for the obligations under the plan (SSAP No. 102 paragraph 86); however, the amounts contributed to the plan by MSF are recorded as expense in the current period.

h. Governmental other postemployment benefit (OPEB) accounting standards (GASB 75) require recognition of an allocation of the state's OPEB liability at the agency level. Under SAP, the recording of a portion of the liability is not required for a reporting entity who participates in a plan sponsored by another entity, but is not directly liable for the obligations under the plan (SSAP No. 92 paragraph 100).

i. The statutory statement of cash flows differs in certain respects from the presentation required within GAAP literature, including presentation of changes of cash and short investments instead of cash and cash equivalents. In addition, GAAP requires a reconciliation of net income to net cash from operating activities. Short-term investments include securities with a maturity of one year or less and are included in the cash balance, whereas GAAP excludes short-term investments from cash. Both statutory and GAAP include cash equivalents in the cash balance. Cash equivalents are defined as highly liquid investments with a maturity of three months or less at acquisition.

j. Comprehensive income is not determined for statutory reporting purposes, whereas, for GAAP, such income is presented.

k. Incremental direct costs that result directly from and are essential to the contract acquisition transaction and would not have been incurred by the Company had the contract acquisition not occurred, are charged against statutory earnings as such costs are incurred, while, under GAAP, such costs, to the extent recoverable, would be deferred and amortized over the effective periods covered by the related policies.

l. A statutory liability is calculated based on the age of the reinsurance recoverable and whether the reinsurer is authorized by the Company's state of domicile. This statutorily required provision for reinsurance is a direct charge to surplus. Under GAAP, no such liability is provided.

m. The statutory financial statements are prepared in conformity with the Annual Financial Reporting Model Regulation # 205, which requires the audited financial statements to conform to the language and groupings used to prepare the Annual Statement filing as set out by the NAIC.

The differences between statutory accounting practices and GAAP are material. See Note 17 for a listing of significant differences.

MSF's financial statements are stated on a NAIC SAP basis except where certain differences are set out in the Montana Code Annotated. MCA references conformity with the Accounting Practices and Procedures Manual within section 33-2-701(1), and therefore, concludes that no legislation is necessary to adopt its use.

For the years ended December 31, 2019 and 2018, there were no differences of MSF's net income and policyholders' equity between NAIC SAP and practices prescribed and permitted by the State of Montana.

**Significant Statutory Accounting Policies**

Cash and Cash Equivalents

Cash, cash equivalents, and short-term investments are stated at net asset value. Cash constitutes a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account. Savings accounts, certificates of deposits with maturity dates of one year or less, and cash equivalents are also classified as cash. Cash equivalents are investments with original maturities of three months or less; are readily convertible to known amounts of cash; and present insignificant risk of change in value due to changes in interest rates. The Montana State Treasury and the Montana Board of Investments (BOI) hold MSF's cash and cash equivalent balances. At times during the year, MSF's cash balances are in excess of federally insured limits. The Company does not consider this a significant credit risk. MSF participates in the Short-Term Investment Pool (STIP), maintained by the BOI. STIP balances are highly-liquid investments in a money market mutual fund.

Short-Term Investments

Short-term investments are those investments with remaining maturities of one year or less at the time of acquisition, excluding those investments classified as cash equivalents. Short-term investments include but are not limited to bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans that meet the above criteria.

Investments

Equity securities, bonds, investments in partnerships and limited liability companies, and certificates of deposit with original maturities greater than one year are long-term investment securities. Long-term securities are held by BOI. State Street Bank is the custodial bank for BOI.

Equity securities held through mutual funds are valued at net asset value (NAV) of shares held by MSF at year end, which is used as a practical expedient for fair market value. The Montana Constitution allows investing in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. The BOI approved a policy statement to maintain the allocation to public equities at no more than 15% of total portfolio market value. Investments in equity securities are carried at NAV as determined by the fund manager, and the related unrealized capital gains (losses) are reported in policyholders' equity.

Bonds, excluding residential and commercial mortgage-backed securities, are rated and valued in accordance with the NAIC Securities Valuation Office (SVO) rating guidelines. Bonds with a SVO rating of 1 and 2 are valued at amortized cost using the scientific (constant yield) interest method. Bonds with a SVO rating of 3 or higher are valued at the lower of amortized cost or market.

Investments in residential and commercial mortgage-backed securities not guaranteed by federal or federally-sponsored agencies utilize a financial model commissioned by the NAIC to determine credit ratings, and ultimately the NAIC designation/rating. This financial model requires a two-step process. MSF first determines the initial rating designation based upon each security's amortized cost in relation to security-specific prescribed break points. This initial rating designation determines whether the security will be stated at amortized cost or fair value, based on the same criteria noted in the preceding paragraph. The lower the amortized cost relative to par, the higher the NAIC designation, and more likely the security will be carried at amortized cost. If the security is to be carried at fair value, MSF then determines the final rating designation based upon each security's fair value in relation to the same security's specific prescribed break points used in the first step. If the security is to be carried at amortized cost, the final designation remains the same as what was determined in the first step.

The final designation is used for risk-based capital (RBC) purposes as well as for NAIC designation disclosure.

Investments in partnerships and limited liability companies are valued based on the net asset value (NAV) of the investment pool which is used as a practical expedient for fair market value. The related unrealized capital gains (losses) are reported in policyholders' equity.

MSF has no derivative investments.

Investments in Real Estate are comprised of property occupied by the Company. These investments are recorded at depreciable cost net of related debt obligation, which was zero as of December 31, 2019 and 2018. Depreciation is calculated on a straight-line basis over the estimated useful life of the property. Land is valued at historical cost.

Investment income consists of interest and dividends, net of related investment expenses. Interest is recognized on an accrual basis and dividends are recorded as earned at the ex-dividend date. Realized capital gains and losses are determined using the first-in first-out method at the time of disposition.

Fair Values of Financial Instruments

Statement of Statutory Accounting Principles (SSAP) No. 100R, "Fair Value" defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

The Company classified its investments based upon an established fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. SSAP No. 100R describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

- Level 1-Quoted prices in active markets for *identical* assets or liabilities.
- Level 2-Inputs other than Level 1 that are observable, either directly or indirectly; such as quoted prices for *similar* assets or liabilities, quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3-Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value or for those assets not stated at fair value in the financial statements but whose estimated fair values are disclosed.

*Bonds - Issuer Obligations, including Industrial and Miscellaneous* - Valued based on market values. For those securities not actively traded, quoted market prices of comparable instruments or discounted cash flow analysis are used based upon inputs that are observable in the markets for similar securities. Inputs include benchmark yields, credit spreads, default rates, prepayments, and non-bonding broker quotes.

*Bonds - Mortgage and Other Asset-Backed Bonds* - Valued based on Commercial and Residential Mortgage-Backed Securities modeling file provided by Clearwater Analytics. The prepayment assumptions used for single class and multi-class mortgage-backed/asset-backed securities were obtained from broker/dealer survey values. These assumptions are consistent with the current interest rate and economic environment.

*Equity Securities - Unaffiliated and Mutual Funds* - Unit value is based on the quoted market value of the individual securities held by the fund less the liabilities of the fund. The NAV of the fund is used as a practical expedient for fair value.

*Other Invested Assets* - Value is based on appraised market values of the properties held by the investment company less liabilities. NAV of the investment is used as a practical expedient for fair value.

*Cash and Cash Equivalents* - NAV is determined by the market values of the underlying assets held in the money market mutual funds. The carrying amounts are reported at NAV as a practical expedient for fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of the future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Other-Than-Temporary Declines in Fair Value

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other-than-temporary. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include: the Company's ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value; the duration and extent to which fair value has been less than cost; and the financial condition and prospects of the issuer. When other-than-temporary impairments are recognized, the security is written down to an estimated fair value, and the amount of the write-down is recorded as a realized loss.

Cash Collateral and Liability for Securities on Loan

Under the provisions of state statutes, the Montana Board of Investments (BOI) has, by a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank, to lend BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral of at least 100% of the market value of the loaned security. BOI retains all rights of ownership during the loan period.

The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the State Street Navigator Securities Lending Government Money Market Portfolio. The relationship between the average maturities of the investment pool and BOI's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which BOI could not determine. On December 31, 2019 and 2018, BOI had no credit risk exposure to borrowers.

Premium Receivable

Premium receivable balances with an amount due over 90 days are non-admitted assets. MSF evaluates the remaining admitted accounts receivable asset for impairment. If it is probable that any amounts are not collectible, the uncollectible receivable is written off and charged to income in the period the determination is made.

Computer Equipment and Software

Computer equipment is capitalized if the actual or estimated historical cost exceeds $5,000. Software is capitalized if the actual or estimated historical cost exceeds $100,000. Computer equipment is depreciated on a straight-line basis over an estimated useful life of three years. Software is amortized on a straight-line basis using a three-year life for operating software and a five year life, or less, for application software. In accordance with statutory accounting principles, computer equipment and operating software are admitted assets, although §33-2-501(11), MCA limits admission of this equipment to a maximum of 1% of admitted assets. Application software is a non-admitted asset.

Furniture, Equipment and Leasehold Improvements

Furniture and equipment are capitalized if the unit cost exceeds $5,000, and are recorded at cost and depreciated on a straight-line basis using estimated useful lives, which range from five to ten years. There are no leasehold improvements. Statutory accounting principles require that furniture, equipment, and leasehold improvements be capitalized, depreciated, and non-admitted.

Other Assets

Other assets include advances for the Other States Coverage reinsurance contracts and prepaid reinsurance.

Risks and Uncertainties

Risks and uncertainties existing as of the date of the financial statements are as follows:

*Credit Risk* - Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. Government securities, fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. MSF investment policy requires fixed income investments, at the time of purchase, to be rated investment grade as defined by Moody's (Baa3 or higher) and/or Standard & Poor's (BBB- or higher) rating services. The U.S. Government securities are guaranteed directly or indirectly by the U.S. Government. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk. The NAIC regards U.S. Treasuries and agencies and all A ratings as Class 1 (highest quality), BBB ratings as Class 2 (high quality), BB ratings as Class 3 (medium quality), B ratings as Class 4 (low quality), C ratings as Class 5 (lower quality), and D ratings as Class 6 (in or near default).

The credit quality of the bond portfolio at December 31, 2019 is presented in the following chart:

| | NAIC Admitted Value | Percentage |
|---|---|---|
| Class 1 - highest quality | $ 938,327,574 | 79.25% |
| Class 2 - high quality | 245,665,422 | 20.75% |
| Total bonds | $ 1,183,992,996 | 100.00% |

The credit quality of the bond portfolio at December 31, 2018 is presented in the following chart:

| | NAIC Admitted Value | Percentage |
|---|---|---|
| Class 1 - highest quality | $ 900,873,769 | 77.23% |
| Class 2 - high quality | 265,587,426 | 22.77% |
| Total bonds | $ 1,166,461,195 | 100.00% |

*Custodial Credit Risk* - Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a company will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of December 31, 2019 and 2018, all the fixed income securities were registered in the nominee name of BOI and held in the possession of BOI's custodial bank, State Street Bank. All equity index funds and real estate partnership and limited liability companies were purchased and recorded in BOI's name.

*Concentration of Credit Risk* - Concentration of credit risk is the risk of loss attributed to the magnitude of a company's investment in a single issuer. The MSF Investment Policy requires credit risk to be limited to 3% of the total securities portfolio market value in any one name. Investments issued or explicitly guaranteed by the U.S. Government are excluded from the concentration of credit risk requirement.

*Interest Rate Risk* - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The MSF Investment Policy sets an average portfolio duration range within 20% of the duration for the Barclays Capital Government/Credit Intermediate Term Index. BOI uses the weighted effective duration method to calculate interest rate risk.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying automobile loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

MSF investments are categorized in Note 2 to disclose credit and interest rate risk as of December 31, 2019 and 2018.

*Uncertainty Due to Litigation* - In the ordinary course of business, MSF is a defendant in various litigation matters. Although there can be no assurances, as of December 31, 2019 and 2018, in the opinion of MSF's management based on information currently available, the ultimate resolution of these legal proceedings would not be likely to have a material adverse effect on its statutory results of revenue and expenses, admitted assets, liabilities, and policyholders' equity or liquidity. For further discussion, refer to Note 14 (Contingencies and Uncertainties).

*Vulnerability Due to Certain Concentrations* - MSF conducts its business primarily within the State of Montana and is susceptible to risk based on the economy of the geographic territory it serves. As of December 31, 2019 and 2018, approximately 73% and 72%, respectively, of total premium was written through appointed agency producers, and about 27% and 28%, respectively, was written directly by MSF. The PayneWest agency represented 39% and 38%, respectively, of MSF's total premium as of December 31, 2019 and 2018.

*Use of Estimates* - The preparation of financial statements in conformity with Statutory Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Material estimates susceptible to significant change include loss and loss adjustment expense reserves, the fair value of investments, investment impairments, and cost allocation processes.

*Reinsurance Risk* - Reinsurance contracts do not relieve the Company from its obligations to insureds. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. Management believes that any liability arising from this contingency would not be material to the Company's financial position.

*Risk-Based Capital* - Risk-based capital (RBC) is a method developed by the NAIC to measure the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formulas for determining the amount of RBC specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk of such activities. The adequacy of the company's actual capital is measured by the RBC results as determined by the formulas. Companies below minimum RBC requirements are subject to specified corrective action. State law 33-2-1902(12), MCA requires that MSF have two times the capital level of other insurers as a more conservative measure to allow earlier regulatory intervention if necessary.

Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments on claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $625K for periods from July 1, 2017 through July 1, 2019, and $1.25M thereafter. MSF received $628K and $596K from the State of Montana for the administration of the Old Fund for years ended December 31, 2019 and 2018, respectively.

Losses Incurred and Loss Adjustment Expense Estimates

Loss and loss adjustment expense (LAE) reserves are established to provide for the estimated ultimate settlement cost of all claims incurred. Loss reserves are based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. There can be no assurance that the ultimate settlement of losses may not vary materially from the estimate recorded. Since liabilities are based on estimates, the ultimate liability may be in excess of, or less than, the amounts provided. Adjustments to these estimates of reserves will be reflected in the Statutory Statement of Income in future years.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Losses and loss adjustment expenses are presented at face value net of estimated reinsurance recoverable. For further discussion, refer to Note 8.

Reinsurance Recoverable on Paid and Unpaid Losses

Reinsurance recoverables are estimates of paid and unpaid losses collectible from MSF’s reinsurers. The amounts ultimately collected may be more or less than these estimates. Any adjustments of these estimates are reflected in revenues and expenses as they are determined.

Premium Deficiency Reserve

Premium deficiency reserves and the related expense are recognized when it is probable that losses, loss adjustment expense and policy maintenance costs under a group of existing contracts will exceed net earned premium, reinsurance recoveries and anticipated investment income. No such reserves were required at December 31, 2019 and 2018.

Other Liabilities

- Security Deposits - Security deposits are monies held on behalf of certain policyholder groups based on arranged payment terms.
- Funds Withheld - Funds withheld are premiums due to reinsurers on a contingent basis in accordance with the reinsurance contracts in place.
- Accounts Payable - Accounts payable includes liabilities incurred on behalf of claimants, refunds, dividends due to policyholders, and amounts due to vendors.

- Compensated Absences - MSF supports two leave programs, the State of Montana Leave Program, (Traditional Plan) and the MSF Personal Leave Program. Employees covered in the Traditional Plan accumulate both annual leave and sick leave and MSF pays employees 100% of unused annual leave and 25% of unused sick leave upon termination. MSF also pays 100% of unused compensatory leave credits upon termination to employees in the Traditional Plan. Employees in the Personal Leave Program accumulate personal leave and extended leave. MSF pays employees for 100% of unused personal leave and banked holiday leave upon termination but extended leave has no cash value at the time of termination.

Income and Premium Taxes Payable

MSF is a component unit of the State of Montana and is not subject to federal or state premium or income tax.

Prepaid Expenses

The Company adopted an accounting policy for prepaid expenses which is to recognize costs that benefit several accounting periods as prepaid assets to the extent that an individual cost exceeds $10,000. The Company has elected to immediately expense those prepaid costs that do not exceed $10,000. Prepaid expenses are amortized and expensed over the period of use. Prepaid expenses that are unamortized at the end of a financial reporting period are nonadmitted and charged to policyholder equity in accordance with statutory accounting principles.

Restricted Assets

The Company reports assets which are not under the exclusive control of the Company. These assets represent funds deposited with reinsured companies. The balances at December 31, 2019 and 2018 were $258K and $278K, respectively.

Premium Revenue and Unearned Premium

Premiums are recognized as revenue on a pro-rata basis over the policy period, beginning on the effective date of the policy. MSF's Board of Directors approves premium rates annually.

Premiums received in advance are deferred until the effective date of the policy at which time they are recognized as revenue on a pro-rata basis over the term of the policy. Premium advances are refundable when the policyholder's coverage is canceled and MSF has credited all earned premiums. State of Montana agency premium is estimated and payments are received quarterly in arrears based on the actual reported payroll.

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $60.5M and $63.9M at December 31, 2019 and 2018, respectively.

Retrospectively Rated Policies

MSF issues policies for which the premiums vary based on loss experience. Future premium adjustments for these retrospective policies are estimated and accrued at the end of each quarter. The premium adjustments are determined through the review of each individual retrospective rated policy, comparing actual losses with projected future losses, to arrive at the best estimates of return or additional retrospective premiums. MSF records retrospective premium accruals and receivables as written premium. Return premiums are recorded as liabilities and additional premiums are recorded as assets and 10% of all retrospective premium receivables are nonadmitted in accordance with SSAP No. 66.

Policy Acquisition Costs

Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions, are charged to operations as incurred.

Advertising Costs

All advertising costs are expensed when incurred. Advertising expense was $967K and $645K for the years ended December 31, 2019 and 2018, respectively.

Policyholder Dividends

Dividends are discretionary and are accrued and expensed when declared and approved by the MSF Board of Directors. The aggregate amount of policyholders' dividends is based on the analysis of policyholder equity balances and the financial results for the policy year. For further discussion, refer to Note 10.

## Note 2 - Investments

The investments of MSF at December 31, 2019 are as follows:

| December 31, 2019 | Total Investment Holdings | Percentage |
|---|---|---|
| Bonds: | | |
| U.S. Government | $ 282,523,842 | 18.27% |
| U.S. Government residential mortgage-backed | 22,022,160 | 1.42% |
| All Other Government | 13,997,745 | 0.91% |
| U.S. Special Revenue | 113,012,216 | 7.31% |
| U.S. Special Revenue residential mortgage-backed | 31,134,408 | 2.01% |
| U.S. Special Revenue commercial mortgage-backed | 54,150,997 | 3.50% |
| Industrial and Miscellaneous | 591,448,364 | 38.24% |
| Industrial and Miscellaneous commercial mortgage-backed | 15,426,683 | 1.00% |
| Industrial and Miscellaneous other loan-backed | 60,276,581 | 3.90% |
| Total bonds | 1,183,992,996 | 76.56% |
| Equity securities | 180,895,162 | 11.70% |
| Real Estate - Property occupied by the Company | 23,993,134 | 1.55% |
| Cash and short-term investments | 69,121,234 | 4.47% |
| Other invested assets | 82,678,575 | 5.35% |
| Securities lending collateral | 5,861,488 | 0.38% |
| Total invested assets | $ 1,546,542,589 | 100.00% |

The investments of MSF at December 31, 2018 are as follows:

| December 31, 2018 | Total Investment Holdings | Percentage |
|---|---|---|
| Bonds: | | |
| U.S. Government | $ 282,543,405 | 19.19% |
| All Other Government | 13,999,098 | 0.95% |
| U.S. Special Revenue | 148,332,179 | 10.08% |
| U.S. Special Revenue residential mortgage-backed | 1,159,396 | 0.08% |
| U.S. Special Revenue commercial mortgage-backed | 38,871,829 | 2.64% |
| Industrial and Miscellaneous | 616,308,437 | 41.87% |
| Industrial and Miscellaneous commercial mortgage-backed | 16,587,189 | 1.13% |
| Industrial and Miscellaneous other loan-backed | 48,659,662 | 3.31% |
| Total bonds | 1,166,461,195 | 79.24% |
| | | |
| Equity securities | 153,602,559 | 10.43% |
| Real Estate - Property occupied by the Company | 24,524,019 | 1.67% |
| Cash and short-term investments | 22,693,392 | 1.54% |
| Other invested assets | 95,728,561 | 6.50% |
| Receivables for securities | 9,000,000 | 0.61% |
| Securities lending collateral | 102,000 | 0.01% |
| Total invested assets | $ 1,472,111,726 | 100.00% |

MSF has investments in four companies which have underlying characteristics of real estate and are classified as other invested assets.

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of invested assets are as follows at December 31, 2019:

| December 31, 2019 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| U.S. Government | $ 282,523,842 | $ 4,162,208 | $ (44,430) | $ 286,641,620 |
| U.S. Government residential mortgage-backed | 22,022,160 | 174,738 | — | 22,196,898 |
| All Other Government | 13,997,745 | 434,225 | — | 14,431,970 |
| U.S. Special Revenue | 113,012,216 | 1,803,411 | (39,864) | 114,775,763 |
| U.S. Special Revenue residential mortgage-backed | 31,134,408 | 92,380 | — | 31,226,788 |
| U.S. Special Revenue commercial mortgage-backed | 54,150,997 | 864,627 | (41,774) | 54,973,850 |
| Industrial and Miscellaneous | 591,448,364 | 28,666,116 | (40,197) | 620,074,283 |
| Industrial and Miscellaneous commercial mortgage-backed | 15,426,683 | 874,867 | — | 16,301,550 |
| Industrial and Miscellaneous other loan-backed | 60,276,581 | 612,883 | (362) | 60,889,102 |
| Total bonds valued at amortized cost | $ 1,183,992,996 | $ 37,685,455 | $ (166,627) | $ 1,221,511,824 |
| | | | | |
| Money market mutual funds | $ 65,530,878 | $ 8,977 | $ — | $ 65,539,855 |
| Equity securities | 62,580,754 | 118,314,409 | (1) | 180,895,162 |
| Other invested assets | 77,907,866 | 5,566,426 | (795,717) | 82,678,575 |
| Total securities valued at fair value | $ 206,019,498 | $ 123,889,812 | $ (795,718) | $ 329,113,592 |

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of invested assets are as follows at December 31, 2018:

| December 31, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| U.S. Government | $ 282,543,405 | $ 1,029,723 | $ (4,370,884) | $ 279,202,244 |
| U.S. Government residential mortgage-backed | — | — | — | — |
| All Other Government | 13,999,098 | 67,840 | (71,328) | 13,995,610 |
| U.S. Special Revenue | 148,332,179 | 792,355 | (2,035,860) | 147,088,674 |
| U.S. Special Revenue residential mortgage-backed | 1,159,396 | 29,803 | — | 1,189,199 |
| U.S. Special Revenue commercial mortgage-backed | 38,871,829 | — | (1,506,465) | 37,365,364 |
| Industrial and Miscellaneous | 616,308,437 | 2,099,910 | (8,868,402) | 609,539,945 |
| Industrial and Miscellaneous commercial mortgage-backed | 16,587,189 | — | (461,245) | 16,125,944 |
| Industrial and Miscellaneous other loan-backed | 48,659,662 | 84,109 | (404,506) | 48,339,265 |
| Total bonds valued at amortized cost | $ 1,166,461,195 | $ 4,103,740 | $ (17,718,690) | $ 1,152,846,245 |
| | | | | |
| Money market mutual funds | $ 17,807,744 | $ — | $ (2,582) | $ 17,805,162 |
| Equity securities | 66,846,798 | 86,756,605 | (844) | 153,602,559 |
| Other invested assets | 87,138,865 | 8,630,431 | (40,735) | 95,728,561 |
| Total securities valued at fair value | $ 171,793,407 | $ 95,387,036 | $ (44,161) | $ 267,136,282 |

The gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows at December 31, 2019:

| December 31, 2019 | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government | $ 20,322,205 | $ (44,430) | $ — | $ — | $ 20,322,205 | $ (44,430) |
| U.S. Special Revenue | 29,948,100 | (39,864) | — | — | 29,948,100 | (39,864) |
| U.S. Special Revenue commercial mortgage-backed | 10,871,124 | (41,774) | — | — | 10,871,124 | (41,774) |
| Industrial and Miscellaneous | 11,895,710 | (40,197) | — | — | 11,895,710 | (40,197) |
| Industrial and Miscellaneous other loan-backed | — | — | 1,020,810 | (362) | 1,020,810 | (362) |
| Equity securities | — | — | 79 | (1) | 79 | (1) |
| Other invested assets | 44,204,283 | (795,717) | — | — | 44,204,283 | (795,717) |
| | $ 117,241,422 | $ (961,982) | $ 1,020,889 | $ (363) | $ 118,262,311 | $ (962,345) |

The gross unrealized losses and fair value of the Company's investments were as follows for December 31, 2018:

| December 31, 2018 | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government | $ 80,587,564 | $ (2,072,411) | $ 118,384,175 | $ (2,298,473) | $ 198,971,739 | $ (4,370,884) |
| All Other Government | 3,969,960 | (22,797) | 4,961,650 | (48,531) | 8,931,610 | (71,328) |
| U.S. Special Revenue | 29,646,875 | (110,457) | 61,779,098 | (1,925,403) | 91,425,973 | (2,035,860) |
| U.S. Special Revenue commercial mortgage-backed | — | — | 37,365,364 | (1,506,465) | 37,365,364 | (1,506,465) |
| Industrial and Miscellaneous | 320,437,207 | (4,575,345) | 126,982,206 | (4,293,057) | 447,419,413 | (8,868,402) |
| Industrial and Miscellaneous commercial mortgage-backed | — | — | 16,125,944 | (461,245) | 16,125,944 | (461,245) |
| Industrial and Miscellaneous other loan-backed | 2,990,983 | (8,943) | 27,683,957 | (395,563) | 30,674,940 | (404,506) |
| Money market mutual funds | 17,805,162 | (2,582) | — | — | 17,805,162 | (2,582) |
| Equity securities | 5,455 | (844) | — | — | 5,455 | (844) |
| Other invested assets | 19,959,265 | (40,735) | — | — | 19,959,265 | (40,735) |
| | $ 475,402,471 | $ (6,834,114) | $ 393,282,394 | $ (10,928,737) | $ 868,684,865 | $ (17,762,851) |

MSF closely monitors its investment portfolio and considers relevant facts and circumstances in evaluating whether the impairment of a security is other than temporary. Relevant facts and circumstances that are considered include: (1) the length of time the fair value has been below cost; (2) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (3) MSF's ability and intent to hold the security to maturity or until it recovers in value. To the extent the Company determines that a security is deemed other-than-temporarily impaired, the difference between amortized cost and fair value is charged to earnings. Based on the Company's evaluation and ability and intent to hold these securities to maturity or market value recovery, the impairment of the securities identified above is deemed to be temporary.

The amortized cost and estimated statutory fair value of MSF's fixed maturity securities as of December 31, 2019, is shown below at effective maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Maturities of mortgage-backed securities depend on the repayment characteristics and experience of the underlying mortgage loans.

The amortized cost and estimated statutory fair value of MSF's fixed maturity securities as of December 31, 2019 was:

| December 31, 2019 | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due one year or less (excludes STIP) | $ 137,382,344 | $ 138,317,157 |
| Due after one year through five years | 610,440,959 | 625,439,550 |
| Due after five years through ten years | 428,632,598 | 450,217,661 |
| Due after ten years through twenty years | 7,470,352 | 7,470,432 |
| Due after twenty years | 66,743 | 67,024 |
| | $ 1,183,992,996 | $ 1,221,511,824 |

The amortized cost and estimated statutory fair value of MSF's fixed maturity securities as of December 31, 2018 was:

| December 31, 2018 | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due one year or less (excludes STIP) | $ 96,320,849 | $ 96,001,084 |
| Due after one year through five years | 643,338,435 | 639,101,569 |
| Due after five years through ten years | 418,805,715 | 409,777,352 |
| Due after ten years through twenty years | 7,996,196 | 7,966,240 |
| | $ 1,166,461,195 | $ 1,152,846,245 |

Proceeds from sales of invested assets and gross realized gains and gross realized losses on the sales of invested assets were as follows for the years ended December 31, 2019 and 2018:

| | 2019 | 2018 |
|---|---|---|
| Proceeds from sales of debt securities | $ 341,331,736 | $ 222,998,637 |
| Proceeds from sales of common stock | 15,000,000 | 25,000,000 |
| Proceeds from sales of other invested assets | 11,218,893 | 24,575,924 |
| Net gains on cash, cash equivalents, and short-term investments | 12,693 | (3,009) |
| Total proceeds from sales of invested assets | $ 367,563,322 | $ 272,571,552 |
| | | |
| Gross realized gains of debt securities | $ 3,906,748 | $ 874,208 |
| Gross realized losses of debt securities | (413,492) | (2,790,990) |
| Gross realized gains of common stock | 10,723,276 | 17,678,079 |
| Gross realized gains of invested assets | 1,993,277 | 5,041,490 |
| Net realized capital gains of invested assets | $ 16,209,809 | $ 20,802,787 |

Investment income and related expenses were as follows for the years ended December 31, 2019 and 2018:

| | 2019 | 2018 |
|---|---|---|
| Investment income | | |
| Interest | | |
| Bonds | $ 34,203,786 | $ 32,520,406 |
| Cash and short-term investments | 1,094,337 | 668,869 |
| Real estate | 1,697,777 | 1,697,777 |
| Equities | 9,829 | 5,366 |
| Other invested assets | 3,300,715 | 3,166,597 |
| Securities lending income | 169,372 | 186,620 |
| Total investment income | 40,475,816 | 38,245,635 |
| Investment expenses | | |
| Investment expenses | 1,364,572 | 1,173,183 |
| Depreciation on real estate | 530,885 | 530,885 |
| Total investment expenses | 1,895,457 | 1,704,068 |
| Net investment income | $ 38,580,359 | $ 36,541,567 |

MSF's investment in property occupied by the Company is as follows at December 31:

| | 2019 | 2018 |
|---|---|---|
| Land | $ 1,139,460 | $ 1,139,460 |
| Properties occupied by the Company, net | 22,853,674 | 23,384,559 |
| Total real estate | $ 23,993,134 | $ 24,524,019 |

## Note 3 - Cash Collateral and Liability for Securities on Loan

The following table presents the carrying and market values of the securities on loan and the total collateral held as of December 31, 2019 and 2018:

| | 2019 | 2018 |
|---|---|---|
| Securities on loan - carrying value | $ 128,552,473 | $ 112,596,108 |
| Securities on loan - market value | 131,669,792 | 112,770,787 |
| Total cash collateral held | 5,861,488 | 102,000 |
| Total non-cash collateral held | 128,572,054 | 114,763,180 |

## Note 4 - Fair Value of Financial Instruments

Certain financial instruments are reported at fair value or net asset value as a practical expedient, and others are stated at cost or amortized cost, as shown below. For those assets carried at fair value or net asset value in the financial statements and for those assets not stated at fair value in the financial statements but whose estimated fair values are disclosed, the following table indicated the inputs used to estimate fair value measurements.

The statement values, fair values, and related inputs for financial instruments at December 31 are:

| | 2019 | | | | |
|---|---|---|---|---|---|
| | Statement Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Assets reported at amortized cost: | | | | | |
| Bonds | $ 1,183,992,996 | $ 1,221,511,824 | $ 286,641,620 | $ 934,870,204 | $ — |
| Assets reported at net asset value (NAV): | | | | | |
| Money market mutual funds | $ 65,539,855 | $ 65,539,855 | $ — | $ — | $ — |
| Equity securities | 180,895,162 | 180,895,162 | — | — | — |
| Other invested assets | 82,678,575 | 82,678,575 | — | — | — |
| Total assets reported at fair value | $ 329,113,592 | $ 329,113,592 | $ — | $ — | $ — |

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Statement Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Assets reported at amortized cost: | | | | | |
| Bonds | $ 1,166,461,195 | $ 1,152,846,245 | $ 279,202,244 | $ 873,644,001 | $ — |
| Assets reported at net asset value (NAV): | | | | | |
| Money market mutual funds | $ 17,805,162 | $ 17,805,162 | $ — | $ — | $ — |
| Equity securities | 153,602,559 | 153,602,559 | — | — | — |
| Other invested assets | 95,728,561 | 95,728,561 | — | — | — |
| Total assets reported at fair value | $ 267,136,282 | $ 267,136,282 | $ — | $ — | $ — |

Equity mutual funds consist of institutional investment funds which invest in domestic and international equities and are structured to mimic the returns of the S&P 500 and All Country World Index ex-U.S. (ACWI) indices, respectively. Unit values are based on the fair market values of the underlying securities held in each fund. These funds are highly liquid, and units can be sold upon request.

Other invested assets represent investors primarily in core real estate, which makes equity investments in operating and substantially-leased institutional quality real estate in traditional property types (apartments, office, retail, industrial, and hotel) via commingled funds. The primary investment objectives of these funds are to invest in real estate which will generate income from predictable sources of revenue and not realize gains on the underlying assets. This investment type receives distributions of generated income and occasionally receives distributions through the liquidation of the underlying assets of the fund. Values are determined through an independent appraisal process of the underlying real estate properties and reflect MSF's ownership interest in the partners' capital of the fund. Redemption of these investments is restricted based on the availability of cash flow arising from investment transactions, sales, and other fund operations occurring in the ordinary course of business. Therefore, requested redemptions from a fund will be redeemed as funds become available.

There were no liabilities reported at fair value as of December 31, 2019 and 2018.

## Note 5 - Cash, Cash Equivalents, and Short-Term Investments

MSF participates in the Short-Term Investment Pool (STIP), a money market mutual fund maintained by BOI. STIP balances are highly liquid investments. The STIP investments' credit risk is measured by investment grade ratings given individual securities. BOI's policy requires that STIP investments have the highest rating in the short-term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The three NRSRO's include Standard and Poor's, Moody's Investors Service, and Fitch, Inc. STIP is reported at NAV based on the underlying values of the assets held.

Cash, cash equivalents, and short-term investments consist of the following at December 31:

| | 2019 | 2018 |
|---|---|---|
| Cash in bank | $ 3,581,378 | $ 4,888,230 |
| STIP investment | 65,539,856 | 17,805,162 |
| | $ 69,121,234 | $ 22,693,392 |

## Note 6 - Receivables, Net

Net receivables consist of the following at December 31:

| | 2019 | 2018 |
|---|---|---|
| Uncollected premiums | $ 7,934,766 | $ 10,597,547 |
| Nonadmitted uncollected premiums | (432,466) | (989,215) |
| Net uncollected premiums | $ 7,502,300 | $ 9,608,332 |
| | | |
| Unbilled premiums and installments | $ 56,451,948 | $ 59,224,315 |
| Earned but unbilled premiums | 4,157,155 | 3,489,104 |
| Nonadmitted earned but unbilled premiums | (415,715) | (348,910) |
| Net unbilled premiums | $ 60,193,388 | $ 62,364,509 |
| | | |
| Accrued retrospective premiums | $ 155,000 | $ 39,000 |
| Nonadmitted retrospective premiums | (15,500) | (3,900) |
| Net accrued retrospective premiums | $ 139,500 | $ 35,100 |
| | | |
| Healthcare and other amounts receivable | $ 1,560,548 | $ 1,974,387 |
| Nonadmitted healthcare and other receivables | (1,560,548) | (1,974,387) |
| Net healthcare and other receivables | $ — | $ — |

## Note 7 - Equipment, Net

Equipment and software are recorded at cost net of accumulated depreciation and admitted or non-admitted in accordance with statutory accounting principles as follows:

| December 31, 2019 | Computer Equipment & Operating Software | Vehicles, Furniture & Office Equipment | Application Software | Total |
|---|---|---|---|---|
| Assets | $ 4,063,684 | $ 3,412,422 | $ 26,459,068 | $ 33,935,174 |
| Accumulated depreciation | (2,704,877) | (2,839,282) | (14,194,202) | (19,738,361) |
| Subtotal | 1,358,807 | 573,140 | 12,264,866 | 14,196,813 |
| Less: Net assets non-admitted | — | (573,140) | (12,264,866) | (12,838,006) |
| Net assets admitted | $ 1,358,807 | $ — | $ — | $ 1,358,807 |
| Depreciation expense | $ 395,038 | $ 257,550 | $ 12,070 | $ 664,658 |

| December 31, 2018 | Computer Equipment & Operating Software | Vehicles, Furniture & Office Equipment | Application Software | Total |
|---|---|---|---|---|
| Assets | $ 4,397,910 | $ 3,337,801 | $ 22,506,590 | $ 30,242,301 |
| Accumulated depreciation | (3,124,562) | (2,630,690) | (14,205,258) | (19,960,510) |
| Subtotal | 1,273,348 | 707,111 | 8,301,332 | 10,281,791 |
| Less: Net assets non-admitted | — | (707,111) | (8,301,332) | (9,008,443) |
| Net assets admitted | $ 1,273,348 | $ — | $ — | $ 1,273,348 |
| Depreciation expense | $ 306,974 | $ 254,833 | $ 110,462 | $ 672,269 |

## Note 8 - Loss and Loss Adjustment Expense Reserves

Loss and loss adjustment expense (LAE) reserves are established to provide for the estimated ultimate settlement cost of all claims incurred. Willis Towers Watson, an external independent actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and IBNR as of December 31, 2019 and 2018. The study provides a range of potential costs associated with the reported claims, the future development of those claims and IBNR. MSF management has recorded an estimate within that range as the estimated loss reserves. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. No significant changes to the reserving methodology were made during the reporting period. The reserves are reported on an undiscounted basis.

The following analysis provides a reconciliation of the activity in the reserve for losses and loss adjustment expenses for the year ended December 31:

| | 2019 (in 000s) | 2018 (in 000s) |
|---|---|---|
| At beginning of the period: | | |
| Gross liability for unpaid losses and loss adjustment expenses | $ 942,970 | $ 933,167 |
| Less reinsurance recoverables | (1,332) | (13,477) |
| Net liability for unpaid losses and loss adjustment expenses | 941,638 | 919,690 |
| Losses and loss expenses incurred during the period related to: | | |
| Current period | 137,785 | 145,340 |
| Prior years | (1,188) | (6,815) |
| Total losses and loss adjustment expenses incurred | 136,597 | 138,525 |
| Losses and loss expenses paid during the period related to: | | |
| Current period | (33,295) | (31,177) |
| Prior years | (88,346) | (85,400) |
| Total losses and loss adjustment expenses paid | (121,641) | (116,577) |
| At end of the period: | | |
| Gross liability for unpaid losses and loss adjustment expenses | 956,981 | 942,970 |
| Less reinsurance recoverables | (387) | (1,332) |
| Net liability for unpaid losses and loss adjustment expenses | $ 956,594 | $ 941,638 |

Changes in the reserve for loss and loss adjustment expenses related to prior years are due to ongoing analysis of loss development trends, re-estimation of unpaid claims, and reinsurance recovery adjustments.

Included in the amounts above are reserves for asbestos exposure. MSF's exposure to asbestos claims arose from the direct sale of workers' compensation policies to companies with incidental exposure to asbestos. There are no differences between the case reserving methodology used for asbestos claims and other claims. Case reserves related to these claims are as follows as of December 31:

| | 2019 | 2018 |
|---|---|---|
| Beginning case reserves (including LAE) | $ 1,617,534 | $ 2,144,254 |
| Losses and LAE incurred | (347,677) | 1,300,596 |
| Payments for losses and LAE | (520,077) | (1,827,316) |
| Ending case reserves (including LAE) | $ 749,780 | $ 1,617,534 |

## Note 9 - Retirement Plans, Deferred Compensation and Postretirement Plans

MSF and its employees contribute to the Montana Public Employees Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB). The first plan is the Defined Benefit Retirement Plan (DBRP), a multiemployer pension plan for the benefit of State employees that provides retirement, disability, and death benefits to plan members and their beneficiaries. MSF is only responsible for the current expense paid each year and has no legal obligation for future pension liabilities under this plan. However, MSF is required to record an allocated amount of the DBRP's unfunded liability on its GAAP financial statements. The amount of that liability is $23.9M and $31.3M as of December 31, 2019 and 2018, respectively. As stated previously, NAIC SAP does not require the unfunded liability to be recognized in the statutory financial statements.

The second plan is the Defined Contribution Retirement Plan (DCRP), a multiemployer plan that also provides retirement, disability, and death benefits to plan members and their beneficiaries. Benefits are based on the balance in the member's account, which includes the total contributions made and the investment earnings less administrative costs.

MSF contributed a total of $1.9M to the two plans during both the year ended December 31, 2019 and 2018. The required employer contribution rate for both plans was 8.67% for the first half of the year ended December 31, 2019, and 8.77% for the second half. For the year ended December 31, 2018, the first half rate was 8.57% and the second half rate was 8.67%. The liability for unpaid contributions at December 31, 2019 and 2018 is $54K and $44K, which was paid in January 2020 and January 2019, respectively.

Other postemployment benefit (OPEB) obligations for retiree healthcare are sponsored and administered by the State of Montana. MSF is not financially responsible for the plan as retirees pay the full amount of required premiums. However, MSF is required to record an allocated amount of the plan's implied rate subsidy liability on its GAAP financial statements. The amount of that liability is $812K and $714K as of December 31, 2019 and 2018, respectively. NAIC SAP does not require the OPEB liability to be recognized in the statutory financial statements.

MSF and its employees are eligible to participate in the State of Montana Deferred Compensation Plan (457 plan) administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred retirement plan designed as a supplement to other retirement plans. Under the plan, eligible employees elect to defer a portion of their salary until future time periods. MSF incurs no costs for this plan.

MSF employees and dependents are eligible to receive health care through the State Employee Group Benefits Plan administered by the State of Montana Department of Administration. The State of Montana provides optional post-employment medical, vision, and dental health care benefits to qualified employees and dependents that elect to continue coverage and pay administratively established premiums.

## Note 10 - Policyholder Dividends

During the year ended December 31, 2019, the MSF Board of Directors authorized dividends of $30M to eligible policyholders for the policy year 2017, all of which had been paid by December 31, 2019. During the year ended December 31, 2018, the MSF Board of Directors authorized dividends of $40M to eligible policyholders for the policy year 2016. As of December 31, 2018, $39.9M had been paid.

## Note 11 - Reinsurance Assumed and Ceded

For the years ended December 31, 2019 and 2018, MSF ceded risk to other reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against occurrences over stipulated amounts and aggregate stop loss contracts. The excess of loss contract provides per-occurrence coverage up to $100M with a $5M maximum-any-one-loss clause. MSF retains the first $5M for each occurrence.

The current aggregate stop loss contract provides coverage based on MSF's premium levels not to exceed 15% of subject net earned premium. In the event reinsurers are unable to meet their obligations under either the excess of loss contracts or aggregate stop loss contract, MSF would remain liable for all losses, as the reinsurance agreements do not discharge MSF from its primary liability to the policyholders.

Direct, assumed, and ceded activity included the following for the year ended December 31:

| | 2019 (in 000's) | 2018 (in 000's) |
|---|---|---|
| Written premiums: | | |
| Direct | $ 159,146 | $ 165,447 |
| Assumed | 3,889 | 2,787 |
| Ceded | (9,552) | (10,007) |
| Net written premiums | $ 153,483 | $ 158,227 |
| Earned premiums: | | |
| Direct | $ 162,679 | $ 168,479 |
| Assumed | 3,744 | 2,788 |
| Ceded | (9,552) | (10,007) |
| Net earned premiums | $ 156,871 | $ 161,260 |
| Unearned premiums: | | |
| Direct | $ 59,826 | $ 63,359 |
| Assumed | 717 | 572 |
| Ceded | — | — |
| Net unearned premiums | $ 60,543 | $ 63,931 |
| Incurred losses and loss adjustment expenses | | |
| Direct | $ 134,655 | $ 134,660 |
| Assumed | 1,643 | 3,732 |
| Ceded | 299 | 132 |
| Net incurred losses and loss adjustment expenses | $ 136,597 | $ 138,524 |

MSF's ceded aggregate stop loss contracts contain a contingent commission that provides for additional or return commission based on the actual loss experience of the ceded business. The amount of accrued commission as of December 31, 2019 and 2018 is $56.8M and $48.4M, respectively.

During the year ended December 31, 2018, MSF commuted one of its outstanding aggregate stop loss contracts covering the period of July 1, 2008 through July 1, 2012. The reinsurers on the commuted contract were Axis Specialty, Ltd., Hannover Re (Ireland) Ltd., and XL Re Ltd. MSF removed $11.9M of reinsurance recoverables from its reserves, as well as $47.0M of funds withheld liability and $35.1M of accrued contingent commission. This commutation did not have any impact on premiums earned, losses incurred, or loss adjustment expenses incurred. In addition, MSF commuted one of its outstanding excess of loss contracts with Transatlantic Reinsurance Company. The contract covered the period August 1, 2001 to July 31, 2002. MSF received $50K, resulting in losses incurred of $(50)K.

## Note 12 - Leases and Commitments

MSF leases office facilities and equipment under various operating leases that expire through October 2022. Rental expense for the years ended December 31, 2019 and 2018 were $105K and $88K, respectively.

MSF has a lease for 350 parking spaces in a parking garage built by the City of Helena adjacent to the MSF offices which expires June 30, 2040. The cost of the parking spaces will be the same monthly rate as equivalent parking passes sold by the City. Parking costs for the years ended December 31, 2019 and 2018 were $297K and $298K, respectively.

Future minimum rental payments are as follows for the years ending December 31:

| | | |
|---|---|---|
| 2020 | $ | 407,888 |
| 2021 | | 368,696 |
| 2022 | | 347,579 |
| 2023 | | 315,000 |
| 2024 | | 315,000 |
| Thereafter | | 4,882,500 |
| | $ | 6,636,663 |

MSF is in a multi-year project to replace its legacy policy management system. Implementation of the core policy management and billing transaction systems, as well as the supporting digital portals, is expected to begin by December 2020 and total expenditures are estimated to be $33.4M. The total project cost through December 31, 2019 was $23.0M. The last phase to develop remaining enhancement features will be planned and arranged with consulting services towards the end of 2020. Costs during the application development phase are being capitalized and recorded as construction work in process until the system is deployed.

## Note 13 - Subsequent Events

Subsequent events were evaluated through March 11, 2020, which is the same date the audited financial statements were available to issue.

## Note 14 - Contingencies and Uncertainties

Susan Hensley v. Montana State Fund. This case involves a constitutional challenge to one of the revisions to the Workers' Compensation Act passed in 2011. At issue is the constitutionality of the changes to §39-71-703 (2), MCA, which state that a Class I impairment is not payable unless the claimant has an actual wage loss. The law was effective July 1, 2011 and is applicable to claims that occurred on or after that date. The Workers' Compensation Court issued its decision on August 22nd, 2019 upholding the statute and granting the State Fund's motion for summary judgment. Hensley's attorney filed a notice of appeal on September 12th, 2019 and the matter is currently before the Montana Supreme Court. Should the statute be held unconstitutional and apply to other claims retroactively, the potential liability is estimated to be at least $2.2 million per year, based on NCCI's initial pricing, and current estimated business volumes. However, based on experience, costs may be substantially higher than the estimate of $2.2 million per year. MSF is vigorously defending the matter.

Steven Hanson v. Montana State Fund. This is a companion case to Susan Hensley v. Montana State Fund and has been held in abeyance pending a decision in Hensley.

Montana State Fund also is involved in other litigation in the areas of workers' compensation and disputes with policyholders. These are of a generally routine nature and there are no known matters at this time that will have a material adverse financial impact to the Company.

## Note 15 - Related Party Transactions

Montana State Fund's administrative attachment to the State of Montana requires that certain processes and transactions be conducted with various state agencies. The Constitution of the State of Montana, Part VIII, Article 13, requires that the Montana Board of Investments invest the assets of MSF. Under Montana statute, state agencies are required to purchase workers' compensation insurance from MSF and the statutes define other administrative relationships that require MSF to pay specific services charges.

The following significant transactions occurred with state agencies during the year ended December 31:

| | 2019 | 2018 |
|---|---|---|
| Income: | | |
| State of Montana agencies | | |
| Premium | $ 10,953,506 | $ 12,073,032 |
| Retrospective premium | 216,576 | (235,000) |
| Dividends | (1,184,168) | (1,793,984) |
| Old Fund administrative cost allocation | 628,317 | 595,684 |
| Net premium income from State of Montana agencies | $ 10,614,231 | $ 10,639,732 |
| Expenses: | | |
| Montana Department of Administration | | |
| Support services costs | $ 2,030,959 | $ 1,968,065 |
| Benefits Bureau: group insurance | 3,659,820 | 3,152,408 |
| PERS retirement contributions | 1,929,654 | 1,895,736 |
| Montana Department of Labor & Industry - unemployment insurance | 53,780 | 69,495 |
| Montana Board of Investments - transaction fees | 386,298 | 294,438 |
| Montana Department of Justice - workers' comp fraud investigation services | 361,157 | 342,677 |
| Montana Commissioner of Securities and Insurance - regulation fees | 200,897 | 223,008 |
| Montana Fire Suppression Fund - SB4 management fee | — | 13,552,282 |
| Montana - various other | 68,114 | 21,078 |
| Expenses paid to State of Montana agencies | $ 8,690,679 | $ 21,519,187 |

The SB4 management fee, enacted during a 2017 special session of the Montana Legislature, expired at the end of 2018 and therefore does not appear in 2019 results.

MSF, under a group plan agreement with state agencies, writes policies for which the premiums vary based on loss experience. Future premium adjustments for these retrospective policies are estimated and accrued through a review comparing actual losses with projected future losses, to arrive at the estimate of return premium. The State of Montana agencies are considered a retrospectively rated group and the estimated accrual at December 31, 2019 and

2018 was $18K and $235K, respectively. Other amounts due to and from other State of Montana agencies are settled regularly and were not material as of December 31, 2019 and 2018.

## Note 16 - Policyholders' Equity - Change in Non-Admitted Assets

The following is an accounting of the changes in non-admitted assets included in the Statement of Changes in Policyholders' Equity for the year ended December 31, 2019:

| | Balance of non-admitted assets, beginning of year | Balance of non-admitted assets, end of year | Change |
|---|---|---|---|
| Increase (decrease) in non-admitted assets | | | |
| Uncollected premiums | $ 989,215 | $ 432,466 | $ (556,749) |
| Deferred premiums | 348,910 | 415,715 | 66,805 |
| Accrued retrospective premiums | 3,900 | 15,500 | 11,600 |
| EDP and software | 8,301,332 | 12,264,866 | 3,963,534 |
| Furniture and equipment | 707,111 | 573,140 | (133,971) |
| Healthcare and other amounts receivable | 1,974,387 | 1,560,548 | (413,839) |
| Other non-admitted assets | 2,043,752 | 1,403,438 | (640,314) |
| Balance of non-admitted assets | $ 14,368,607 | $ 16,665,673 | $ 2,297,066 |

The following is an accounting of the changes in non-admitted assets included in the Statement of Changes in Policyholders' Equity for the year ended December 31, 2018:

| | Balance of non-admitted assets, beginning of year | Balance of non-admitted assets, end of year | Change |
|---|---|---|---|
| Increase (decrease) in non-admitted assets | | | |
| Uncollected premiums | $ 949,725 | $ 989,215 | $ 39,490 |
| Deferred premiums | 394,093 | 348,910 | (45,183) |
| Accrued retrospective premiums | 2,224 | 3,900 | 1,676 |
| EDP and software | 1,504,209 | 8,301,332 | 6,797,123 |
| Furniture and equipment | 848,141 | 707,111 | (141,030) |
| Healthcare and other amounts receivable | 1,467,533 | 1,974,387 | 506,854 |
| Other non-admitted assets | 2,125,691 | 2,043,752 | (81,939) |
| Balance of non-admitted assets | $ 7,291,616 | $ 14,368,607 | $ 7,076,991 |

## Note 17 - Policyholders' Equity - Reconciliation of Statutory Equity to GASB Net Position

The following schedule reconciles statutory policyholders' equity calculated in accordance with NAIC SAP to GASB Net Position as determined by governmental accounting principles generally accepted in the United States of America at December 31, 2019 and 2018. The audited GASB financial statements were not available as of the date of this report, and, therefore the information below was prepared by management and is unaudited.

| | 2019 | 2018 |
|---|---|---|
| Statutory policyholders' equity (NAIC) | $ 550,665,280 | $ 512,475,039 |
| Add: | | |
| Non-admitted assets as shown above | 16,665,673 | 14,368,607 |
| Change in investment value of bonds to fair market value | 34,941,775 | (15,696,307) |
| Change in investment lot inventory method | 1,689,846 | 2,001,572 |
| Change in investment value of other invested assets to equity method | 1,077,312 | (1,468,909) |
| Change in allowance for doubtful accounts | (1,879,181) | (2,666,868) |
| Effect of differences in pension accounting standards on income and policyholders' equity | (24,025,356) | (24,795,721) |
| Effect of differences in OPEB accounting standards on income and policyholders' equity | (1,043,309) | (1,031,150) |
| Rounding differences | 7 | (9) |
| GASB net position | $ 578,092,047 | $ 483,186,254 |

Supplementary Information
December 31, 2019

Montana State Fund

CPAs & BUSINESS ADVISORS

**Independent Auditor's Report on Supplementary Information**

To the Board of Directors
Montana State Fund
Helena, Montana

We have audited the statutory financial statements of Montana State Fund as of December 31, 2019 and for the year then ended, and our report thereon dated March 11, 2020, which expressed an unmodified opinion on those financial statements, appears on page 1. Our audit was conducted for the purpose of forming an opinion on the basic statutory-basis financial statements taken as a whole. The accompanying supplementary information included in the *Supplemental Schedule of Investment Risk Interrogatories*, *Summary Investment Schedule, and Supplemental Reinsurance Interrogatories* on pages 33 through 39 are required to be presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and are not a required part of the basic statutory-basis financial statements. Such information included in the schedules referred to above is the responsibility of management, is presented for purposes of additional analysis and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic statutory-basis financial statements taken as a whole.

Eide Bailly LLP

Fargo, North Dakota
March 11, 2020



4310 17th Ave. S. | P.O. Box 2545 | Fargo, ND 58108-2545 | T 701.239.8500 | F 701.239.8600 | EOE

**Basis of Presentation**

The following supplemental disclosures present selected statutory-basis financial data as of December 31, 2019, and for the year then ended, for purposes of complying with the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and agree to or are included in the amounts reported in the Company's 2019 Statutory Annual Statement.

**Supplemental Investment Risk Interrogatories**

1. The Company's total admitted assets as of December 31, 2019 are $1.7B.

2. The Company's ten largest exposures to a single issuer/borrower/investment are as follows:

| | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| Federal National Mortgage Association | $ 83,824,147 | 4.99% |
| Federal Farm Credit Banks Funding Corporation | 49,730,796 | 2.96% |
| Federal Home Loan Banks | 28,353,345 | 1.69% |
| Citigroup Inc. | 27,008,735 | 1.61% |
| UBS Trumbull Property Fund | 24,656,265 | 1.47% |
| American Realty Advisors | 22,347,994 | 1.33% |
| Starbucks Corporation | 19,956,405 | 1.19% |
| Heitman America | 19,548,018 | 1.16% |
| Verizon Communications Inc. | 18,012,993 | 1.07% |
| Wells Fargo & Company | 16,999,777 | 1.01% |

3. The amounts and percentages of the Company's total admitted assets held in bonds by NAIC rating are as follows:

| | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| NAIC-1 | $ 938,327,574 | 55.81% |
| NAIC-2 | 245,665,422 | 14.61% |
| NAIC-3 | — | —% |
| NAIC-4 | — | —% |
| NAIC-5 | — | —% |
| NAIC-6 | — | —% |
| Total Bonds | $ 1,183,992,996 | 70.42% |

4. The amount of assets held in foreign investments is $114.2M, which is 6.79% of the Company's total admitted assets. None of that amount is denominated in a foreign currency.

5. Of the assets held in foreign investments, $99.3M, or 5.90% of total admitted assets, is held in countries designated as NAIC-1, while $14.9M, or 0.89% of total admitted assets, is held in countries designated as NAIC-3.

6. The largest foreign investment exposures by country, categorized by the country's NAIC sovereign designation are as follows:

| December 31, 2019 | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| United Kingdom | $ 59,918,098 | 3.56% |
| Netherlands | 14,979,181 | 0.89% |
| Guernsey | 14,887,654 | 0.89% |

7. The ten largest non-sovereign foreign issues as of December 31, 2019 were as follows:

| | NAIC Designation | Amount | Percentage of Total Admitted Assets |
|---|---|---|---|
| UBS Trumbull Property Fund | Real Estate Fund | $ 24,656,265 | 1.47% |
| Barclays PLC | 2FE | 14,984,822 | 0.89% |
| Shell International Finance B.V. | 1FE | 14,979,181 | 0.89% |
| Credit Suisse Group Funding (Guernsey) Limited | 2FE | 14,887,654 | 0.89% |
| HSBC Holdings plc | 1FE | 10,343,746 | 0.62% |
| Total Capital International | 1FE | 9,995,756 | 0.59% |
| Diageo Capital plc | 1FE | 9,933,265 | 0.59% |
| Alibaba Group Holding Limited | 1FE | 8,671,243 | 0.52% |
| Credit Suisse Group AG | 2FE | 3,000,000 | 0.18% |
| UBS Group Funding (Jersey) Ltd. | 1FE | 2,775,353 | 0.17% |

8. The amount of assets held in Canadian investments is less than 2.5% of the Company's total admitted assets.

9. The Company does not hold any assets with contractual sales restrictions.

10. The amounts and percentages of the Company's total admitted assets held in equity interests are as follows:

| | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| UBS Trumbull Property Fund | $ 24,656,265 | 1.47% |
| American Core Realty Fund LLC | 22,347,994 | 1.33% |
| Heitman America RE Trust LP | 19,548,018 | 1.16% |
| PRISA LP | 16,126,297 | 0.96% |

11. The Company does not hold any privately placed equities.

12. The Company does not hold any general partnership interests.

13. The Company does not hold any mortgage loans.

14. The amount of assets held in real estate is less than 2.5% of the Company's total admitted assets.

15. The Company does not hold any mezzanine real estate loans.

16. The amounts and percentages of the Company's total admitted assets subject to securities lending agreements are as follows:

| | Amount | Percentage of Total Admitted Assets |
|---|---|---|
| Securities lending agreements | $ 128,552,473 | 7.65% |

17. The Company does not hold any warrants.

18. The Company does not have any exposure for collars, swaps, or forwards.

19. The Company does not have any exposure for futures contracts.

| | Gross Investment Holdings | | Admitted Assets as Reported in the Annual Statement | | | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | Securities Lending Reinvested Collateral Amount | Total Amount | % |
| Long-term bonds: | | | | | | |
| U.S. governments | $ 304,546,002 | 19.69% | $ 304,546,002 | $ 839,759 | $ 305,385,761 | 19.75% |
| All other governments | 13,997,745 | 0.91% | 13,997,745 | — | 13,997,745 | 0.91% |
| U.S. special revenue and special assessment obligations, non-guaranteed | 198,297,621 | 12.82% | 198,297,621 | 704,762 | 199,002,383 | 12.87% |
| Industrial and miscellaneous | 667,151,628 | 43.14% | 667,151,628 | — | 667,151,628 | 43.14% |
| Total long-term bonds | 1,183,992,996 | 76.56% | 1,183,992,996 | 1,544,521 | 1,185,537,517 | 76.66% |
| Common stocks: | | | | | | |
| Mutual funds | 180,895,162 | 11.70% | 180,895,162 | — | 180,895,162 | 11.70% |
| Real estate: | | | | | | |
| Properties occupied by the company | 23,993,134 | 1.55% | 23,993,134 | — | 23,993,134 | 1.55% |
| Cash, cash equivalents and short-term investments: | | | | | | |
| Cash | 3,581,378 | 0.23% | 3,581,378 | 432,152 | 4,013,530 | 0.26% |
| Cash Equivalents | 65,539,856 | 4.24% | 65,539,856 | 3,884,815 | 69,424,671 | 4.49% |
| Total cash, cash equivalents and short-term investments: | 69,121,234 | 4.47% | 69,121,234 | 4,316,967 | 73,438,201 | 4.75% |
| Other invested assets | 82,678,575 | 5.35% | 82,678,575 | — | 82,678,575 | 5.35% |
| Securities lending | 5,861,488 | 0.38% | 5,861,488 | N/A | N/A | N/A |
| Total invested assets | $ 1,546,542,589 | 100.0% | $ 1,546,542,589 | $ 5,861,488 | $ 1,546,542,589 | 100.0% |

The following interrogatories are included in accordance with SSAP No. 62R:

7.1 Has the reporting entity reinsured any risks under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g. deductible, a loss ratio corridor, loss cap)? If yes, indicate the number of reinsurance contracts containing such provision and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

Yes [ ] No [X]

8.1 Has the reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured?

Yes [ ] No [X]

9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative UW result greater than 5% of prior year-end surplus as regards to policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

a. A contract term longer than two years and the contract is non-cancellable by the reporting entity during the contract term;
b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
c. Aggregate stop loss reinsurance coverage;
d. An unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party;
e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
f. Payment schedule, accumulating retention from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Yes [ ] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under commune control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders or the reporting entity is a member, where:

a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents 50% or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
b. 25% or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.

Yes [ ] No [X]

9.4 Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62R, has the reporting entity ceded any risk under any reinsurance contract during the period covered by the financial statements, and either:

a. Accounted for that contract as reinsurance (either prospective or retroactive) under SAP and as a deposit under GAAP; or
b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

Yes ☐ No ☒

The accompanying schedules and interrogatories present selected statutory-basis financial data as December 31, 2019 and for the year then ended for the purpose of complying with paragraph 9 of the Annual Audited Financial Reports in the Annual Audited Report section of the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and agree to or are included in the amounts reported in the Company's December 31, 2019 Statutory Annual Statement.