



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Montana State Fund

*For the Calendar Year Ended
December 31, 2020*

AUGUST 2021

LEGISLATIVE AUDIT
DIVISION

21-05A

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting and many staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2019, was issued March 30, 2020. The Single Audit Report for the two fiscal years ended June 30, 2021, will be issued by March 31, 2022.

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LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

August 2021

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Fund, a component unit of the state of Montana, for the calendar year ended December 31, 2020. This report does not contain any recommendations, and we issued an unmodified opinion on the financial statements, which means the reader can rely on the information presented.

Montana State Fund's response to our audit is on page C-1. We thank the Montana State Fund President/CEO and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

Montana State Fund

Laurence Hubbard, President/CEO

Mark Burzynski, Vice President, Corporate Support

Richard Duane, Vice President, Human Resources

Julie Jenkinson, Vice President, Insurance Operations

Will Anderson, Interim Vice President, Insurance Operations Support

Kevin Braun, Vice President, General Counsel

Al Parisian, Vice President, Chief Information Officer

		<u>Qualifications</u>	<u>Location</u>	<u>Term Expires</u>
State Fund Board of Directors	Richard Miltenberger, Chair	Insurance Industry Representative	Clancy	2025
	Karen Fagg	Public Representative	Billings	2025
	Michael Marsh	Licensed Insurance Producer	Billings	2025
	John Maxness	Private Enterprise, Policyholder	Helena	2025
	Jack Owens	Private Enterprise, Policyholder	Missoula	2023
	Dexter Thiel	Private Enterprise, Policyholder	Sidney	2023
	Janice VanRiper	Private Enterprise, Policyholder	Missoula	2023

For additional information concerning the Montana State Fund, contact:

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MONTANA LEGISLATIVE AUDIT DIVISION

Montana State Fund

FOR THE CALENDAR YEAR ENDED DECEMBER 31, 2020

BACKGROUND

Montana State Fund (MSF) is established by Title 39, Chapter 71, Part 23 of the Montana Code Annotated. Operating as a nonprofit, independent public corporation, MSF functions like a private insurance carrier in a competitive marketplace. Under state law, MSF functions as the “guaranteed market,” and is required to insure any employer in this state who requests coverage unless the employer or the employer’s principles have defaulted on a state fund obligation and the obligation remains unsatisfied. MSF is governed by a seven-member board of directors appointed by the governor. The board of directors appoints the President/CEO who oversees MSF’s day-to-day operations.

In accordance with state law, MSF is under the regulatory authority of the Insurance Commissioner at the State Auditor’s Office.

Claims occurring before July 1, 1990, referred to as the old fund claims, are an obligation of the primary government and are reflected on the state of Montana’s financial statements.

In calendar year 2020, Montana State Fund saw a decrease in Premium Revenue of about \$8 million due to the pandemic, and a decrease in Operating Expenses of about \$30 million due to updated loss estimates and increased claim settlements. Overall, there was a positive change in Net Position of about \$94 million, due primarily to Total Investment Income of about \$113 million. The audit did not result in any audit recommendations.

AUDITOR’S OPINION (page A-1) – UNMODIFIED:

This means you can rely on the financial statements and notes in this report in all material respects.

For the full context of Montana State Fund’s financial activity, see the financial statements and notes beginning on page A-3.

RECOMMENDATIONS:

In this report, we issued the following recommendations:

To the State Fund: 0

To the legislature: 0

SUMMARY OF AUDIT WORK:

We performed work over MSF’s internal controls and business processes related to the payment of claims expenses, reserves for future claims payments, collection of insurance premium revenue, investment activity, reinsurance activity, and compliance with selected laws and regulations. We considered the overall reasonableness of the financial statement presentation, to determine if they can be used for decision-making purposes.

For the full report or more information, contact the Legislative Audit Division.

leg.mt.gov/lad

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REPORT ON INTERNAL CONTROL AND COMPLIANCE

(page B-1):

In this report, we identified the following:

Material Weaknesses in Internal Control: 0

Significant Deficiencies in Internal Control: 0

Material Non-Compliance: 0

Other Matters: 0

For the full context of this information, including the distinction between the types of items reported, see the report beginning on page B-1.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana State Fund (MSF) for the calendar year ended December 31, 2020. MSF is the only state entity that operates on a calendar year.

The objectives of the audit were to:

1. Determine whether the MSF's financial statements present fairly the financial position, results of operations, and cash flows for the calendar year ended December 31, 2020.
2. Obtain an understanding of the MSF's control systems to the extent necessary to support our audit of MSF's financial statements, and if appropriate, make recommendations for improvement in MSF management and internal controls.
3. Determine whether MSF complied with selected applicable laws and regulations.

Our audit work included testing MSF's internal controls and business processes related to:

- ♦ Payment of claim expenses
- ♦ Reserves for future claim payments
- ♦ Assessment and collection of policy premiums
- ♦ Investment activity
- ♦ Reinsurance activity
- ♦ Transactions and activities at calendar year-end
- ♦ Compliance with selected laws and regulations
- ♦ Overall reasonableness of the financial statement presentations.

MSF personnel prepared the management discussion and analysis, financial statements, notes, and required supplementary information based on accounting information from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustments. Adjustments are made to presented financial activity in accordance with Generally Accepted Accounting Principles (GAAP). We issued an unmodified opinion on the financial statements, meaning the reader can rely on the information presented.

Background

MSF is a state entity operating as a nonprofit, independent public corporation that 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.

MSF's Board of Directors must set premium rates at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of MSF, and to maintain a surplus over a calculated amount based on the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The investments of the MSF, per state law, are managed by the Montana Board of Investments.

MSF is under the regulatory authority of the Insurance Commissioner at the State Auditor's Office, and reports on a calendar-year basis. State law requires MSF to submit financial statements in a format required by the Insurance Commissioner by March 1 of each year. State law also requires MSF to prepare annual financial statements in accordance with GAAP, and that the Legislative Audit Division audit those statements.

In calendar year 2020, MSF expected a significant decrease in premium revenue due to the COVID-19 pandemic and resulting decreased business operations across Montana. However, the decrease in premium revenue was only about \$8 million. There was also a decrease in Operating Expenses of about \$30 million due to updated loss estimates and increased claim settlements. Overall, there was a positive change in Net Position of about \$94 million, due primarily to Total Investment Income of about \$113 million.

Claims occurring before July 1, 1990, referred to as the old fund claims, are an obligation of the General Fund and are reflected on the state of Montana's financial statements. MSF administers the claims of the old fund.

Independent Auditor's Report and Montana State Fund Financial Statements

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Statement of Net Position of the Montana State Fund, a component unit of the state of Montana, as of December 31, 2020, the related Statement of Revenues, Expenses and Changes in Fund Net Position and the Statement of Cash Flows for the calendar year then ended, and the related notes which collectively comprise the Montana State Fund's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Montana State Fund's preparation and fair presentation of the 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 Montana State Fund's internal control, and 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 the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund as of December 31, 2020, and the changes in net position and cash flows for the calendar year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis and the risk management, retirement, and other post-employment benefits Required Supplementary Information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 1, 2021, on our consideration of the Montana State Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Fund's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

July 1, 2021

Montana State Fund
(A Component Unit of the State of Montana)
Management Discussion and Analysis
December 31, 2020

Montana State Fund (MSF) is a non-profit, independent public corporation that provides workers' compensation insurance. Its statutory purpose is to act as a competitive insurance carrier, providing an available market and thereby guaranteeing coverage for all employers in Montana. Operating solely on the premium dollars paid by its insured employers and the net proceeds from its investments, MSF is not funded by the State General Fund for primary business operations. MSF functions like a private insurance carrier in a competitive marketplace and, as provided by law, performs all the functions and exercises all the powers of a private insurance carrier that are necessary, appropriate or convenient for the administration of the Montana State Fund.

In Montana, employers have three options for purchasing and providing workers' compensation coverage:

- Plan 1 - Develop a self-insurance program
- Plan 2 - Purchase from a private company
- Plan 3 - Purchase from MSF.

These options provide employers an approach that will best meet their needs and promotes competition, while also ensuring a guaranteed market exists for Montana employers. Out of the \$17.9 billion total annual state payroll reported in 2018, self-insured programs cover 23%, private companies cover 46%, and MSF covers about 31% of the market. MSF cannot refuse to insure an employer unless there is an outstanding obligation owed to MSF. Private carriers have the advantage to "selectively" insure based on their underwriting analysis and willingness to accept various levels of risk, potentially avoiding adverse risk, while MSF does not have that latitude.

MSF has undergone a number of changes since its creation in 1990. MSF continues to strive to improve efficiencies in all operational areas and has made major investments in safety management services as it works diligently with Montana employers in developing accident prevention programs. MSF is in the software development phase of a multi-year project to transition from its legacy policy management system to a more customer-interactive policy and billing system. Effective January 1, 2016, the State Auditor's Office, which regulates all insurance companies doing business in Montana, became responsible for oversight of MSF. The State Auditor's Office requires specific information and filings throughout the year and reviews and approves premium rates. External independent audits are completed annually of financial statements based on standards set by the National Association of Insurance Commissioners (NAIC).

MSF also administers and manages the claims remaining in the Old Fund for the State of Montana. The assets of the Old Fund were completely liquidated in 2011 and benefit payments and administrative costs for claims occurring before July 1, 1990, are supported by General Fund resources as required under state law (§39-71-2352, MCA). Therefore, the Old Fund is considered to be part of the Primary Government for financial reporting purposes and is not included in the accompanying financial statements.

Overview of the Financial Statements

This overview is an introduction to Montana State Fund financial statements. MSF's financial statements consist of two components: (1) basic financial statements, and (2) notes to the basic financial statements.

The Statement of Net Position presents information regarding all of MSF's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and total net position.

The Statement of Revenues, Expenses, and Changes in Fund Net Position presents the financial results of operations for MSF for the year ending December 31, 2020. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

The Statement of Cash Flows details the cash used and provided by the various activities of MSF during the fiscal period. However, this statement does not consider unpaid responsibilities which have been established by contract or other underlying events during the period.

Financial Highlights

MSF continues to deliver high-quality services to Montana businesses while instituting annual rate reductions. MSF supports a competitive insurance market in Montana, offering competitively priced insurance coverage based upon actuarially sound rates while still fulfilling its role as the carrier for the guaranteed market. Rates remained flat for the policy year effective from July 1, 2020 to June 30, 2021 and the Board of Directors recently approved an average 10% rate reduction effective July 1, 2021. Since 2007, MSF's rates have been reduced by 52.7%.

The Board of Directors, based on analysis of policyholder equity adequacy and financial results, declares the amount of dividends to be distributed to current and former policyholders. MSF has declared and paid dividends to policyholders for 22 consecutive years. Dividends reward employers that have demonstrated a focus on workplace safety. A dividend of \$20M (million) was declared in September 2020 to qualifying policyholders. Subsequently, when 2020 year-end financial results became available and reflected better than expected investment gains and reduced claim liabilities, a second dividend of \$20M was declared on behalf of these same employers.

Analysis of Financial Position and Results of Operations

The following analysis presents comparative condensed financial data for MSF.

Net Position (in thousands)

	December 31, 2020	December 31, 2019
Current and Other Assets	\$ 185,790	\$ 203,966
Capital Assets (Net)	49,379	38,190
Investments	1,557,720	1,486,141
Total Assets	<u>1,792,889</u>	<u>1,728,297</u>
Total Deferred Outflows of Resources	<u>6,360</u>	<u>3,317</u>
Current Liabilities	193,936	217,467
Long-term Liabilities	930,739	932,394
Total Liabilities	<u>1,124,675</u>	<u>1,149,861</u>
Total Deferred Inflows of Resources	<u>2,753</u>	<u>3,661</u>
Net Position:		
Net Investment in Capital Assets	49,379	38,190
Unrestricted	622,442	539,902
Total Net Position	<u>\$ 671,821</u>	<u>\$ 578,092</u>

MSF's overall net position increased during the year ended December 31, 2020, largely due to unrealized gains on MSF's investment portfolio. With around \$1.8B in combined assets and deferred outflows of resources to meet \$1.1B of liabilities and deferred inflows of resources, MSF is well-positioned to meet the commitments to policyholders that it has incurred, which is the hallmark of prudent insurance planning and operations.

The largest component of MSF assets is investments, which increased during the year ended December 31, 2020. The change in value is summarized in the following display (in thousands):

	Year Ended December 31, 2020	Year Ended December 31, 2019
Prior Year Market Value	\$ 1,486,140	\$ 1,410,418
Purchases at Cost	389,489	394,786
Sales	(395,659)	(416,655)
Net Realized Gains	17,688	16,370
Net Accretion (Amortization) of Bonds	451	551
Unrealized Gain (Loss)	59,611	80,670
Current Year Market Value	<u>\$ 1,557,720</u>	<u>\$ 1,486,140</u>

The most significant MSF liability is estimated claims payable, which decreased during the year ended December 31, 2020. This liability increases from new claims added for the year and decreases from claim payments made. Additionally, changes to the estimates for prior years can increase or decrease the liability.

During 2011, the State of Montana Legislature enacted a set of cost-saving measures including an expansion of an insurer's ability to settle a claim's medical liability. MSF has begun to realize the positive effects of these measures and as a result, had favorable development on prior accident years that reduced the total estimated claims liability by \$16.4M from the prior year. The increase in claim payments between 2020 and 2019 is due to a slight uptick in settlement activity during 2020. Otherwise, MSF is still experiencing a downward trend in claim payments that began in early 2018. The changes are summarized in the following display (in thousands):

	<u>Year Ended</u> <u>December 31,</u> <u>2020</u>	<u>Year Ended</u> <u>December 31,</u> <u>2019</u>
Estimated Claims Payable - Beginning	\$ 956,594	\$ 941,638
Incurred Claims Payable	98,375	119,989
Claim Payments	<u>(114,808)</u>	<u>(105,033)</u>
Estimated Claims Payable - Ending	<u><u>\$ 940,161</u></u>	<u><u>\$ 956,594</u></u>

Willis Towers Watson, an independent actuarial firm, prepares an annual actuarial study used to estimate claims liabilities for MSF and provides a range of potential costs associated with claims. MSF management recommended and the Board of Directors approved an estimate within that range as the estimated claims payable, consisting of unpaid claims, reserve strengthening, and claim adjustment expenses.

Changes in Net Position (in thousands)

	Year Ended December 31, 2020	Year Ended December 31, 2019
Operating Revenues:		
Net Premium Earned	\$ 148,625	\$ 156,871
Operating Expenses:		
Benefits and Claims	98,375	119,989
Personal Services	32,197	29,490
Dividend Expense	19,999	30,007
Other Operating Expense	20,356	21,411
Total Operating Expense	<u>170,927</u>	<u>200,897</u>
Net Operating Income (Loss)	(22,302)	(44,026)
Nonoperating Revenue (Expense):		
Investment Income	113,728	135,838
Other Nonoperating Revenue	2,083	1,117
Total Nonoperating Revenue (Expense)	<u>115,811</u>	<u>136,955</u>
Change in Net Position	93,510	92,930
Prior Period Adjustment	219	1,976
Beginning Net Position	578,092	483,186
Total Net Position	<u><u>\$ 671,821</u></u>	<u><u>\$ 578,092</u></u>

For the year ended December 31, 2020, MSF produced a increase in net position of \$93.5M after returning \$20.0M in dividends to eligible policyholders. Net premium income was down about 5% from the prior year and was less of a decrease than expected considering the impacts of COVID-19 on the Montana economy. New business written during 2020 offset business lost and premium retention, or the amount of premium that was retained from the prior year, was approximately 91% for the year ended December 31, 2020, which is consistent with MSF's recent history.

The significant decrease in benefit and claims expenses from the prior year was due to improved loss estimates for both current and prior accident years. The accident year ultimate loss, which is the expected ultimate cost of all claims incurred during the year, was approximately 92.3% of the prior year ultimate loss, indicating declining loss experience from period to period. Prior year loss estimates were also reduced as Willis Towers Watson acknowledged that claim settlements are shortening the medical tail, or costs, on prior year claims.

Overall, other operating expense levels decreased in 2020 as compared to the prior year. While the COVID-19 pandemic decreased certain expenses like travel, training, and commissions, other expenses like salaries and pension expense increased.

The final major contributing factor in the \$93.5M change in net position is MSF's investment income. The rates of return from the fixed-income portfolio remained relatively constant throughout the two years

shown above, however, it should be noted MSF had significant unrealized gains on equity securities during both 2020 and 2019 due to continued market growth.

An operating loss of \$22.3M that includes a \$20M dividend, offset by significant investment income resulted in a change in net position of \$93.5M.

COVID-19 Pandemic

While the full impact of the COVID-19 pandemic remains unknown, MSF has not experienced a significant detrimental impact. Management is closely monitoring the situation and is actively working to minimize the current and future effect on business operations. The following list is not exhaustive, but summarizes some changes made, impacts of, and ongoing evaluation related to the coronavirus pandemic:

- Total net premium for the year was higher than initially projected once the effects of the pandemic first impacted the economy and came in at 99.7% of the original planned amount of \$149M. Although some policyholders closed their businesses or reported less payroll, the decline was offset by new business written and better than expected payroll in other industries.
- From April through September 2020, MSF did not cancel policyholders for nonpayment, but rather, offered an optional premium deferral program that allowed for an extended period to pay premium owed.
- Employment classification changes were adopted, as required by NCCI, so that employees who are paid but not working are tracked differently and that payroll is not used to assess premium or experience rating. Thus far a minimal amount of this payroll has been reported.
- Safety management consulting services were provided virtually to educate businesses, essential workers, and employees working remotely about safe work practices.
- MSF distributed approximately \$260,000 worth of personal protective equipment through a grant program designed to assist COVID-19 high-risk and vulnerable frontline businesses and workers.
- A cross-functional team of claims, medical, and legal professionals is monitoring and handling all reported claims associated with COVID-19.

Looking Forward

As a mono-line insurer only licensed to write business within the State of Montana, MSF cannot look to other lines of business and/or geographic markets in order to diversify its risk and/or create economies of scale to strengthen its position in the industry on behalf of its policyholders and other Montana businesses. As a result, MSF must and will continue to focus on providing the excellent customer service and prudent financial management that has solidified it as the insurer of choice for a significant number of Montana employers. Although MSF is statutorily required to offer guaranteed workers' compensation coverage, it has evolved into a business partner by offering stable premiums, superior customer service, robust safety training, and educational programs, which all contribute to MSF's competitiveness as a carrier and MSF's relevance and sustainability, which is reflected in MSF's retention rate of 90.8% in 2020.

As examples of its intense commitment to the State of Montana, MSF offers comprehensive safety programs to its policyholders and the education system designed to improve the workplace safety culture in Montana. MSF invests about \$3 million a year to provide safety training, consulting services, and resources to MSF's policyholders and their employees. Moreover, MSF is a significant mentor and contributor to high school students pursuing trade careers and the schools which they attend. MSF has provided safety materials to numerous high schools across the state over the last several years and offered college scholarships, which are helping to prepare students for long, productive careers serving Montanans just as MSF does.

To the extent that comments presented above constitute forward-looking statements, these statements are not guarantees of future performance. Forward-looking statements are based on current expectations and projections that may change significantly over time due to changes in the industry, market fluctuations, and other factors.



Statement of Net Position

Montana State Fund is a component unit of the State of Montana

	<u>December 31, 2020</u>
ASSETS	
Current Assets	
Cash and Cash Equivalents	\$ 36,745,380
Receivables, Net	77,788,785
Securities Lending Collateral	4,266,130
Other Assets	1,712,346
Total Current Assets	<u>120,512,641</u>
Noncurrent Assets	
Investments	1,557,719,945
Reinsurance Receivables	65,277,305
Capital Assets:	
Land	1,139,460
Other Capital Assets, Net of Depreciation	48,239,896
Total Capital Assets	<u>49,379,356</u>
Total Noncurrent Assets	<u>1,672,376,606</u>
Total Assets	<u>1,792,889,247</u>
DEFERRED OUTFLOWS OF RESOURCES	<u>6,360,149</u>
LIABILITIES	
Current Liabilities	
Accounts Payable	13,675,656
Estimated Claims Payable	111,878,107
Unearned Premium	62,154,933
Securities Lending Liability	4,266,130
Other Current Liabilities	1,961,459
Total Current Liabilities	<u>193,936,285</u>
Noncurrent Liabilities	
Estimated Claims Payable	828,282,650
Reinsurance Funds Withheld	65,277,305
Net Pension Liability	29,586,757
Other Noncurrent Liabilities	7,592,275
Total Noncurrent Liabilities	<u>930,738,987</u>
Total Liabilities	<u>1,124,675,272</u>
DEFERRED INFLOWS OF RESOURCES	<u>2,753,130</u>
NET POSITION	
Net Investment in Capital Assets	49,379,356
Unrestricted	622,441,638
Total Net Position	<u>\$ 671,820,994</u>

The notes to the financial statements are an integral part of this statement.



Statement of Revenues, Expenses, and Changes in Fund Net Position

Montana State Fund is a component unit of the State of Montana

	For the Year Ended December 31, 2020
Net Premiums Earned	\$ 148,625,434
Operating Expenses	
Benefits and Claims	98,375,174
Personal Services	32,196,528
Contractual Services	7,961,960
Supplies and Materials	1,044,818
Communications	1,433,103
Travel	34,473
Rent and Utilities	230,167
Repair and Maintenance	2,379,140
Depreciation and Amortization	1,548,594
Dividend Expense	19,999,084
Other Operating Expenses	5,723,271
Total Operating Expenses	<u>170,926,312</u>
Operating Income (Loss)	<u>(22,300,878)</u>
Nonoperating Revenue (Expenses)	
Investment Income	113,727,873
Securities Lending Income	252,309
Securities Lending Expenses	(115,736)
Loss on Retirement of Assets	(55,240)
Other Income	2,001,904
Total Nonoperating Revenue (Expenses)	<u>115,811,110</u>
Change in Net Position	93,510,232
Total Net Position - Beginning (As Previously Reported)	578,092,047
Prior Period Adjustment	218,715
Total Net Position - Beginning (As Restated)	<u>578,310,762</u>
Total Net Position - Ending	<u><u>\$ 671,820,994</u></u>

The notes to the financial statements are an integral part of this statement.



Statement of Cash Flows

Montana State Fund is a component unit of the State of Montana

YEAR ENDED DECEMBER 31,	2020
Cash Flows from Operating Activities	
Receipts for Premiums	\$ 143,413,953
Payments for Claims	(114,814,020)
Payments to Employees	(29,328,575)
Payments to Suppliers for Goods and Services	(19,004,650)
Payments for Dividends	(19,964,794)
Other Operating Receipts	2,237,062
Net Cash Provided by (Used for) Operating Activities	(37,461,024)
Cash Flows from Capital and Related Financing Activities	
Acquisition of Fixed Assets	(7,469,739)
Proceeds from Disposal of Fixed Assets	18,706
Net Cash Used for Capital and Related Financing Activities	(7,451,033)
Cash Flows from Investing Activities	
Purchase of Investments	(420,106,608)
Proceeds from Sales or Maturities of Investments	395,658,252
Interest and Dividends on Investments	36,984,571
Net Cash Provided by (Used For) Investing Activities	12,536,215
Net Increase (Decrease) in Cash and Cash Equivalents	(32,375,842)
Cash and Cash Equivalents - January 1	69,121,222
Cash and Cash Equivalents - December 31	<u><u>\$ 36,745,380</u></u>

The notes to the financial statements are an integral part of this statement.



Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED DECEMBER 31,

2020

**Reconciliation of Change in Net Position to
 Net Cash Provided by (Used for) Operating Activities**

Change in Net Position \$ 93,510,232

**Adjustments to Reconcile Change in Net Position to Net
 Cash Provided by (Used for) Operating Activities**

Depreciation	1,164,372
Amortization	384,222
Loss on Sale of Fixed Assets	58,677
Gain on Sale of Fixed Assets	(3,437)
Income on Investments	(113,864,446)
Decrease (Increase) in	
Accounts Receivable	(7,813,607)
Reinsurance Receivables	(8,523,817)
Deferred Outflows of Resources	(3,043,425)
Other Assets	(50,598)
Increase (Decrease) in	
Accounts Payable	1,612,519
Unearned Premium	1,612,130
Property Held in Trust	(100,000)
Reinsurance Funds Withheld	8,523,817
Estimated Claims Payable	(16,432,886)
Deferred Inflows of Resources	(907,544)
Pension Liabilities	5,673,839
OPEB Liability	324,282
Lease Liability	(406,155)
Compensated Absences	820,801

Total Adjustments (130,971,256)

Net Cash Provided by (Used for) Operating Activities \$ (37,461,024)

The notes to the financial statements are an integral part of this statement.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2020

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (MSF) 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 a discretely presented component unit of the State of Montana and results are included in the State's Comprehensive Annual Financial Report because of the significance of MSF's financial relationship with the State. 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. MSF's Board is allocated to the State of Montana, Department of Administration for administrative purposes only.

In 1990 legislation passed establishing separate 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 the New Fund. Hereafter, any reference to MSF refers to the New Fund or those claims occurring on or after July 1, 1990.

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. MSF administers and manages the claims remaining in the Old Fund for the State of Montana. Other than the administrative fees paid for the management of the Old Fund claims, no State of Montana General Fund money is used for MSF operations.

Effective January 1, 2016, MSF became an authorized insurer regulated by the Montana State Auditor's Office and is subject to the provisions of Title 33, Montana Insurance Code. As a result, MSF reports financial results on a calendar year basis instead of using the State's fiscal year ending June 30th.

Prior Period Adjustment

During the year ended December 31, 2020, the State of Montana's other post-employment benefits (OPEB) actuarial valuation was revised to show actual distribution of deferred inflows and outflows of resources between entities. In the past, these amounts were allocated based on an entity's share of the total liability. Accordingly, MSF restated its beginning net position to reflect this change. The net impact of the adjustment was \$216K.

In addition, MSF corrected an error in the accumulated depreciation balance for one of its assets. This correction required a restatement of beginning net position in the amount of \$2K.

Montana State Fund
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Notes to Financial Statements
December 31, 2020

Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles (GAAP) as prescribed by GASB. MSF insurance operations are classified as one of the State's enterprise funds, in the proprietary fund category. The financial statements in this report reflect the financial position and results of operations and cash flows of MSF for the year ending December 31, 2020.

An enterprise fund is used to account for operations: (a) financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; (b) where laws or regulations require that the activity's costs of providing services be recovered with fees and charges, rather than with taxes or similar revenues; or (c) where the pricing policies of the activity establish fees and charges designed to recover its costs, where the primary focus of these criteria is on fees charged to external users.

Basis of Accounting

MSF uses the accrual basis of accounting, as defined by GAAP, for its workers' compensation insurance operations. Under the accrual basis, revenues are recorded in the accounting period earned, if measurable, and expenses are recorded in the period incurred, if measurable.

Cash and Cash Equivalents

Cash balances include funds held by the State Treasury. Cash equivalents are short-term, highly-liquid investments that are both readily-convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value. MSF participates in the Montana Board of Investments' Short Term Investment Pool (STIP), an external investment pool. STIP is managed and administered under the direction of the Montana Board of Investments (BOI) as authorized by the Unified Investment Program. STIP is a commingled pool for investment purposes and requested redemptions from the pool are redeemed the next business day. The STIP portfolio is reported at net asset value. STIP balance as of December 31, 2020, was \$32.5M.

Investments

MSF holds investments in long-term debt securities, mutual funds, and real estate partnerships through the BOI. Under the provisions of the state constitution, MSF's invested assets are managed by the BOI. Securities are stated at fair value. Premiums and discounts are amortized using the scientific method over the life of the securities.

The investment risk disclosures are described in the following paragraphs.

Credit Risk

Credit risk is the risk that an issuer or other counterparties to an investment will not fulfill its obligation. Except for U.S. Government securities, MSF's fixed income instruments have credit risk as measured by Nationally Recognized Statistical Rating Organizations (NRSRO) ratings. Credit risk is managed by constraining portfolio purchases around investment-grade NRSRO ratings, as appropriate.

Montana State Fund
 (A Component Unit of the State of Montana)
 Notes to Financial Statements
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The U.S. Government guarantees its securities directly or indirectly. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit risk.

MSF's investment policy requires investment grade fixed income investments, at the time of purchase, to be rated investment grade by two NRSROs.

Asset-backed securities are bonds backed by cash flows from principal and interest payments emanating from a trust containing a pool of underlying assets. These securities, while sensitive to prepayments due to interest rate changes, generally have less credit risk than unsecured bonds. Their credit risk is based on the structure itself rather than balance sheet risk. This includes factors such as default rates, over collateralization, and quality of collateral.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, BOI may not be able to recover the value of the investment or collateral securities that are in possession of an outside party. Per policy, BOI's custodial bank must have bank rating from at least two NRSROs on an annual basis.

As of December 31st, all of the public securities, core real estate, and commingled equity index funds were registered in the nominee name for the Montana Board of Investments and held in possession of BOI's custodial bank.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of any single investment per issuer name. Excluded from the concentration of credit risk requirement are investments explicitly guaranteed by the U.S. Government. MSF's investment policy addresses this risk by limiting a maximum of 3% of the market value of the portfolio to any single parent company issuer, foreign/quasi government issuer, or asset backed security specific pool at the time of purchase, with the exception of U.S. Government/Agency securities.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. BOI uses effective duration as a measure of interest rate risk for the MSF portfolio.

MSF's investment policy states the duration is to remain within 20% of the Bloomberg Barclays Intermediate US Aggregate Bond Index benchmark in duration.

According to the STIP Investment Policy, interest rate risk is minimized by:

- 1) structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations, thereby normally avoiding the need to sell securities on the open market prior to maturity;

Montana State Fund
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Notes to Financial Statements
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- 2) maintaining a dollar-weighted average portfolio maturity of 60 days or less ; and
- 3) maintaining a reserve account.

The fixed coupon holdings pay a fixed rate of interest until maturity while floating rate securities pay a variable rate of interest until maturity. The portfolio held certain variable rate issues. Interest payments on these securities are based on an underlying reference rate.

Investments at fair value are categorized to disclose credit risk and interest rate risk on the following table for fixed income securities. Credit risk is disclosed using the weighted credit quality rating by investment type. Interest rate risk is disclosed using weighted effective duration. The credit quality ratings have been calculated excluding non-rated investment types. NRSRO provides the credit ratings presented in the following tables.

<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating</u>	<u>Effective Duration</u>
Treasuries	\$ 249,280,106	AAA	3.75
Agency/Government Related	90,415,335	AAA	3.39
Asset Backed Securities	53,098,530	AAA	2.19
Mortgage Back Securities - Noncommercial	226,375,357	AAA	3.36
Mortgage Back Securities - Commercial	32,722,766	AAA	6.63
Corporate-Financial	228,226,694	A-	3.64
Corporate-Industrial	350,383,303	A-	4.40
Corporate-Industrial (Unrated)	35,648	N/A	—
Corporate-Utility	9,882,552	BBB	3.31
Total Fixed Income Investments	<u>\$ 1,240,420,291</u>		
Short-term Investment Pool (Unrated)	\$ 32,531,366	N/A	0.14

Securities Lending

MSF participates in a securities lending program through the BOI. The BOI is authorized by law to lend its securities and has contracted with the custodial bank, State Street Bank and Trust, to lend securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The custodial bank is required to maintain collateral equal to 102% of the fair value of domestic securities and 105% of the fair value of international securities while the securities are on loan. On any day, including December 31st, the markets may move in a positive or negative direction resulting in under or over collateralization. The custodial bank compensates for market movement by recalculating on the following business day to meet the collateralization requirements. BOI and the custodial bank split the earnings, 80/20% respectively, on security lending activities. BOI retains all rights and risks of ownership during the loan period. The custodial bank indemnifies BOI's credit risk exposure to borrowers.

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During the year, the custodial bank loaned MSF's public securities and received as collateral: U.S. dollar cash; U.S. Government and government-sponsored agency securities; U.S. corporate debt securities and structured securities rated AA-/Aa3 or higher; sovereign debt securities of the Group of Ten nations; and debt securities issued by certain supranational agencies. The custodial bank cannot sell collateral securities unless the borrower defaults.

BOI imposed no restrictions on the number of securities available to lend during the year ended December 31, 2020. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the period that resulted in a declaration and notice of default of the borrower. There were no losses during the year ended December 31, 2020, resulting from a borrower default. As of December 31, no securities were recalled and not yet returned.

The cash collateral received for each loan was invested, together with cash collateral of other qualified plan lenders, in an investment fund, the Navigator Securities Lending Government Money Market (Navigator) portfolio.

The following table presents the market values of the securities on loan and the total collateral held as of December 31, 2020:

	<u>Amount</u>
Fair Value On Loan	\$ 88,622,573
Collateral Cash	4,266,130
Collateral Securities	<u>86,130,523</u>
Collateral Total	\$ 90,396,653
% of Fair Value	102 %

BOI and the borrowers maintain the right to terminate all securities lending transactions on notice. Since the securities lending transactions were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral received from the borrower. As of December 31, 2020, the Navigator portfolio's average duration was .13 days, and its average weighted final maturity was 47 days.

Income earned related to securities lending for the year ended December 31, 2020, was \$252K. Expenses related to securities lending for the year ended December 31, 2020, were \$116K.

Receivables

At December 31, 2020, MSF had a net receivable balance of \$77.8M. The gross receivables for billed premium and claim benefits overpayments are \$4.1M, which are then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of \$2.7M. Other receivables include \$66.4M in unbilled premium, \$7.0M in investment income due, \$213K in retrospective premium and \$533K in notes receivable, all of which are short term. Accounts receivable also includes \$2.3M at December 31, 2020, for premium that is earned but unbilled (EBUB).

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Reinsurance Receivables

As part of the aggregate stop loss reinsurance program, MSF records a receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of a recoverable or in the event of a commutation. The reinsurance receivables were \$65.3M at December 31, 2020.

Equipment, Accumulated Depreciation and Intangible Assets

Equipment and intangible assets are capitalized if the actual or estimated historical unit cost exceeds \$5K and \$100K, respectively. Depreciation expense is computed on a straight-line basis for equipment over a period of three to ten years and amortization of intangible assets is computed on a straight-line basis over four years. Amortization of intangible assets is recorded directly to the asset balance. All fixed assets are shown net of depreciation.

Construction Work in Process

Costs for internally-generated intangible assets exceeding \$500K are capitalized once activities in the preliminary project stage are completed and management authorizes and commits to funding the project. Costs incurred during the design of the chosen path, including software configuration and interfaces, coding, installation of hardware, and testing are capitalized. Amortization begins once the asset is placed in service on a straight-line basis over four years.

Other Assets

Other assets include advances and prepaid expenses.

Land and Buildings

As of December 31, 2020, MSF financial statements include \$1.1M in land and \$22.3M in buildings, net of depreciation. Buildings are depreciated on a straight-line basis over a period of 50 years. For additional disclosure related to capital assets, see Note 3.

Accounts Payable

Accounts payable is a short-term liability account reflecting amounts owed for goods and services received by MSF.

Estimated Claims Payable

The estimated claims payable, also called loss reserves, is established to provide for the estimated ultimate settlement cost of all claims incurred. Estimated claims payable is 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. Willis Towers Watson, an external actuarial firm, prepares an actuarial study that provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. The MSF Board of Directors approved estimates within that range as the

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estimated claims payable for MSF. The claim costs estimated to be paid in the next year are displayed in Current Liabilities as Estimated Claims Payable and the remainder of the total is shown in Noncurrent Liabilities. For additional disclosure related to the estimated claims payable, refer to Note 5.

Unearned Premium

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was \$62.2M at December 31, 2020.

Reinsurance Funds Withheld

Reinsurance funds withheld represents the reinsurance funds held on behalf of the reinsurer, a requirement of MSF's aggregate stop-loss reinsurance contract. Additional information regarding the funds withheld account can be found in Note 4.

Net Position

Net Position consists of the net excess or deficit of assets plus deferred outflows of resources over liabilities plus deferred inflows of resources. Net Position as of December 31, 2020, was \$671.8M.

Premiums

The MSF Board of Directors approves premium rates annually. These rates are then filed with the Montana State Auditor's Office for approval in accordance with MCA, Title 33. Generally, policies are effective for the term of the policy period not to exceed 12 months. Premium revenue is recognized over the term of the policy year as it is earned or when MSF is liable for coverage.

Policyholders are contractually obligated to pay certain premiums to MSF in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by MSF.

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2. Investments

The Company has the following recurring fair value measurements as of December 31, 2020:

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Fixed Income Investments				
Treasuries	\$ 249,280,106	\$ 249,280,106		
Agency/Government related	90,415,335		90,415,335	
Asset-backed securities	53,098,530		53,098,530	
Mortgage-backed securities-noncommercial	226,375,357		226,375,357	
Mortgage-backed securities-commercial	32,722,766		32,722,766	
Corporate-Financial	228,226,694		228,226,694	
Corporate-Industrial	350,418,951		350,418,951	
Corporate-Utility	9,882,552		9,882,552	
Equity investments	219,304,064	219,304,064		
Total investments by fair value level	1,459,724,355	468,584,170	991,140,185	—
<u>Investments measured at the net asset value (NAV)</u>				
Core real estate	97,985,085	None	Quarterly	45-90 days
Cash equivalents held at custodial bank (STIP)	32,531,366	None	Daily	1 day
Total Investments at NAV	130,516,451			
Total investments at fair value	1,590,240,806			
<u>Investments at cost</u>				
Cash and cash equivalents	906,877			
Total investments not categorized	906,877			
Total investments	\$ 1,591,147,683			

MSF categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles as follows:

- Level 1- Quoted prices for identical assets or liabilities in active markets.
- Level 2- Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly.
- Level 3- Prices determined using unobservable inputs.

Fixed income investments classified in Level 1 of the fair value hierarchy are valued using prices quoted

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in active markets for those securities. Fixed income investments classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. MSF does not classify any holdings within Level 3 of the fair value hierarchy.

MSF holds two commingled equity index funds which invest in domestic equities and funds that invest in international equities. The fair values of the investments of this type have been determined using quoted market prices of the underlying securities in each investment pool.

MSF holds five core real estate funds which make equity investments in operating and substantially-leased institutional-quality real estate in the traditional property types (apartments, office, retail, industrial and hotel) through commingled funds. The primary investment objectives of these core real estate funds are to invest in real estate that 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 through the liquidation of the underlying assets of the fund. The fair values of the investments in this category use the NAV per share (or its equivalent) of MSF's ownership interest in the partners' capital. 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.

In October 2019, a full redemption request for approximately \$25 million was submitted for one core real estate fund. As of December 31, 2020, \$1.5 million has been redeemed. BOI is confident that the full redemption will be received over a reasonable period. As of December 31, 2020, there are no unfunded commitments.

The Short Term Investment Program (STIP) is managed and administered under the direction of the BOI as authorized by the Unified Investment Program. It is a commingled pool for investment purposes and requested redemptions from the pool are redeemed the next business day. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment.

The amortized cost and estimated market value of MSF's fixed maturity securities as of December 31, 2020, are shown below at contractual 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.

	<u>Amortized Cost</u>	<u>Market Value</u>
Due one year or less	\$ 101,363,198	\$ 102,573,981
Due after one year through five years	435,793,557	466,577,567
Due after five years through ten years	392,172,639	431,723,681
Due after ten years	234,462,726	239,555,569
Total	<u>\$ 1,163,792,120</u>	<u>\$ 1,240,430,798</u>

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During the year ended December 31, 2020, MSF realized gross gains from sales of securities of \$18.5M and gross realized losses of \$0.8M. During the year ended December 31, 2020, net investment income for MSF was \$113.7M, which is comprised of investment income of \$54.6M and unrealized gains on investments in the amount of \$59.1M.

3. Capital Assets

Capital assets are used for the business activities of MSF. Balances for the year ended December 31, 2020 are as follows:

	Beginning Balances	Increases	Decreases	Ending Balances
Capital assets not being depreciated:				
Land	\$ 1,139,460	\$ —	\$ —	\$ 1,139,460
Construction Work in Process	12,130,231	7,045,726	—	19,175,957
Total capital assets not being depreciated	13,269,691	7,045,726	—	20,315,417
Capital assets being depreciated:				
Buildings/improvements	27,941,323	—	—	27,941,323
Equipment, furniture, and vehicles	7,476,106	424,015	(572,722)	7,327,399
Software	14,328,837	—	—	14,328,837
Intangible right-to-use leased buildings	—	5,263,625	(2,448)	5,261,177
Intangible right-to-use leased equipment	—	77,849	—	77,849
Total capital assets being depreciated	49,746,266	5,765,489	(575,170)	54,936,585
Less accumulated depreciation for:				
Buildings/improvements	(5,087,649)	(530,885)	—	(5,618,534)
Equipment, furniture, and vehicles	(5,544,160)	(636,258)	503,855	(5,676,563)
Software	(14,194,202)	(34,375)	—	(14,228,577)
Intangible right-to-use leased buildings	—	(317,633)	875	(316,758)
Intangible right-to-use leased equipment	—	(32,214)	—	(32,214)
Total accumulated depreciation	(24,826,011)	(1,551,365)	504,730	(25,872,646)
Total capital assets being depreciated, net	24,920,255	4,214,124	(70,440)	29,063,939
Total capital assets, net	<u>\$ 38,189,946</u>	<u>\$ 11,259,850</u>	<u>\$ (70,440)</u>	<u>\$ 49,379,356</u>

4. Reinsurance

For the year ended December 31, 2020, MSF ceded premiums to reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against individual occurrences over stipulated amounts and an aggregate stop loss contract which protects MSF against the potential that aggregate losses will exceed expected levels expressed as a percentage of premiums.

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The excess of loss contract provides coverage up to \$100 million with an MSF retention of \$10 million on the first layer of coverage. The excess of loss protection applies to an individual occurrence with a maximum of \$10 million on any one life.

The term of the current aggregate stop loss contract is January 1, 2020, through January 1, 2021. The contract provides coverage based on MSF's premium levels, not to exceed 15% of the 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.

Premium revenue is reduced by premiums paid for reinsurance coverage of \$8.9M for the year ended December 31, 2020. The aggregate stop loss contract requires that MSF maintain a funds withheld liability account which represents the basic premium portion of the total premium paid for aggregate stop loss coverage. The funds withheld liability account at December 31, 2020, is \$65.3M for contracts in place from July 1, 2012, to December 31, 2020. Interest must be accrued on the funds withheld account which resulted in accrued interest of \$2.8M for the year ended December 31, 2020.

Estimated claim reserves were reduced by \$290K as of December 31, 2020, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excess of loss reinsurance contracts. The estimated claim reserves were not reduced due to the aggregate stop loss contract, as no recoverable amounts are expected at the end of 2020.

As part of the aggregate stop loss reinsurance program, MSF records a reinsurance receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of the recoverable or in the event of a commutation. The reinsurance receivables were \$65.3M at December 31, 2020.

MSF also has assumed reinsurance relationships with Zurich American Insurance Company and Argonaut Insurance Company related to Other States' Coverage (OSC). MSF assumes risk related to Montana-domiciled businesses with operations in other states, which are then covered under MSF's ceded reinsurance contract. For the year ended December 31, 2020, assumed premium is \$2.8M and incurred losses from OSC benefits were \$1.0M. The assumed liability for OSC claims was \$3.7M at December 31, 2020.

5. Risk Management

MSF provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the MSF financial statements. At December 31, 2020, approximately 23,000 active policies were insured by MSF.

MSF is a self-supporting, competitive workers' compensation carrier and functions as the guaranteed market insurer for employers since workers' compensation coverage is mandated in Montana. Employers may obtain coverage through private carriers, through MSF, or through self-funding if they meet certain criteria. State of Montana agencies are required by law to insure through MSF.

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Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other social and economic factors. Willis Towers Watson, an external actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of December 31, 2020. Because actual claim costs depend on such complex factors such as inflation, duration, 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. A provision for inflation is implicit in the calculation of estimated future claim costs because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Willis Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims, and IBNR. The MSF Board of Directors approved an estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for December 31, 2020. The MSF estimated unpaid claims and claims adjustment expenses payable presented at face value, net of estimated reinsurance recoverable were \$940.2M, as of December 31, 2020. The Statement of Net Position displays this total separated as current and noncurrent estimated claims payable.

State law (Section 39-71-2311, MCA) 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. Anticipated investment income is considered when computing premium rate levels. State law also requires the MSF Board of Directors to establish surplus above risk-based capital requirements to secure MSF against risks inherent in the business of insurance.

Changes in Claims Liabilities

The following table presents changes in the aggregate liabilities for MSF, net of estimated reinsurance recoverable. The information presented has not been discounted.

	<u>2020</u>
Unpaid claims and claim adjustment expenses at beginning of period	\$ 956,593,643
Incurred claims and claim adjustment expenses:	
Provision for insured events of the current year	125,599,500
Increase(Decrease) in provision for events in prior years	<u>(27,224,320)</u>
Total incurred claims and claim adjustment expenses	98,375,180
Payments:	
Claims and claim adjustment expenses attributable to insured events of the current year	(23,890,295)
Claims and claim adjustment expenses attributable to insured events of prior years	<u>(90,917,771)</u>
Total payments	(114,808,066)
Total unpaid claims and claim adjustment expenses at the end of the period	<u><u>\$ 940,160,757</u></u>

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6. Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990, (Old Fund) from those occurring on or after July 1, 1990, (MSF). MSF allocated \$601K in administration costs to the Old Fund for the year ended December 31, 2020. The administration costs are recorded in non-operating revenue as other income. The State of Montana General Fund is responsible for the cost of administering and paying the Old Fund claim benefits.

7. MSF Distributions

The MSF Board of Directors declared a \$20M dividend in September 2020. As of December 31, 2020, \$34K remained unpaid.

8. Compensated Absences

MSF supports two leave programs, the State of Montana Leave Program (Traditional Plan) and the MSF Personal Leave Program, implemented in January 2002. The State of Montana Leave Program covers union represented employees who have elected to remain in the plan. These employees 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 non-exempt employees in the Traditional Plan. The MSF Personal Leave Program covers all non-union employees, union employees hired before July 26, 2006, who have elected to adopt the plan, and all employees hired on or after July 26, 2006. Employees in the Personal Leave Program accumulate personal leave and extended leave. MSF pays employees for 100% of unused personal leave upon termination, but extended leave has no cash value at the time of termination.

The total MSF compensated absences liability is \$4.0M as of December 31, 2020.

9. Retirement Plans

MSF and its employees contribute to the Public Employees' Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB), a defined benefit retirement plan (PERS-DBRP) and a defined contribution retirement plan (PERS-DCRP).

Defined Benefit Retirement Plan

Benefits provided. The PERS-DBRP is a multiple-employer, cost-sharing plan that provides retirement, disability, and death benefits to plan members and their beneficiaries. Benefits are established in state law and may only be amended by the State of Montana Legislature. Members are vested after five years of membership service, which entitles the member to an accrued normal retirement benefit payable at age 60 (or age 65 if hired after June 30, 2011). A member may receive a refund of accumulated contributions in lieu of a pension, thereby forfeiting the right to a monthly benefit. A description of the benefits and eligibility rules for the plan are shown in the following table:

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Eligibility for benefit

Service retirement:

- Hired prior to July 1, 2011: Age 60, 5 years of membership service; Age 65, regardless of membership service; or Any age, 30 years of membership service.
- Hired on or after July 1, 2011: Age 65, 5 years of membership service; Age 70, regardless of membership service.

Early retirement:

- Hired prior to July 1, 2011: Age 50, 5 years of membership service; or Any age, 25 years of membership service.
- Hired on or after July 1, 2011: Age 55, 5 years of membership service.

Second Retirement (requires returning to PERS-covered employer or PERS service):

Retire before January 1, 2016, and accumulate less than 2 years additional service credit or retire on or after January 1, 2016, and accumulate less than 5 years additional service credit:

- A refund of member's contributions plus return interest (currently 2.02% effective July 1, 2018).
- No service credit for second employment;
- Start the same benefit amount the month following termination; and
- Guaranteed Annual Benefit Adjustment (GABA) starts again in the January immediately following the second retirement.

Retire before January 1, 2016, and accumulate at least 2 years of additional service credit:

- A recalculated retirement benefit based on provisions in effect after the initial retirement; and
- GABA starts on the recalculated benefit in the January after receiving the new benefit for 12 months.

Retire on or after January 1, 2016, and accumulate 5 or more years of service credit:

- The same retirement as prior to the return to service;
- A second retirement benefit as prior to the second period of service based on laws in effect upon the rehire date; and
- GABA starts on both benefits in the January after receiving the original and the new benefit for 12 months.

Member's highest average compensation (HAC)

- Hired prior to July 1, 2011 - highest average compensation during any consecutive 36 months;

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- Hired on or after July 1, 2011 – highest average compensation during any consecutive 60 months;

Compensation Cap

- Hired on or after July 1, 2013 – 110% annual cap on compensation considered as a part of a member's highest average compensation.

Monthly benefit formula

- Members hired prior to July 1, 2011
 - Less than 25 years of membership service: 1.785% of HAC per year of service credit;
 - 25 years of membership service or more: 2% of HAC per year of service credit.
- Members hired on or after July 1, 2011
 - Less than 10 years of membership service: 1.5% of HAC per year of service credit;
 - 10 years or more, but less than 30 years of membership service: 1.785% of HAC per year of service credit;
 - 30 years or more of membership service: 2% of HAC per year of service credit.

Guaranteed Annual Benefit Adjustment (GABA)

After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage (provided below) each January, inclusive of all other adjustments to the member's benefit.

- 3.0% for members hired prior to July 1, 2007
- 1.5% for members hired between July 1, 2007, and June 30, 2013
- Members hired on or after July 1, 2013:
 - a. 1.5% for each year PERS is funded at or above 90%;
 - b. 1.5% reduced by 0.1% for each 2.0% PERS is funded below 90%; and
 - c. 0% whenever the amortization period for PERS is 40 years or more.

There have been no changes to benefit terms since the prior measurement date.

Contributions. Contribution requirements for the plan are established in Montana Code Annotated Title 19, Chapter 3, Part 3, and can only be amended by the State of Montana Legislature. All members contribute 7.9% of their compensation. This is a temporary 1% increase for members hired prior to July 1, 2011, and remains the same for members hired on or after July 1, 2011. Interest is credited to member accounts at the rates determined by the PERB. All member contributions will be decreased to 6.9% on January 1 following the actuarial valuation results that project the amortization period to drop below 25 years and remain below following the termination of the 1% additional member contribution rate.

MSF contributes 8.77% of each member's compensation. This was increased from 6.9% to 7.035% on July 1, 2007, 7.17% on July 1, 2009, and to 8.17% on July 1, 2013. The rate will continue to increase .1% each year until 2024. These increased contributions will terminate on January 1 following the actuarial valuation results that project the amortization period to drop below 25 years and remain below following the termination of the additional employer contribution rates. The State also contributes a statutory appropriation from the general fund. The plan recognized \$1,648,568 in MSF (employer) contributions

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during the plan year ended June 30, 2020.

Actuarial assumptions. The Total Pension Liability (TPL) used to calculate the Net Pension Liability (NPL) was determined by taking the results of the June 30, 2019, actuarial valuation and applying standard roll forward procedures to update the TPL to June 30, 2020. There were several significant assumptions and other inputs used to measure the TPL. The actuarial assumptions used in the June 30, 2020, valuation were based on the results of the last actuarial experience study, dated May 2017, for the six- year period July 1, 2010 to June 30, 2016. Among those assumptions were the following:

- Investment Return (net of admin expense) 7.34%
- Admin Expense as % of Payroll 0.30%
- General Wage Growth (includes inflation at 2.40%) 3.50%
- Merit Increases 0% to 4.8%
- Postretirement Benefit Increases:
 Guaranteed Annual Benefit Adjustment (GABA)
 After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage each January, inclusive of other all adjustments to the member's benefit.
 - 3.0% for members hired prior to July 1, 2007
 - 1.5% for members hired between July 1, 2007, and June 30, 2013
 - Members hired on or after July 1, 2013:
 - (•) 1.5% for each year PERS is funded at or above 90%;
 - (•) 1.5% reduced by 0.1% for each 2.0% PERS is funded below 90%; and
 - (•) 0% whenever the amortization period for PERS is 40 years or more.
- Mortality assumptions among contributing members, terminated vested members, service retired members and beneficiaries were based on RP 2000 Combined Employee and Annuitant Mortality Tables projected to 2020 with scale BB, males set back 1 year.
- Mortality assumptions among disabled members were based on RP 2000 Combined Health Mortality Tables with no projections.

Since the last actuarial valuation, the discount rate was lowered from 7.65% to 7.34%, the investment rate of return was lowered from 7.65% to 7.34%, and the inflation rate was reduced from 2.75% to 2.40%.

Discount rate. The discount rate used to measure the TPL was 7.34%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities would be made based on the Board's funding policy, which established the contractually required rates under the Montana Code Annotated. The State contributed 0.10% of the salaries paid by local governments and 0.37% paid by school districts. In addition, the State contributed a statutory appropriation from the general fund. Based on those assumptions, the Plan's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2123. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the TPL. A municipal bond rate was not incorporated in the discount rate.

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The long-term expected return on pension plan assets was reviewed as part of the regular experience study prepared for the Plan. The most recent analysis, performed for the period of July 1, 2010, to June 30, 2016, was outlined in a report dated May 2017 and can be located on the MPERA website. The long-term expected rate of return on pension plan investments was determined by considering information from various sources, including historical rates of return, rate of return assumptions adopted by similar public sector systems, and by using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation as of June 30, 2020, are summarized below.

Asset Class	Target Allocation	Expected Rate of Return
Cash	2.0 %	0.11 %
Domestic Equity	30.0 %	6.19 %
International Equity	16.0 %	6.92 %
Private Investments	14.0 %	10.37 %
Natural Resources	4.0 %	3.43 %
Real Estate	9.0 %	5.74 %
Core Fixed Income	20.0 %	1.57 %
Non-Core Fixed Income	5.0 %	3.97 %
Total	100.0 %	

The following table displays MSF's proportionate share of the net pension liability using the 7.34% discount rate as well as the proportionate share using 6.34% and 8.34%, a decrease of 1% and an increase of 1%, respectively.

	1% Decrease (6.34%)	Discount Rate (7.34%)	1% Increase (8.34%)
MSF's Proportionate Share of the Net Pension Liability	\$40,724,420	\$29,586,757	\$20,231,197

Plan fiduciary net position. The financial statements of the Montana Public Employees Retirement Board (PERB) Comprehensive Annual Financial Report (CAFR) and the GASB 68 Report disclose the Plan's fiduciary net position. The reports are available from the PERB at PO Box 200131, Helena MT 59620-0131, (406) 444-3154 or both are available on the MPERA website at <http://mpera.mt.gov>

Pension liabilities, expense, and deferred inflows and outflows of resources. At December 31, 2020, MSF reported a liability for its proportionate share of the plan's total net pension liability based on the ratio of MSF's contributions to the sum of all employer and non-employer contributions during the measurement

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period. The State of Montana's proportionate share associated with MSF represents the ratio of contributions for MSF to the total State contributions paid. The following table displays the proportionate shares:

	Net Pension Liability	Percent of Collective NPL	Change in Percent of Collective NPL Since Prior Meas.
MSF Proportionate Share	\$ 29,586,757	1.121470 %	(0.022519)%
State of Montana Proportionate Share Associated with MSF	8,969,480	0.339983 %	(0.018547)%
Total	\$ 38,556,237	1.461453 %	(0.041066)%

The NPL was measured as of June 30, 2020, and the TPL used to calculate the NPL was determined by an actuarial valuation as of June 30, 2019, with updated procedures used to roll forward the liability to June 30, 2020. There were no significant events between the measurement date and reporting date that are expected to have an impact on MSF's proportionate share of the liability.

For the year ended December 31, 2020, MSF recognized pension expense of \$5,142,097, consisting of \$3,675,210 for its proportionate share of the Plan's pension expense and \$1,466,887 for the support provided by the State of Montana General Fund. At December 31, 2020, MSF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experiences	\$ 477,591	\$ 845,930
Changes of assumptions	2,048,770	—
Actual vs. Expected Investment Earnings	2,561,949	—
Changes in Proportion and Differences Between Actual Contributions and Proportionate Share Contributions	—	1,515,833
Contributions Subsequent to the Measurement Date	844,519	—
Total	<u>\$ 5,932,829</u>	<u>\$ 2,361,763</u>

The \$844,519 reported as deferred outflows of resources related to pensions resulting from MSF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

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State of Montana's year ended June 30:	
2021	\$ (283,398)
2022	\$ 1,474,708
2023	\$ 895,166
2024	\$ 640,071
Thereafter	\$ —

Defined Contribution Retirement Plan

The PERS-DCRP is a multiple-employer plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefit terms are established in state law by the State of Montana Legislature. Those terms are as follows:

Eligibility for benefit

Termination of service

Vesting

Immediate for participant's contributions and attributable income;
5 years of membership service for the employer's contributions to individual accounts and attributable income.

Benefit

Depends upon eligibility and individual account balance;
various payout options are available, including: taxable lump sums, periodic payments per participant direction and IRS permitted rollovers.

Member and employer contribution rates are established in state law by the State of Montana Legislature. The member contribution rate for the year ended December 31, 2020, was 7.9% of member compensation, while the MSF contribution rate was 8.77% of member compensation for the first half of the year and 8.87% for the second half. Both the member and employer rates have been temporarily increased by the Legislature and will decrease to 6.9% on January 1 following actuarial valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and will remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

For the year ended December 31, 2020, MSF contributed \$2.0M to the defined benefit and defined contribution plans combined. MSF cannot determine the portion of that total that relates to the defined contribution plan. Of that amount, \$73K remains outstanding at December 31, 2020.

Deferred Compensation Plan

MSF and its employees are eligible to participate in the State of Montana 457(b) Deferred Compensation Plan administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred

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supplemental retirement plan sponsored by the Montana Public Employee Retirement Board and held in trust for the exclusive benefit of public employees and their beneficiaries. The Plan is authorized by IRC Section 457(b) and is subject to specific Internal Revenue Service's laws and requirements. It allows employees to voluntarily contribute a portion of their compensation on a pre-tax basis. The amount invested, plus interest credited on any fixed options and any gain on the variable options, is not taxable until withdrawn at a future date. MSF incurs no costs for this plan. A summary of eligibility and benefits is shown in the following table:

Contribution

Voluntary, pre-tax deferral or designated Roth contribution.

Eligibility for benefit

Not available to participant until separation from service, retirement, death, or upon an unforeseeable emergency, while still employed, provided IRS-specified criteria are met.

Vesting

Participants are fully vested in their accounts immediately.

Benefit

Lump sum or periodic benefit payment at the option of the participant. Based on individual account balances and plan provisions. IRS permitted rollovers are also possible.

10. Leases and Commitments

During 2020, MSF early-adopted GASB Statement No. 87, *Leases*. Accordingly, for all of its long-term leases, MSF created a right-to-use lease asset and a lease liability. The assets are amortized over the term of the lease, while the liabilities are reduced as scheduled lease payments are made. The total amount of lease assets and associated accumulated amortization by major asset class are disclosed in Note 3.

MSF leases office facilities outside of Helena, minor office equipment, and 350 parking spaces from the City of Helena in a parking garage adjacent to the MSF facility. The cost of the parking spaces is the same monthly rate as equivalent parking passes sold by the City and has the potential to change based on parking rates assigned by the Helena Parking Commission until the lease expires on June 30, 2040.

The future principal and interest requirements for all in-force leases are as follows:

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	Principal	Interest	Total
2021	\$ 265,169	\$ 111,646	\$ 376,815
2022	250,062	104,764	354,826
2023	221,737	99,032	320,769
2024	220,992	94,008	315,000
2025	225,943	89,057	315,000
2026 - 2030	1,207,935	367,065	1,575,000
2031 - 2035	1,349,422	225,578	1,575,000
2036 - 2040	1,192,481	67,519	1,260,000
	<u>\$ 4,933,741</u>	<u>\$ 1,158,669</u>	<u>\$ 6,092,410</u>

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 in 2021 and total expenditures are estimated to be \$39.2M. The total project cost through December 31, 2020 was \$33.3M. The next phase to develop remaining enhancement features will be planned and arranged with consulting services towards the end of 2021. Costs during the application development phase are being capitalized and recorded as construction work in process until the system is deployed.

11. Other Post-Employment Benefits (OPEB)

MSF participates in a single-employer, defined-benefit post-employment healthcare plan administered by the State of Montana. In accordance with Section 2-18-704, MCA, the plan provides optional post-employment medical, dental, and vision benefits to eligible MSF retirees and their dependents, as well as surviving dependents of deceased employees. In accordance with GASB Statement 75, MSF is required to report in its financial statements its proportionate share of the collective total OPEB liability, OPEB expense, and deferred inflows and outflows of resources related to OPEB.

OPEB Plan Description

The plan allows retirees to participate in the State health insurance plan, as a group, at a rate that does not cover all the related costs. Retirees pay their entire administratively-determined premium. Accordingly, reported contributions are not a result of direct funding to the plan or for associated liabilities, but are a measure of the difference in retiree payments into the plan and actual medical costs associated with those individuals paid for by the plan.

The plan is not administered through a trust and therefore there are no accumulated plan assets to offset the total OPEB liability. The plan is funded on a pay-as-you-go-basis, and Section 2-18-8, MCA, gives authority for establishing and amending the funding policy of the State group health insurance plan to the Montana Department of Administration.

As of December 31, 2020, the OPEB plan's administratively established retiree medical premiums vary between \$457.00 and \$2,172.00 per month, depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between \$41.10 and \$70.00 and

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vision hardware premiums vary between \$7.64 and \$22.26, depending on the coverage selected. The plan provides different coinsurance amounts and deductibles depending on whether members use in-network or out-of-network providers. The plan automatically reduces claim reimbursement for members eligible for Medicare, even if the member is not enrolled in Medicare.

Schedule of Changes in OPEB Liability

The following schedule presents the change in MSF's proportionate share of the total OPEB liability (TOL). As of the measurement date, MSF's share of the TOL is 1.94%, based on the number of total plan participants. MSF's share of the TOL increased .10% since the prior measurement date.

December 31, 2019 Balance	\$ 811,797
Changes for the year:	
Service cost	37,879
Interest	23,366
OPEB expense	<u>61,245</u>
Benefit payments	(11,927)
Difference between expected and actual experience	95,831
Changes of assumptions or other inputs	<u>(37,272)</u>
December 31, 2020 Balance	<u><u>\$ 919,674</u></u>

Actuarial Assumptions

The plan's TOL was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

Valuation date	December 31, 2019
Measurement date	March 31, 2020
Cost method	Entry age normal funding method
Amortization method	Open basis
Remaining amortization period	20 years
Asset valuation method	N/A - no plan assets
Discount rate	2.75%
Projected payroll increases	2.50%
Participation:	
Future retirees	40.00%
Future eligible spouses	70.00%
Marital status at retirement	70.00%

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Health Care Cost Trend Rate: The following health care cost trend rates were used:

<u>Plan Year</u>	<u>Medical</u>	<u>Prescription Drug</u>
2020	6.0%	9.0%
2021	6.0%	8.5%
2022	5.9%	5.9%
2023	5.8%	5.8%
2024	5.7%	5.7%
2025	5.6%	5.6%
2026	5.5%	5.5%
2027	5.4%	5.4%
2028	5.3%	5.3%

Mortality - Healthy: Healthy mortality is assumed to follow the RP2000 Combined Mortality Table with improvements projected to Scale BB to 2020, set back one year for males.

Mortality - Disabled: Disabled mortality is assumed to follow the RP2000 Combined Mortality Table with no projections.

Changes in actuarial assumptions and methods since last measurement date: Changes in actuarial assumptions include a reduction in the participation rate from 55% to 40%, revisions to the rates per the retirement system pension valuations as of July 1, 2019, and revised interest rate based upon the average of multiple March 31, 2020 municipal bond rate sources.

Changes in benefit terms since last measurement date: None.

Rate Sensitivity

The following tables present MSF's proportionate share of the TOL calculated using a healthcare cost trend and discount rate that are 1% higher and 1% lower than the assumed rates:

	<u>Healthcare Cost Trend Rate</u>		
	<u>1% Decrease</u>	<u>Assumed rate</u>	<u>1% Increase</u>
	<u>5.0%</u>	<u>6.0%</u>	<u>7.0%</u>
Proportionate share of OPEB liability (in thousands)	\$ 697,743	\$ 919,674	\$ 1,231,303

	<u>Discount Rate</u>		
	<u>1% Decrease</u>	<u>Assumed rate</u>	<u>1% Increase</u>
	<u>1.75%</u>	<u>2.75%</u>	<u>3.75%</u>
Proportionate share of OPEB liability (in thousands)	\$ 1,220,228	\$ 919,674	\$ 698,846

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Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At December 31, 2020, MSF's proportionate share of the plan's deferred outflows and inflows of resources are as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 88,219	\$ (70,574)
Changes of assumptions or other inputs	329,519	(320,793)
Transactions subsequent to the measurement date	9,582	—
Total	\$ 427,320	\$ (391,367)

Net deferred outflows and inflows of resources will be recognized as OPEB expense as follows:

State of Montana's year ended June 30:

2021	\$ 1,453
2022	\$ 1,453
2023	\$ 1,453
2024	\$ 1,453
2025	\$ 1,453
Thereafter	\$ 19,106

12. Contingencies

Montana State Fund management is closely monitoring the impacts of the world-wide coronavirus pandemic and is actively working to minimize the current and future impact of this unprecedented situation on business operations. As of the date of issuance of these financial statements, the Company has not experienced a major detrimental impact. However, given the current economic climate, there are risks and uncertainties related to this matter.

At times Montana State Fund is involved in 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.

13. 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 service charges.

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The following significant transactions occurred with state agencies during the year ended December 31, 2020:

Income:	
Premium	\$ 11,731,492
Retrospective premium	(790,000)
Dividends	(841,692)
Old Fund administrative cost allocation	601,159
Net income from State of Montana agencies	<u>\$ 10,700,959</u>
Expenses:	
Montana Department of Administration	
Support services costs	\$ 2,196,058
Benefits Bureau: group insurance	3,582,477
PERS retirement contributions	1,994,463
Montana Department of Labor & Industry - unemployment insurance	36,477
Montana Board of Investments - transaction fees	433,182
Montana Department of Justice - workers' comp fraud investigation services	300,200
Montana Commissioner of Securities and Insurance - regulation fees	237,737
Montana - various other	39,742
Expenses paid to State of Montana agencies	<u>\$ 8,820,336</u>

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.

14. Subsequent Events

MSF evaluated its financial statements for subsequent events through July 1, 2021, which is the date of financial statement issuance.

The MSF Board of Directors declared a \$20M dividend at its March 12, 2021 board meeting. The dividend was issued in May 2021 to eligible policyholders for the 2018 policy year.

REQUIRED SUPPLEMENTARY INFORMATION**Risk Management (Financial Statement Note 5)**

The following table illustrates how MSF's earned revenues plus investment income compare to related costs of loss and other expenses incurred for fiscal years 2012 through 2015, the six-month period ended December 31, 2015 (shown as 2015.5), and calendar years 2016 through 2020. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims trends. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

Risk Management Trend Information**(In Thousands)**

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2015.5*</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
1. Premiums and Investment Revenue									
Earned	198,151	195,854	208,125	201,969	107,497	200,491	191,289	191,363	172,017
Ceded	11,501	8,459	9,460	11,310	5,545	9,841	10,007	9,552	8,905
Net Earned	<u>186,650</u>	<u>187,395</u>	<u>198,665</u>	<u>190,659</u>	<u>101,952</u>	<u>190,650</u>	<u>181,282</u>	<u>181,811</u>	<u>163,112</u>
2. Unallocated expenses including overhead	49,557	49,515	46,206	52,570	27,822	74,235	77,032	60,848	61,657
3. Estimated losses and expenses, end of accident year									
Incurred	118,066	128,522	139,145	124,831	66,142	126,403	126,243	119,507	115,909
Ceded	<u>1,099</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net Incurred	<u>116,967</u>	<u>128,522</u>	<u>139,145</u>	<u>124,831</u>	<u>66,142</u>	<u>126,403</u>	<u>126,243</u>	<u>119,507</u>	<u>115,909</u>
4. Net paid (cumulative) as of:									
End of policy year	24,729	25,706	26,808	24,150	16,181	24,597	22,903	24,965	23,890
One year later	54,982	50,574	55,957	59,787	27,202	56,481	49,584	51,945	
Two years later	70,487	64,327	74,159	60,844	35,629	71,008	64,901		
Three years later	80,144	73,805	75,811	70,093	39,857	83,149			
Four years later	85,661	74,955	81,706	75,235	41,957				
Five years later	88,453	78,447	85,888	80,235	43,334				
Six years later	92,201	80,123	87,736	82,318					
Seven years later	93,719	81,124	89,014						
Eight years later	95,222	82,413							
Nine years later	97,135								
5. Re-estimated ceded losses and expenses	9,639	—	—	—	—	—	—	—	—
6. Re-Estimated net incurred losses and expense:									
End of policy year	116,967	128,522	139,145	124,831	66,142	126,403	126,243	119,507	115,909
One year later	130,507	123,912	134,698	140,598	69,180	139,589	137,713	118,725	
Two years later	130,281	119,972	136,257	120,835	66,085	135,801	121,459		
Three years later	119,821	120,415	126,431	118,624	69,645	124,105			
Four years later	119,313	115,453	125,011	122,442	67,061				
Five years later	115,802	113,205	126,465	119,045	63,438				
Six years later	115,694	113,265	124,773	116,299					
Seven years later	116,321	112,825	121,594						
Eight years later	117,120	110,085							
Nine years later	115,316								
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(1,650)	(18,437)	(17,551)	(8,532)	(2,704)	(2,299)	(4,784)	(783)	—

* Column represents the six-month period ended December 31, 2015.

Retirement Plans (Financial Statement Note 9)

Schedule of MSF's Proportionate Share of the Net Pension Liability*

June 30:	2020	2019	2018	2017	2016	2015	2014
Proportion of the Net Pension Liability	1.12 %	1.14 %	1.14 %	1.44 %	1.39 %	1.39 %	1.35 %
Proportionate Share of the Net Pension Liability	\$29,586,757	\$23,912,918	\$31,263,987	\$28,106,689	\$23,678,261	\$19,369,771	\$16,863,200
Defined Benefit Pensionable Payroll	\$18,635,965	\$18,657,942	\$18,494,222	\$17,690,906	\$16,452,061	\$15,976,817	\$15,340,151
Proportionate Share as % of Pensionable Payroll	158.76 %	128.16 %	128.23 %	158.88 %	143.92 %	121.24 %	111.22 %
Plan Fiduciary Net Position as a % of Total Pension Liability	68.90 %	73.85 %	73.47 %	73.75 %	74.71 %	78.40 %	79.87 %
June 30:	2020	2019	2018	2017	2016	2015	2014
Contractually Required Contributions	\$1,648,568	\$1,623,434	\$1,582,700	\$1,498,428	\$1,391,782	\$1,332,551	\$1,351,735
Plan Choice Rate Required Contributions	—	—	—	—	69,744	110,334	—
Contributions in Relation to the Contractually Req. Contributions	1,648,568	1,623,434	1,582,700	1,498,428	1,461,526	1,442,885	1,351,735
Contribution Deficiency (Excess)	—	—	—	—	—	—	—
Defined Benefit Pensionable Payroll	18,635,965	18,657,942	18,494,222	17,690,906	16,452,061	15,976,817	15,132,665
Proportionate Share as % of Pensionable Payroll	8.85 %	8.70 %	8.56 %	8.47 %	8.88 %	9.03 %	8.93 %

*This schedule is intended to show ten years of data. Additional years will be presented as they become available.

Other Post-Employment Benefits (Financial Statement Note 11)

In accordance with GASB 75, the following information is presented to reflect the funding progress of the OPEB plan. There are no assets accumulated in a trust that meets the criteria of GASB 75 paragraph 4 with which to pay benefits.

Schedule of Funding Progress*

	2020	2019	2018
Proportion of TOL	1.94 %	1.84 %	1.41 %
Proportionate share of TOL	\$ 919,674	\$ 811,797	\$ 713,776
Covered-employee payroll	\$21,643,005	\$22,479,877	\$22,248,980
Proportionate share of TOL as % of covered-employee payroll	4.25 %	3.61 %	3.21 %

*This schedule is intended to show ten years of data. Additional years will be presented as they become available.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Montana State Fund, as of and for the calendar year ended December 31, 2020, and the related notes to the financial statements, which collectively comprise the Montana State Fund's basic financial statements, and have issued our report thereon dated July 1, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Montana State Fund's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Montana State Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of Montana State Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify

any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Montana State Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Montana State Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

July 1, 2021

MONTANA STATE FUND

STATE FUND RESPONSE



P.O. Box 4759, Helena, MT 59604-4759
Customer Service 800-332-6102
Fraud Hotline 888-682-7463
(888-MT-CRIME)
montanastatefund.com

August 13, 2021

Mr. Angus Maciver
Legislative Auditor
Legislative Audit Division
State Capitol Building, Room 106
Helena, MT 59620-1705

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AUG 13 2021
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

Montana State Fund (MSF) appreciates the professionalism and work of the Legislative Audit Division staff in completing the financial-compliance audit of our calendar year 2020 governmental financial statements. We are pleased that Legislative Audit Division issued an unmodified opinion with no recommendations.

The management and staff of MSF continually strive to improve our operation and prioritize high-level service to Montana employers and employees. We thank the Legislative Audit Division for its assurance and assistance in achieving our vision to be an indispensable partner in achieving a safer, healthier and more prosperous Montana.

Sincerely,

A blue ink signature of Laurence A. Hubbard, written in a cursive style.

Laurence A. Hubbard
President/CEO

Our vision: To be an indispensable partner in achieving a safer, healthier and more prosperous Montana.