

Montana State Fund

Financial Report

Fiscal Year End June 30, 2008 (FY08)

This is a summary of the financial results of Montana State Fund (MSF) for the fiscal year ended June 30, 2008. These financial results are subject to the following,

- The review and approval by the Board of Directors of the Loss Reserves to be included in the financial statements. The MSF independent consulting actuary has completed their analysis of ultimate losses and has provided their report. Laurence Hubbard, CEO, will provide management's recommendation of loss reserves to include in the financial statements. The attached statements include management's recommended amounts.
- Review and audit of the financial statements by the Legislative Audit Division of the State of Montana and Galusha, Higgins, and Galusha. The auditors will audit the statements and recommend audit adjustments if necessary. In prior years, these adjustments have not materially changed the statements as provided to the Board.

Montana State Fund prepares financial statements on both the Governmental Accounting Standards Board, (GASB) accounting basis, (Montana State Fund and Old Fund) and the National Association of Insurance Commissioners (NAIC) accounting basis for the Montana State Fund, (MSF). The attached statements for Fiscal Year 2008 are included. Audits of these statements are ongoing and are subject to recommended audit adjustments. State law requires the Board of Directors to submit an annual financial report of the business done by MSF the previous year. This report is to be submitted to the Governor and the Legislature. To comply with this law, MSF prepares financial statements under the GASB accounting principals. These statements, audited by the State of Montana, Legislative Audit Division, include the Montana State Fund and the Old Fund and are presented for review by the Legislative Audit Committee. These statements are in turn included in the state of Montana's Comprehensive Annual Financial Report as MSF is considered a component unit of the state of Montana. A component unit is defined as a unit that is legally separate from the state but where the governing board is appointed by the state and the state has a potential to influence the organization, such as finance a deficit, even if that potential is remote or only implied.

In addition, MSF prepares financial statements based on accounting standards established by the NAIC, referred to as Statutory Basis. This is a comprehensive basis of accounting all insurance companies follow and allows for state insurance commissioners to ensure comparability and consistent application of accounting practices by insurers. Galusha, Higgins and Galusha complete the audit of these statements. These statements will be available in our annual report issued and sent to the Governor and Legislature as well as our agents and other key customers. These NAIC based statements allow for

comparability to other insurance companies and are a basis for assessing our performance in relation to the industry in areas including the expense ratio, the combined ratio, premium to equity ratios and reserve to equity ratios.

Management will request the Board to approve the NAIC based statements and request the Board's approval to include these statements in the MSF Annual Report for FY 2008.

The primary differences between GASB accounting and NAIC (also known as statutory) accounting can be summed up in the following three areas.

Investments

GASB:

All Bonds and Stocks carried at Fair Market Value.

Unrealized gain/loss on Investments is included in Investment Income (Net Income impact).

NAIC:

Bonds carried at Book Value.

Stocks carried at Fair Market Value.

Unrealized gain/loss on Stocks is a direct adjustment to Equity (no Net Income impact).

Non-Admitted Assets

GASB:

All assets carried on Balance Sheet at net realizable value.

NAIC:

Non-liquid assets are written off the Balance Sheet as a direct adjustment to Equity.

Examples of non-liquid assets are: Intangibles assets, majority of Fixed Assets, Notes Receivable, and Accounts Receivable greater than 90 Days.

Deferred Acquisition Costs (DAC)

GASB:

Matching of expenses with revenues by recognizing acquisition expense over the period premiums are earned.

NAIC:

Acquisition expense is recognized when it is incurred rather than matching.

Montana State Fund

The discussion that follows on the Fiscal Year 2008 performance of Montana State Fund is on the statements created on the Statutory Basis of Accounting.

Operating Results

Net operating income for fiscal year 2008 (FY08) is \$32.2M (million). Equity increased \$17.5M in FY08 bringing equity to \$216.6M. The following summarizes FY08 results.

Net earned premium for the year ended June 30, 2008 was \$231.0M. This compares to \$221.8M in planned net earned premium for the fiscal year. This increase is from a combination of the following:

- Maintaining a higher retention of current policyholders than planned.
- More payroll growth than expected on renewing business.

Incurred losses for the year were \$194.2M. The fiscal year loss ratio is 84.1% of net earned premium compared to the planned loss ratio of 82.0% for the fiscal year. The incurred losses for FY 2008 include the following adjustments.

- Accident Year 2008 ultimate losses of \$165.3 million as determined by the independent actuary
- Accident Years 1991 to 2007 Adverse Development of \$19.9M
- Additional Reserve Strengthening of \$14.0M
- Additional Reinsurance Recovery on Aggregate Stop Loss and Excess of Loss Treaties of (\$6.2M)
- Fiscal Year 2008 Other States Coverage Incurred Loss of \$1.2M

Operating expenses for FY 2008 were \$45.6M. This includes Loss Adjustment Expenses (LAE) of \$18.7M and underwriting expenses of \$26.9M. Underwriting expenses have been reduced by (\$11.2M) due to a commission earned under our Aggregate Stop Loss Reinsurance Treaty, for the period ended June 30, 2008. Our expense ratio for FY 2008 was 19.8% net of contingent commission and 24.6% without the contingent commission. The planned expense ratio without contingent commission was 26.6% for FY 2008.

Net investment income and net realized capital gains/(losses) were \$44.3M for FY 2008, compared with planned net investment income and net realized capital gains of \$41.5M for FY 2008.

Comparison to Strategic Business Plan (SBP) Financial Targets

The operating results as compared to our strategic business plan targets are as follows.

Financial Indicators	FY 2008			% of Plan
	Actual	SBP	Variance	
Net Operating Income	\$32.20	\$28.20	\$4.00	114.18%
Net Earned Premium	\$231.00	\$221.80	\$9.20	104.15%
Incurred Loss Ratio	84.10%	82.00%	(2.10%)	97.50%
Expense Ratio (No CC)	24.60%	26.60%	2.00%	108.13%
Investment Income (including realized)	\$44.30	\$41.50	\$2.80	106.75%

Balance Sheet

MSF's total assets for FY 2008 increased by \$99.6M, while total liabilities increased by \$82.1M for the same period. Included in the increase of total assets was an increase in invested assets of \$93.8M.

Loss and LAE reserves increased \$73.0M for the year to \$752.3M. This increase includes the additional loss exposure of AY 2008, additional development on prior years losses of \$19.9M determined by the independent actuary, and additional reserve strengthening.

Overall equity increased \$17.4M to \$216.6M. Although MSF had operating income of \$32.2M for the year, the value of our equity holdings decreased (\$13.1M). Both the change in equity holding and the change in non-admitted assets are reflected in surplus.

Reconciliation of GASB Equity To NAIC Statutory Equity at June 30, 2008

NAIC Accounting Ending Equity	\$ 216,623,581
<i>Reconciling Items:</i>	
Change in Investment Value of Bonds to Fair Market Value	\$ (7,051,202)
Net Effect of Cumulative Change in Non-Admitted Assets	\$ 9,947,441
Other (Deferred Acquisition Cost reversal, GAAP Adj.)	\$ <u>5,090,983</u>
GASB Net Assets (Equity)	\$ <u>224,610,803</u>

Old Fund

The Old Fund financial report is presented on a Governmental Accounting Standards (GASB) basis. At June 30, 2008, the Old Fund deficit position has weakened by (\$3.9M) compared to FY 2007 and is now at (\$36.5M). At the end of FY 2007 the deficit was (\$32.6M).

The additional deficit in the Old Fund is driven by the following,

- The ultimate loss selections by the consulting actuary increased \$1.3M from selections in the prior year.
 - \$2.1M increase in medical loss selections
 - (\$0.8M) decrease in indemnity loss selections
- Change in assumed rate on invested assets from 5.0% to 4.5% as a result of investment market returns

Based on the expected payout patterns for the Old Fund Claims, there are sufficient invested assets to meet it's obligations until early in Fiscal Year 2012.

MONTANA STATE FUND
 STATUTORY STATEMENT OF ADMITTED ASSETS, LIABILITIES AND SURPLUS
 NEW FUND

DRAFT

	As Of June 30, 2008 (AUDITED)	As of June 30, 2007 (AUDITED)	Variance Increase (Decrease)
ADMITTED ASSETS			
Investments			
Bonds	\$ 870,571,895	\$ 776,129,409	\$ 94,442,486
Equity Securities	87,443,325	100,545,339	(13,102,014)
Real Estate Investment	2,449,478	1,139,460	\$ 1,310,018
Cash and Short-Term Investments	24,925,611	13,744,136	11,181,475
Other Investments - Collateral Securities on Loan	143,710,846	146,413,103	(2,702,257)
Total Investments and Cash	\$ 1,129,101,155	\$ 1,037,971,447	\$ 91,129,708
Premium Receivable	22,737,995	25,321,721	(2,583,726)
Equipment (net)	1,106,684	1,521,390	(414,707)
Interest Receivable	11,413,760	11,214,265	199,495
Other Assets	32,316,071	21,074,298	11,241,774
Total Admitted Assets	\$ 1,196,675,665	\$ 1,097,103,121	\$ 99,572,543
LIABILITIES AND EQUITY			
Liabilities			
Losses Incurred Reserves	\$ 677,196,077	\$ 607,086,257	\$ 70,109,820
Loss Adjustment Expense Reserves	75,057,223	72,122,743	2,934,480
Liability for Securities on Loan	143,710,845	146,413,103	(2,702,257)
Deferred Revenue	9,842,296	10,216,394	(374,098)
Other Liabilities	74,245,643	62,096,107	12,149,536
Total Liabilities	\$ 980,052,084	\$ 897,934,604	\$ 82,117,480
Equity			
Equity	\$ 216,623,581	\$ 199,168,517	\$ 17,455,064
Total Liabilities and Equity	\$ 1,196,675,665	\$ 1,097,103,121	\$ 99,572,544

DRAFT

MONTANA STATE FUND STATUTORY STATEMENT OF OPERATIONS AND CHANGES IN EQUITY NEW FUND

	<u>12 Months Ended June 30, 2008 (AUDITED)</u>	<u>12 Months Ended June 30, 2007 (AUDITED)</u>	<u>Variance Favorable (Unfavorable)</u>
Gross Premium Earned	\$ 245,641,381	\$ 253,058,478	\$ (7,417,097)
Ceded Premium	(14,676,074)	(14,855,770)	179,697
Net Earned Premium	\$ 230,965,307	\$ 238,202,708	\$ (7,237,401)
Losses Incurred	194,249,598	187,821,156	(6,428,442)
Loss Expenses Incurred	18,687,513	35,428,189	16,740,676
Underwriting Expenses Incurred	26,946,211	24,277,149	(2,669,062)
Net Underwriting Loss	\$ (8,918,015)	\$ (9,323,786)	\$ 405,771
Net Investment Income Earned	44,407,106	37,919,659	6,487,447
Net Realized Capital Gains (Losses)	(113,523)	(655,807)	542,284
Receivable Balances Recovered (Charged Off)	(1,164,866)	(520,732)	(644,133)
Other Income (Expense)	(2,056,415)	(1,503,672)	(552,743)
Net Income before Dividends	\$ 32,154,287	\$ 25,915,662	\$ 6,238,626
Policyholder Dividends	-	(7,000,966)	7,000,966
Net Income after Dividends	\$ 32,154,287	\$ 18,914,696	\$ 13,239,592
Prior Year End Equity	199,168,589	163,101,495	36,067,093
Net Unrealized Gains (Losses) on Equity Securities	(13,102,014)	17,167,977	(30,269,991)
Change in Nonadmitted Assets	(1,597,281)	(14,880)	(1,582,401)
Aggregate Write In for Gains (Losses) in Surplus	-	(771)	771
Aggregate Effect of Prior Year DAC Expense	-	-	-
End of Period Equity	\$ 216,623,581	\$ 199,168,517	\$ 17,455,064
Premium to Equity Ratio (Before Dividends)	1.07	1.16	
Reserve to Equity Ratio (Before Dividends)	3.47	3.29	

MONTANA STATE FUND - NEW FUND
STATEMENT OF NET ASSETS
Montana State Fund is a component unit of the State of Montana

DRAFT

JUNE 30,	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets		
Cash and cash equivalents	24,925,611	13,744,136
Receivables, net	29,421,393	31,041,246
Due from primary government	8,042	13,411
Due from component units	614,802	611,577
Securities lending collateral	143,710,845	146,413,103
Other assets	<u>38,167,896</u>	<u>25,883,738</u>
Total Current Assets	236,848,589	217,707,211
Noncurrent Assets		
Investments	953,413,426	868,026,676
Notes and loans receivable	-	33,598
Equipment	4,863,684	4,559,954
Accumulated depreciation	(3,469,305)	(2,760,981)
Intangible assets	<u>6,264,316</u>	<u>4,972,722</u>
Total Noncurrent Assets	<u>961,072,121</u>	<u>874,831,969</u>
Total Assets	<u><u>1,197,920,710</u></u>	<u><u>1,092,539,180</u></u>
LIABILITIES		
Current Liabilities		
Accounts payable	17,869,533	17,212,084
Due to primary government	1,498,778	1,415,043
Due to component units	-	-
Estimated claims payable	-	137,986,975
Compensated absences	1,231,568	1,310,087
OPEB Liability	858,215	-
Securities lending liability	143,710,845	146,413,103
Deferred revenue	9,842,296	10,216,394
Property held in trust	<u>44,888,625</u>	<u>34,273,741</u>
Total Current Liabilities	219,899,860	348,827,427
Noncurrent Liabilities		
Estimated claims payable	752,253,300	541,222,025
Compensated absences	<u>1,156,747</u>	<u>884,566</u>
Total Noncurrent Liabilities	<u>753,410,047</u>	<u>542,106,591</u>
Total Liabilities	<u>973,309,907</u>	<u>890,934,018</u>
NET ASSETS		
Invested in capital assets, net of related debt	7,658,695	6,771,695
Unrestricted	<u>216,952,108</u>	<u>194,833,467</u>
Total Net Assets	224,610,803	201,605,162
Total Liabilities and Net Assets	<u><u>1,197,920,710</u></u>	<u><u>1,092,539,180</u></u>

DRAFT

MONTANA STATE FUND - NEW FUND
STATEMENT OF REVENUES, EXPENSES, and CHANGES IN FUND NET ASSETS
Montana State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	<u>2008</u>	<u>2007</u>
Net premiums earned	230,965,307	238,202,708
Operating Expenses		
Benefits and claims	201,333,093	208,627,247
Personal services	22,984,130	19,506,793
Contractual services	8,943,666	13,480,301
Supplies and materials	634,314	910,424
Depreciation	668,018	453,815
Amortization	1,102,235	905,704
Rent and utilities	460,256	484,457
Communications	1,623,405	1,158,400
Travel	283,431	231,570
Repair and maintenance	928,390	875,434
Other operating expenses	3,028,599	(72,955)
Total Operating Expenses	<u>241,989,537</u>	<u>246,561,190</u>
Operating Loss	<u>(11,024,230)</u>	<u>(8,358,482)</u>
Nonoperating Revenue (Expenses)		
Investment income	33,034,058	59,893,136
Gain on sale of investments	282,605	167,506
Securities lending income	6,841,075	6,164,519
Loss on sale of investments	(396,128)	(823,312)
Securities lending expense	(5,803,640)	(6,100,391)
Penalties and interest	34,576	35,367
Loss on retirement of assets	-	(771)
Dividend expense	-	(7,000,966)
Other income	37,325	44,047
Total Nonoperating Revenue (Expense)	<u>34,029,871</u>	<u>52,379,135</u>
Change in Net Assets	23,005,641	44,020,653
Total Net Assets - Beginning	<u>201,605,162</u>	<u>157,584,509</u>
Total Net Assets - Ending	<u><u>224,610,803</u></u>	<u><u>201,605,162</u></u>

**MONTANA STATE FUND - OLD FUND
STATEMENT OF NET ASSETS**

DRAFT

JUNE 30,	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets		
Cash and cash equivalents	13,586,766	7,861,757
Receivables, net	269,183	574,258
Due from component units	111,803	-
Prepaid Expenses	-	224
Securities lending collateral	<u>4,179,153</u>	<u>13,687,883</u>
Total Current Assets	18,146,905	22,124,122
Noncurrent Assets		
Investments	<u>18,722,003</u>	<u>34,713,171</u>
Total Assets	<u><u>36,868,908</u></u>	<u><u>56,837,293</u></u>
LIABILITIES		
Current Liabilities		
Accounts payable	151,212	108,096
Due to primary government	-	826
Due to component units	615,425	611,578
Estimated claims payable	-	10,353,698
Securities lending liability	<u>4,179,153</u>	<u>13,687,883</u>
Total Current Liabilities	4,945,790	24,762,081
Noncurrent Liabilities		
Estimated claims payable	<u>68,434,910</u>	<u>64,709,380</u>
Total Noncurrent Liabilities	<u>68,434,910</u>	<u>64,709,380</u>
Total Liabilities	<u>73,380,700</u>	<u>89,471,461</u>
NET ASSETS		
Restricted	-	-
Unrestricted	<u>(36,511,792)</u>	<u>(32,634,168)</u>
Total Net Assets	(36,511,792)	(32,634,168)
Total Liabilities and Net Assets	<u><u>36,868,908</u></u>	<u><u>56,837,293</u></u>

DRAFT**MONTANA STATE FUND - OLD FUND
STATEMENT OF REVENUES, EXPENSES, and CHANGES IN FUND NET ASSETS**

YEARS ENDED JUNE 30,	2008	2007
Operating Expenses		
Benefits and claims	4,659,487	12,071,873
Personal services	11,020	32,176
Contractual services	1,064,611	864,563
Depreciation	40,306	48,467
Amortization	66,505	244,411
Other operating expenses	229,053	179,140
	<hr/>	<hr/>
Total Operating Expenses	6,070,982	13,440,630
	<hr/>	<hr/>
Operating Loss	(6,070,982)	(13,440,630)
	<hr/>	<hr/>
Nonoperating Revenue (Expenses)		
Investment income	2,015,677	2,692,467
Gains on investments	140,185	13,402
Securities lending income	343,751	312,700
Losses on investments	(5,383)	(3,217)
Securities lending expense	(300,872)	(307,487)
Liability tax revenue	-	-
	<hr/>	<hr/>
Total Nonoperating Revenue (Expenses)	2,193,358	2,707,865
	<hr/>	<hr/>
Change in Net Assets	(3,877,624)	(10,732,765)
Total Net Assets - Beginning	(32,634,168)	(21,901,403)
Total Net Assets - Ending	(36,511,792)	(32,634,168)
	<hr/> <hr/>	<hr/> <hr/>