LOOKING BACK WHILE MOVING AHEAD
An interview with President and CEO Laurence Hubbard

The economy dominates every headline and lead story in the news. It is being watched warily by business owners and workers across Montana. So when we sat down with Montana State Fund President and CEO Laurence Hubbard to discuss the company's performance in fiscal year 2008 (July 1, 2007 – June 30, 2008), the state of our state's economy was very much top of mind.

In the interview, which took place in a conference room at the company's headquarters in Helena, Mr. Hubbard covered Montana State Fund's strong 2008 performance, talked about the importance of safety to every business' bottom line, and laid out the differences between the missions of a company like AIG and Montana State Fund.

It’s a glimpse into the leadership that’s helped make Montana State Fund a strong provider for Montana companies and workers.

Q. Let’s start with a look back at fiscal year 2008, which ended in June. How did Montana State Fund perform?

A. Fiscal year ’08 was an excellent performance year for Montana State Fund, both in terms of key success measures—our financial goals—as well as initiatives that we undertook as a company.

Q. Can you give some examples of initiatives and their impact on customers?

A. Improving customer service and the value we deliver to customers is at the center of our company. In fiscal year ’08, we revamped our invoices to make them more user-friendly. We reviewed the correspondence we send to customers to make sure we communicate clearly. Workers’ compensation information can be complicated, and we continually work to simplify it … make it less onerous and time-consuming for policyholders.

Q. You also invested quite a bit in safety initiatives as well, didn’t you?

A. Montana has an accident rate that’s 50 percent higher than the national average. And it isn’t because our jobs are more dangerous than other states. That rate spreads across all industries. Ultimately, that has a significant impact in the dollars paid out in claims and in the cost of workers’ compensation insurance. Why? Because the premiums we collect are set in order to build reserves to cover future claims … some of which we pay out for decades. So, changing those statistics by reducing the frequency and severity of injury will reduce premiums over time.

In 2008, we launched our WorkSafe Champions program, which puts employers and employees through a nine-month workplace safety program. We are training the trainers, providing the skill sets and knowledge that might normally be supplied on a consultative basis right in the workplace where it can have an effect every day. It’s a true partnership between our customers and us.

We also built on our efforts to instill workplace safety through public education. Our Work hard. Be safe. campaign exposed Montana workers to the importance of safety. And our NoJack campaign reached out to our youngest workers (ages 16 to 24) who make up about 17 percent of Montana’s workforce but account for nearly a quarter of workplace injuries.

Q. It sounds as though cultural and social change is part of your mission?

A. The more people we get to buy into safety, the more effective we’ll be at actually changing workplace culture. We want people to stop and think before they put up the ladder or fire up the welder; that’s a surprisingly difficult thing to do. It doesn’t happen overnight. It’s something we must collectively work toward and something we’ll only accomplish together. In terms of mission, it’s imperative that we take a leadership role in that.
We also believe very strongly in Return to Work programs. Historically, Montanans stay out of work longer after an injury than workers in other states. That doesn’t help anyone—not the worker, the employer or family members. So we invest in those programs and help guide customers through processes to get people back to work and productive again.

Q. It’s very altruistic for a company to do that.
A. Actually, I see it as a competitive advantage in a competitive market. Helping our customers reduce costs through safety and Return to Work programs builds value into the products and services we provide. It separates us in a very tangible way from other insurance providers in our state. Employers have choices and I want them to choose us.

Q. Are there any other accomplishments from fiscal year 2008 that stand out in your mind?
A. We upgraded our entire claims system, made progress toward a new financial reporting system and installed an insurance intelligence system that enables us to slice and dice our loss data to pull useful information to help us manage and guide our actions.

For example, the outcome differences in treatments for back injuries. The ramifications of different prescription medications. The short- and long-term implications of a serious injury in a 20-year-old versus one in a 50-year-old. And so on … all with an eye toward better medical management of claims and better outcomes for Montana’s injured workers.

Q. It strikes me that, while it’s very easy to make insurance about actuarial stats and claim rates, it’s actually about helping people.
A. You know, we have a little over 8,000 open claims, and if you do the math on that—including the families, coworkers and employers—our work impacts tens of thousands of Montanans. Then, when you add the lives impacted by our safety initiatives—the workers who didn’t get injured—it grows exponentially.

We take that responsibility very seriously. It’s what motivates our employees more than anything. It’s also what gives me pause in our current economy.

Q. Yes, we’ve been talking about the period prior to July of last year, but, clearly, things have radically changed in the past six months.
A. These times are unprecedented for us. We’ve gone through, certainly, economic cycles and downturns—recessionary periods—but really this is the worst since the Great Depression. So there are a lot of uncertainties and unknowns and that’s the most challenging thing about managing an insurance business: … what we don’t know. Montana and Montana businesses have been, traditionally, fortunate during these cycles. They don’t seem to run as deep or as long as they do elsewhere in the country, and in many ways that helps the state because we aren’t feeling what happens in, for example, California or Florida as directly.

Q. Do you see a recession of this size having an impact on the State Fund’s ability to meet its mission to serve Montanans?
A. First of all, it’s important not to overreact or panic. We need to closely watch the dynamics of the economy unfold before taking precipitous action that might ultimately be detrimental to our customers. We can’t, for example, start cutting back on initiatives to improve customer service or improve safety in the workplace out of economic fear. That would set us back as a company and, literally, hurt Montanans. So we have to be very careful and deliberate. It puts a real emphasis on strategic planning, something that has been important for our organization always, but now more than ever.

Q. Yours is a long-term corporate mission, isn’t it?
A. Absolutely. Montana State Fund maintains a very healthy balance sheet both in terms of our loss reserves and our policyholder equity. We have claims incurred today that we’ll pay for 40 or 50 years. We have to set aside enough dollars so that, when our funds are invested, they will cover our liability—our commitment, if you will—to the very last dollar on the last day of every claim.

We do that in the face of many unknowns. Nobody could have predicted 10 years ago the economic situation we’re in today. It has impacted our investments to a degree and is likely to impact the premium we collect. Yet, as an insurance company committed to policyholders and Montana, we have to be prepared to weather it.

Q. How do you do that? How, in such an unpredictable time, do you shield your reserves from a poor economy, ailing stock market, rising medical costs and on and on?
A. We use actuarial science, as all good insurers do, and take the variables you mention into account, but we’re certainly not clairvoyant (laughs). That’s where the business judgment of a very competent insurance team, which I believe we have at Montana State Fund, comes into play. You hire the right people. You hire people who are committed to a mission and vision larger than themselves. We’re a nonprofit, independent public corporation. Unlike a private carrier, we’re not tasked with
returning stakeholder value to stockholders. We make decisions based solely on being a stable workers’ compensation carrier for Montana employers.

Q. That brings up a question—it’s very easy to see a company like AIG out there ... and wonder if Montana State Fund might have similar problems. What would you say to ease those concerns?

A. Well first, let me say that insurance tends to be a pretty conservative business. AIG is, unfortunately, an example where, although its insurance business was fundamentally sound, its corollary businesses exposed the company’s assets to more risk than was wise. That’s not our situation. Montana State Fund is a nonprofit, so there aren’t the same economic drivers for our company that there are for a private company. Just as important, our assets are managed by the state Board of Investments. So even if Lanny Hubbard thought that there was a sweet deal on equities this week, I wouldn’t be able to start shifting assets around. That’s unlike a private company, which has total discretion over its asset portfolio.

Q. Isn’t there also a limit on the percentage of funds that can be invested in stocks?

A. Yes there is. The Montana constitution specifically states that no more than 25 percent of our invested assets can be placed in equities. We don’t even go that high. The Board of Investments maintains a very conservative mix of investments. More than 88 percent of our assets are invested in government and corporate bonds. We buy them for the investment income. When they mature, we also get the face value back. So it’s a very calculated return on investment.

Q. With that discipline in mind, do you have suggestions for your customers in the coming year?

A. People need to stay the course when it comes to investing in workplace safety and Return to Work programs. In fact, I could argue that, rather than withdraw from investing in safety, now is the time to invest more in it because good workers are more valuable than ever. They’ll be the people who steer you through this rough patch. Now that’s not going to seem natural when you’re looking for places to cut back. But when you consider that the average workers’ compensation claim in Montana costs around $50,000, the financial implications of an unsafe workplace are too great to look at in any other way.

Q. Do safety programs have to be expensive?

A. Not at all. For example, our safety site—www.safemt.com—has excellent information, and it’s free to access and use. Our free Return to Work kit has been extremely popular and effective, and helps businesses set up their own programs. Plus, safety actually pays. During our history, Montana State Fund has returned more than $50 million in dividends to our safest customers. That’s real bottom-line impact.

Q. Any other final thoughts for your fellow Montana business leaders?

A. I think it’s tempting to take draconian measures given what we see and hear on the news, but I think we have to remember that we’re going to come out of this. And so, I’d say, stay in your comfort zone, adhere to your principles, make sound choices based on the information you have. Don’t do anything knee-jerk at the expense of your ability to take advantage of what will soon be a stronger economy. At least, that’s how we plan to move forward.
A LETTER FROM THE CHAIRMAN

It has once again been a pleasure to chair the Montana State Fund board of directors and work with a tremendous executive team and 280 dedicated employees. There was much to be proud of in fiscal year 2008. We completed many progressive initiatives in safety services, claims management and customer service.

We understand the important role we play in our state’s economy and social well-being. Unlike private carriers, MSF cannot refuse coverage to any Montana business—no matter the risk. We are committed to providing employers with a workers’ compensation product that is stable and fairly priced. At the same time, it is our job to provide injured employees the benefits they have been granted by our legislature. We take our mission seriously and work to maintain a stable financial portfolio that will cover all claims to completion.

I must also acknowledge the commitment of my fellow board members. The countless hours they have put in are a testament to the quality workers’ compensation product that Montana State Fund provides. I appreciate their work and applaud their efforts on behalf of the people of Montana.

And finally, to our customers, partnering agents and legislators, thank you for your support. The board and MSF employees look forward to working with all of you in the coming year to ensure Montana is a safer place to work and live.

Joe Dwyer
Chairman

A SAFER MONTANA IN 2008

Montana’s injury rate is alarming. Our days lost to injury or illness are about 50 percent higher than the national average. We also have the distinction of having the fourth highest rate of workplace fatalities in the country.

Work hard. Be safe.

To change these frightening statistics we developed our Work hard. Be safe. media campaign in FY08. The campaign intended to raise broad awareness about workplace safety. The ads appeared in statewide newspapers and on television and radio. In addition, they ran in cinemas prior to the start of movies.

Two new safety websites

Another critical component of the campaign was the creation of two safety-focused websites: Safemt.com and NoJack.net.

Safemt.com is dedicated to workplace safety. It offers a comprehensive set of practical safety tips, useful resources and convenient forms.

NoJack.net is focused on the safety of young workers (ages 16 – 24). It features a number of humorous videos to help young workers think smart about safety, real-life stories of injured young workers and safety tips young employees can relate to.

Our innovative No Jack campaign garnered statewide print, TV and radio attention. Perhaps most impressive, Montana State Fund received several reports of employers and even high school teachers using the website as an educational tool for young workers.
2008 ACCOMPLISHMENTS AT A GLANCE

• Our ACE (Assisting Charitable Endeavors) program awarded $43,300 to 14 worthy projects. ACE makes matching funds available to qualifying Montana nonprofit organizations that contribute safety and community well-being in our state.

• The efforts of the Special Investigations Unit to uncover fraudulent claims has saved nearly $39.6 million since the program’s inception in 1993.

• We hosted 1,451 Montana employers at 77 safety trainings we held throughout the state.

• Safety Management Consultants visited 1,985 policyholders last year.

• Over 100 medical providers and workers’ compensation professionals from across Montana attended our seventh annual medical education conference—Upper Extremity Joint Injuries: Diagnosis, Interventions and Rehabilitation.

• Our scholarship program assists children and spouses of workers who were fatally injured in a work-related accident. $16,000 in scholarships was awarded to nine individuals in 2008. While nothing can replace the untimely loss of a loved one, our scholarship program provides an additional benefit for those who are most affected by significant loss.

• We launched two new websites: www.safemt.com (safety specific) and www.nojack.net (young worker specific).

• 163 forms and documents were rewritten to make them more user-friendly for our customers.

OPERATIONAL IMPROVEMENTS

Building Our Future

It’s been the culmination of an intense three-year process, but MSF has broken ground for our new headquarters. The 110,000-square-foot green building will be located in downtown Helena and is scheduled for completion in June 2010.

The need for the new building is two-fold. First, the new space will have the capacity to house the entire MSF staff under one roof; employees are currently located in three separate spaces.

Second, the building is a responsible way to invest our assets. In the insurance world, it is not unusual for companies to have real estate in their asset portfolio. Generally, these buildings are the company headquarters. Companies then record their buildings as an invested asset on their balance sheet. MSF will do the same.

The state of Montana’s Board of Investments (MBOI), which manages our investments, will devote about two percent of our $1.2 billion investment portfolio into this building. There will be no taxpayer dollars involved in this project.

The green construction has future generations in mind and is unlike any public building in the state. The structure will include state-of-the-art air circulation systems that could save 30 – 50 percent on energy costs. Filled with plenty of natural light, the building will have a green roof (literally) filled with planters to absorb heat in the summer and mitigate storm-water runoff. Captured rainwater will be used to water the outdoor landscaping.

As a responsible public entity and insurance company, this building is the right thing to do for the economy of our state and the health of our employees. We have asked our policyholders to think differently when it comes to safety programs and return to work solutions. And we need to follow suit.

No Jobs. Just Careers.

As baby boomers begin to exit the workforce, many companies are now faced with the dilemma of retaining seasoned professionals while trying to compete against other organizations to attract the younger generation. MSF is no different. That is why we created MSF University last fiscal year. While it may not be chic in this day and age to stay with a company for 25 – 30 years, we want to change that attitude. This means making a long-term investment in our employees. The goal of MSF University is to have one centralized department that coordinates meaningful training opportunities for growth and development of our employees. This includes a progressive succession-planning curriculum. It’s accomplished by identifying and training future leaders in our organization who will carry on our commitment of superior service for the people of Montana.

WorkSafe Champions

We launched our WorkSafe Champions program in six Montana cities. The 12-month safety education curriculum was created for employers, employees, and others dedicated to creating a culture of safety in their workplaces.
REPORT OF MANAGEMENT

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

The financial statements are presented for our fiscal years ending June 30, 2008 and 2007 and include amounts based on the best estimates and judgments of management. These financial results are presented on a statutory basis, which is consistent with insurance industry financial statement presentation. MSF governs, operates and completes its financial reporting as an insurance company domiciled in the state of Montana, and its financial statements are presented on the basis of accounting practices prescribed or permitted by the Montana Insurance Department.

The statements included in this annual report should not be considered complete audited financial statements. The statements presented are representative of audited financial statements as audited by Galusha, Higgins & Galusha, an independent public accounting firm. Galusha, Higgins & Galusha issued an unqualified opinion on MSF’s statutory financial statements. The complete audited financial statements, including the accompanying notes, are available upon request. The preparation and independent external audit of statutory financial statements is discretionary on the part of MSF, but one that is seen as important. Evaluating the financial results of MSF in comparison to other insurers aids in assessing the financial health and maintaining the financial security and stability of MSF as a workers’ compensation insurer. In addition, MSF is a component unit of the state of Montana. As required by law, the Legislative Audit Division (LAD) of the state of Montana conducts independent audits of financial statements of MSF presented in accordance with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). For the financial periods ending June 30, 2008 and 2007, MSF received an unqualified audit opinion from the LAD. The audited governmental financial statements and the related audit opinion are issued under separate cover. To obtain a copy of the full governmental financial statements, contact the Legislative Audit Division. The presentation of the statutory financial statements in this report differs from the governmental presentation basis (GASB). A financial reconciliation of equity between the audited GASB financial statements and the audited statutory financial statements presented in this report is provided below.

A COMPARISON OF GASB TO STATUTORY ACCOUNTING ENDING EQUITY FOR THE YEAR ENDED JUNE 30, 2008 (IN 000s):

Governmental Accounting (GASB) Ending Equity........... $224,551
Reconciling Items:
Unrealized Gain on Fixed Income Securities...............(11,985)
Net Effect of Cumulative Unrealized Gain on Equity Securities...............19,037
Net Effect of Cumulative Change in Nonadmitted Assets...............(9,948)
Other (Deferred Acquisition Costs, etc.).....................(5,091)
Statutory Accounting Ending Equity....................... $216,564


Net Earned Premium...........................................$230,965,307
Number of Policies Serviced...............................32,494
Total Number of Claims Processed........................14,462
Investment Income...........................................$44,234,327
Net Income After Dividends.................................$32,095,032
Loss and LAE Reserves.......................................$752,253,300
Equity..............................................................$216,564,182
Reserves to Equity Ratio (after dividend)..................3.47
Premium to Equity Ratio (after dividend)..................1.07

Current estimates indicate that average claim costs declined by 21 percent from 2001 to 2004, reflecting operational improvements in MSF claims management. Normally, we expect the cost of claims to rise by the rate of general medical inflation and the rate of wage inflation. Since 2004, claims have been rising at an average annual rate of 3.4 percent, driven primarily by medical costs. Indemnity benefits have been flat while medical benefits have been rising 6 percent per year.
### STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND EQUITY

as of June 30

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INVESTMENTS AND CASH</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td>$870,571,824</td>
<td>$776,129,409</td>
</tr>
<tr>
<td>Equity Securities</td>
<td>87,443,325</td>
<td>100,545,339</td>
</tr>
<tr>
<td>Real Estate Investment</td>
<td>2,390,150</td>
<td>1,139,460</td>
</tr>
<tr>
<td>Cash and Short-Term Investments</td>
<td>24,925,611</td>
<td>13,744,136</td>
</tr>
<tr>
<td>Other Investments - Collateral Securities on Loan</td>
<td>143,710,846</td>
<td>146,413,103</td>
</tr>
<tr>
<td>Total Investments and Cash</td>
<td>1,129,041,756</td>
<td>1,037,971,447</td>
</tr>
<tr>
<td><strong>OTHER ADMITTED ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premium Receivables</td>
<td>22,737,995</td>
<td>25,321,721</td>
</tr>
<tr>
<td>Equipment (net)</td>
<td>1,106,684</td>
<td>1,521,390</td>
</tr>
<tr>
<td>Interest Receivable</td>
<td>11,413,760</td>
<td>11,214,265</td>
</tr>
<tr>
<td>Other Assets</td>
<td>32,316,071</td>
<td>21,074,298</td>
</tr>
<tr>
<td>Total Other Admitted Assets</td>
<td>67,574,510</td>
<td>59,131,674</td>
</tr>
<tr>
<td>Total Admitted Assets</td>
<td>$1,196,616,266</td>
<td>$1,097,103,121</td>
</tr>
</tbody>
</table>

### STATUTORY STATEMENTS OF REVENUE AND EXPENSES AND CHANGES IN EQUITY

for the years ended June 30

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>REVENUE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Premium Earned</td>
<td>$230,865,307</td>
<td>$238,202,708</td>
</tr>
<tr>
<td>Losses Incurred</td>
<td>(194,249,698)</td>
<td>(187,821,156)</td>
</tr>
<tr>
<td>Loss Expenses Incurred</td>
<td>(18,687,513)</td>
<td>(35,428,189)</td>
</tr>
<tr>
<td>Underwriting Expenses Incurred</td>
<td>(26,946,211)</td>
<td>(24,277,149)</td>
</tr>
<tr>
<td>Net Underwriting Loss</td>
<td>(8,918,015)</td>
<td>(9,323,780)</td>
</tr>
<tr>
<td>Net Investment Income Earned</td>
<td>44,347,779</td>
<td>37,919,659</td>
</tr>
<tr>
<td>Net Realized Capital Gains (Losses)</td>
<td>(113,452)</td>
<td>(655,807)</td>
</tr>
<tr>
<td>Premium Balances Charged Off</td>
<td>(1,164,866)</td>
<td>(520,732)</td>
</tr>
<tr>
<td>Other Income (Expense)</td>
<td>(2,056,414)</td>
<td>(1,503,672)</td>
</tr>
<tr>
<td>Net Income Before Dividends</td>
<td>32,095,032</td>
<td>25,915,662</td>
</tr>
<tr>
<td>Policyholder Dividends</td>
<td>-</td>
<td>(7,000,966)</td>
</tr>
<tr>
<td>Net Income After Dividends</td>
<td>32,095,032</td>
<td>18,914,696</td>
</tr>
<tr>
<td>Prior Year End Equity</td>
<td>199,168,517</td>
<td>163,101,495</td>
</tr>
<tr>
<td>Net Unrealized Gains/(Losses) on Equity Securities</td>
<td>(13,102,014)</td>
<td>17,167,977</td>
</tr>
<tr>
<td>Change in Nonadmitted Assets</td>
<td>(1,597,353)</td>
<td>(14,880)</td>
</tr>
<tr>
<td>Aggregate Write In for Other Losses in Equity</td>
<td>-</td>
<td>(771)</td>
</tr>
<tr>
<td><strong>END OF PERIOD EQUITY</strong></td>
<td>$216,564,182</td>
<td>$199,168,517</td>
</tr>
</tbody>
</table>

The complete financial statements, including the accompanying notes, are available upon request.

---

**MSF Covered Gross Earned Premium**

In $Millions

MSF premium declined from approximately $182 million in 1994 to $71 million in 1999. Since 1999, gross earned premium has significantly risen as MSF has gained business due to improvements in services, and rates have increased to cover the increasing cost of claims. MSF premium has fallen slightly since 2007 due to rate reductions, increased competition, and faltering wage and employment conditions in Montana.
CHANGE SERVICE REQUESTED

Important MSF Contact Information

Customer Service
800-332-6102

Web Address/Safety Seminar Registration
www.montanastatefund.com

ACE Program
800-332-6102
Extension 5982 (Carl Kochman)

Fraud Hotline
888-MT-CRIME
888-682-7463 or report online
at www.montanastatefund.com

BOARD OF DIRECTORS

EXECUTIVE TEAM

Standing, back: Peter Strauss, Vice President, Insurance Operations Support; Mark Barry, Vice President, Corporate Support; Al Parisian, Chief Information Officer

Seated, front: Dick Root, Vice President, Insurance Operations; Laurence Hubbard, President/CEO; Nancy Butler, General Counsel