KENTUCKY EMPLOYERS' MUTUAL INSURANCE AUTHORITY dba KENTUCKY EMPLOYERS' MUTUAL INSURANCE

Statutory Basis Financial Statements and Supplementary Information

Years Ended December 31, 2018 and 2017
with Report of Independent Auditors

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Report of Independent Auditors

Board of Directors
Kentucky Employers' Mutual Insurance Authority dba
Kentucky Employers' Mutual Insurance
Lexington, Kentucky

Report on the Financial Statements

We have audited the accompanying statutory basis financial statements of Kentucky Employers' Mutual Insurance Authority dba Kentucky Employers' Mutual Insurance (KEMI), which comprise the statements of admitted assets, liabilities and policyholder surplus - statutory basis as of December 31, 2018 and 2017, the related statements of income - statutory basis, changes in policyholder surplus - statutory basis, and cash flows - statutory basis for the years then ended, and the related notes to the statutory basis financial statements (collectively, the 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 the accounting practices prescribed or permitted by the Department of Insurance of the Commonwealth of Kentucky. Management is also responsible for the design, implementation and maintenance of internal control 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 audits. We conducted our audits 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 control relevant to the entity'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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2 of the financial statements, the financial statements are prepared by KEMI on the statutory basis of accounting prescribed or permitted by the Department of Insurance of the Commonwealth of Kentucky, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statements of the variances between these statutory basis accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of KEMI as of December 31, 2018 and 2017, or the results of its operations or its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and policyholder surplus of KEMI as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying Summary Investment Schedule as of December 31, 2018, Supplemental Investment Risks Interrogatories as of December 31, 2018 and for the year then ended, and Reinsurance Interrogatories as of December 31, 2018 (collectively, Supplementary Information) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Supplementary Information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The effects on the Supplementary Information of the variances between the statutory basis accounting practices and the accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. As a consequence, the Supplementary Information does not present fairly, in conformity with accounting principles generally accepted in the United States of America, such information of KEMI as of December 31, 2018 and for the year then ended. The Supplementary Information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to the prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplementary Information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2019 on our consideration of KEMI'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 solely 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 the effectiveness of KEMI's 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 KEMI's internal control over financial reporting and compliance.

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
March 28, 2019

KENTUCKY EMPLOYERS' MUTUAL INSURANCE AUTHORITY dba
KENTUCKY EMPLOYERS' MUTUAL INSURANCE

Statements of Admitted Assets, Liabilities and Policyholder Surplus - Statutory Basis

December 31, 2018 and 2017

	2018	2017
Admitted Assets		
Long-term bonds	**$ 838,021,650**	$ 803,970,573
Common stock	**70,699,997**	60,542,661
Cash, cash equivalents, and short-term investments	**35,224,679**	32,872,947
Real estate	**5,020,818**	5,020,818
Other invested assets	**13,082,901**	9,235,298
Investment income due and accrued	**6,309,754**	5,352,520
Premiums in course of collection	**12,652,243**	10,501,158
Premiums booked but deferred and not yet due	**46,897,826**	39,725,019
Reinsurance receivable on losses and loss adjustment expenses	**56,225**	79,517
Electronic data processing equipment at cost, less accumulated depreciation of $3,124,780 and $3,073,988 in 2018 and 2017, respectively	**19,142**	57,558
Receivables for retroactive reinsurance reserves assumed	**15,051,836**	26,615,629
Total admitted assets	**$ 1,043,037,071**	$ 993,973,698
Liabilities and Policyholder Surplus		
Unpaid losses, net	**$ 584,639,044**	$ 558,327,157
Unpaid loss adjustment expenses, net	**48,643,467**	43,558,258
Commissions payable	**12,699,833**	10,841,626
Unearned premiums	**74,838,627**	71,487,584
Amounts withheld or retained for others	**13,381,070**	10,571,124
Reinsurance premiums payable	**192,229**	459,627
Funds withheld under reinsurance treaties	**866,624**	459,642
Remittances and items not allocated	**817,173**	842,533
Retroactive reinsurance reserves assumed	**70,734,602**	69,023,448
Retroactive reinsurance reserve ceded	**(14,115,842)**	(22,982,011)
Funds withheld on retroactive reinsurance ceded	**18,028,065**	25,544,461
Minimum pension and postretirement benefits	**10,852,340**	13,537,265
Payable for securities purchased	**500,000**	-
Other liabilities	**5,156,920**	5,556,573
Total liabilities	**827,234,152**	787,227,287
Policyholder surplus	**215,802,919**	206,746,411
Total liabilities and policyholder surplus	**$ 1,043,037,071**	$ 993,973,698

See accompanying notes.

KENTUCKY EMPLOYERS' MUTUAL INSURANCE AUTHORITY dba
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Statements of Income - Statutory Basis

Years ended December 31, 2018 and 2017

	2018	2017
Premiums earned:		
Direct	$ 159,779,512	$ 155,029,740
Assumed	3,058,135	3,332,996
Ceded	(5,085,545)	(4,661,047)
	157,752,102	153,701,689
Losses and loss adjustment expenses incurred:		
Direct	103,488,146	110,293,383
Assumed	642,988	3,622,557
Ceded	(2,079,575)	(1,616,306)
Loss adjustment expenses, net of ceded	28,297,970	18,814,327
	130,349,529	131,113,961
Commissions and brokerage fees	18,791,004	18,070,645
Other underwriting expenses	15,352,948	17,778,965
Total underwriting expenses	164,493,481	166,963,571
Net underwriting loss	(6,741,379)	(13,261,882)
Investment income, net of investment expenses of $1,461,328 and $1,636,862 in 2018 and 2017, respectively	25,058,082	22,813,377
Net realized capital gains	5,806,415	5,304,734
Pension and postretirement benefits expense	(2,485,223)	(3,762,569)
Bad debt and other expenses	(830,524)	(373,733)
Net income	$ 20,807,371	$ 10,719,927

See accompanying notes.

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Statements of Changes in Policyholder Surplus - Statutory Basis

Years ended December 31, 2018 and 2017

	2018	2017
Policyholder surplus, beginning of year	**$ 206,746,411**	$ 186,653,307
Net income	**20,807,371**	10,719,927
Change in net unrealized (losses) gains on investments	**(14,693,870)**	4,571,642
Change in non-admitted assets	**255,082**	(4,386,736)
Change in provision for reinsurance	**3,000**	(3,000)
Change in projected pension and postretirement benefits	**2,684,925**	9,191,271
Policyholder surplus, end of year	**$ 215,802,919**	$ 206,746,411

See accompanying notes.

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Statements of Cash Flows - Statutory Basis

Years ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Premiums collected, net of reinsurance	**$ 151,278,876**	$ 152,589,835
Investment income, net of investment expenses	**26,769,821**	25,915,948
Miscellaneous expenses	**(3,315,747)**	(4,136,302)
Benefit and loss related payments	**(75,716,381)**	(91,698,553)
Commissions, expenses paid and aggregate write-ins	**(55,788,960)**	(56,202,803)
Net cash provided by operating activities	**43,227,609**	26,468,125
Cash flows from investing activities:		
Proceeds from investments sold or matured	**295,145,304**	225,729,159
Cost of investments acquired	**(352,905,537)**	(253,946,786)
Net cash used in investing activities	**(57,760,233)**	(28,217,627)
Cash flows from miscellaneous activities:		
Other cash provided	**16,884,356**	19,008,323
Net change in cash, cash equivalents, and short-term investments	**2,351,732**	17,258,821
Cash, cash equivalents, and short-term investments, beginning of year	**32,872,947**	15,614,126
Cash, cash equivalents, and short-term investments, end of year	**$ 35,224,679**	$ 32,872,947

See accompanying notes.

1. Description of Organization

Kentucky Employers' Mutual Insurance Authority dba Kentucky Employers' Mutual Insurance (KEMI) is a non-profit, independent, self-supporting de jure municipal corporation and political subdivision of the Commonwealth of Kentucky (the Commonwealth). KEMI was established by legislation of the Commonwealth enacted April 4, 1994 to serve as a competitive state fund for the purpose of providing both a market of last resort for employers in the Commonwealth and another competitive source of insurance in the voluntary market through which employers may secure and maintain their workers' compensation coverage as required by state law. KEMI began writing business effective September 1, 1995.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying statutory basis financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Department of Insurance of the Commonwealth of Kentucky (the Department), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP or U.S. GAAP). Prescribed statutory accounting policies include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting policies other than those prescribed. The NAIC *Accounting Practices and Procedures Manual* (NAIC SAP Version March 2018) has been adopted as a component of prescribed practices by the Commonwealth of Kentucky. KEMI does not employ any practices not prescribed by the NAIC or the Department in the preparation of its statutory basis financial statements. The more significant differences between statutory accounting practices and GAAP are as follows:

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

2. Summary of Significant Accounting Policies, continued

Basis of Presentation, continued

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

Also, for GAAP purposes, other-than-temporary impairment losses (related to non loan-backed and structured securities) related to debt securities are bifurcated between credit and non-credit, where for statutory purposes the total other-than-temporary impairment loss is reported in earnings.

b. Assets having economic value other than those that can be used to fulfill policyholder obligations are categorized as "nonadmitted assets" and are not permitted to be included in the statutory basis financial statements of admitted assets, liabilities, and policyholder surplus, whereas, for GAAP, these assets are recognized in the balance sheet. Included with nonadmitted assets are furniture, equipment and supplies, prepaid expenses, certain receivables and other items that do not meet statutory criteria for admitted assets.

c. Receivables over 90 days outstanding are not admitted to the statutory basis financial statements and charged to policyholder surplus, whereas, for GAAP, the company assesses the collectability of premiums receivable and any charge is to the income statement.

d. The statutory basis financial statements are presented net of the effects of reinsurance, whereas, for GAAP, the financial statements are presented gross of the effects of reinsurance.

e. Commissions allowed by reinsurers on business ceded are reported as income when received rather than being deferred and, to the extent recoverable, amortized with deferred policy acquisition costs, as required under GAAP.

f. Comprehensive income is not determined for statutory reporting purposes, whereas, for GAAP, such income is recognized.

g. Costs incurred in connection with acquiring new insurance business, including commissions, are charged against statutory earnings as such costs are incurred, while, under GAAP, such costs, to the extent recoverable, would be deferred and amortized over the effective periods covered by the related policies.

2. Summary of Significant Accounting Policies, continued

Basis of Presentation, continued

h. A statutory liability is established and charged to policyholder surplus for amounts due from unauthorized reinsurers in excess of letters of credit, funds held, and premiums payable. Under GAAP, no such liability is provided.

i. The statutory basis statement of cash flows differs in certain respects from the presentation required within GAAP literature, including the presentation of changes in cash and short-term investments instead of cash and cash equivalents.

j. The statutory basis financial statements are prepared in a form using language and groupings substantially the same as the annual statements that KEMI files with the NAIC and the state regulatory authorities, which differ from the presentation and disclosures of financial statements presented under GAAP reporting.

The effect of the differences between statutory accounting practices and accounting principles generally accepted in the United States of America has not been determined, but is presumed to be material.

Risks and Uncertainties

Certain risks and uncertainties are inherent to KEMI's day-to-day operations and to the process of preparing its statutory basis financial statements. The more significant of those risks and uncertainties are presented below and throughout the notes to the statutory basis financial statements.

Use of Estimates - The preparation of the statutory basis financial statements requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the statutory basis financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of unpaid losses and loss adjustment expenses. In connection with the determination of this liability, management uses the methodology described in Unpaid Losses and Loss Adjustment Expenses later in this footnote. While management uses the best information available to estimate unpaid losses and loss adjustment expenses, future changes to the liability may be necessary based on claims experience and changing claims frequency and severity conditions, as well as changes in doctrines of legal liability and damage awards in Kentucky. The future changes will be charged or credited to expense when they occur.

2. Summary of Significant Accounting Policies, continued

Risks and Uncertainties, continued

Loss Reserves - KEMI estimates losses and loss adjustment expenses (LAE) based on the accumulation of case estimates and loss reports, as well as estimates of incurred but not reported (IBNR) losses, net of applicable policy deductibles and deduction of amounts for reinsurance ceded on reported and unreported claims and incidents. KEMI also offers its Kentucky-based policyholders multi-state coverage through the use of assumptive reinsurance agreements, under which unaffiliated cedents write certain policies for which KEMI assumes 100% of the business. The liability for LAE is provided by estimating future expenses to be incurred in settlement of the claims provided for in the reserve for losses, net of reinsurance ceded. Actual results could differ from these estimates.

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

Investment Risk - KEMI is exposed to risks that issuers of securities owned by KEMI will default or that interest rates will change and cause a decrease in the value of its investments. With mortgage-backed securities, KEMI is exposed to credit risk and prepayment risk.

As interest rates change, the velocity at which these securities pay down the principal will change as well. Management mitigates these risks by conservatively investing in high-grade securities and by matching maturities of its investments with the anticipated payouts of its liabilities.

KEMI maintains balances at financial institutions that may exceed federally insured limits; however, it also utilizes repurchase agreements and money market funds to mitigate this risk. KEMI's management continually evaluates the financial stability of these financial institutions, and does not believe they are exposed to unnecessary risk.

Since most of KEMI's investments consist of securities that are traded in the public securities markets, they are subject to risk related to fluctuations in overall market performance and are potentially subject to heightened levels of market risk attributable to issuer, industry, and geographic region concentrations. KEMI's investment portfolio is regularly reviewed and the extent of its diversification is considered in the context of statutory requirements and other risk management and performance objectives.

2. Summary of Significant Accounting Policies, continued

Risks and Uncertainties, continued

External Factors - KEMI is highly regulated by the state in which it is domiciled. Such regulations, among other things, limit the amount of dividends and impose restrictions on the amount and types of investments. In addition, from time to time, KEMI may be affected by changes in federal regulations such as the Dodd–Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), or the Patient Protection and Affordable Care Act (PPACA). Additionally, the PPACA contained an amendment with specific language related to black lung claims (the Byrd Amendment). KEMI continues to monitor the impact of such regulations and will assess any potential impact of these changes.

Risk-Based Capital - The NAIC has developed property-casualty risk-based capital (RBC) standards that relate an insurer's reported statutory basis capital and policyholder surplus to the risks inherent in its overall operations. The RBC formula uses the statutory basis annual statement to calculate the minimum indicated capital level to protect KEMI from the various risks that it faces. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. KEMI continues to monitor its internal capital requirements and the NAIC's RBC requirements. KEMI has determined that its capital levels are in excess of the minimum capital requirements for all RBC action levels. Management believes that KEMI's capital levels are sufficient to support the level of risk inherent in its operations.

Investments

Investments, excluding residential mortgage-backed securities not guaranteed by federal or federally sponsored agencies, are stated at values prescribed by the NAIC's SVO, which generally are as follows:

Non loan-backed bonds rated 1 and 2 by the NAIC are stated at amortized cost using the scientific (constant yield) interest method with bonds containing call provisions being amortized to the call or maturity date, which ever results in a lower asset value. Loan-backed bonds rated 1 and 2 by the NAIC are stated at amortized cost using the scientific (constant yield) interest method including anticipated prepayments. Bonds rated 3 through 6 are carried at fair value with the change run through policyholder surplus.

2. Summary of Significant Accounting Policies, continued

Investments, continued

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

Investments in preferred stocks with an NAIC rating designation of 1 or 2 are stated at amortized cost; all other preferred stocks are stated at the lesser of amortized cost or fair value.

Investments in common stocks are stated at fair value with unrealized gains and losses being reported as a separate component of unassigned policyholder surplus.

Realized gains or losses are determined on the specific-identification method. Investment income is recognized as earned, net of related investment expenses. Bond premiums and discounts are amortized by the scientific-yield method and are charged or credited to net investment income. For mortgage-backed securities, KEMI anticipates prepayments utilizing published data in applying interest income.

The assessment of other-than-temporary impairments is performed on a case-by-case basis. Factors considered by management in determining whether an other-than-temporary impairment exists (in other than loan-backed or structured securities) include: the financial condition, business prospects and creditworthiness of the issuer, the length of time and extent to which fair value has been less than cost for equity securities or amortized cost for fixed income securities, and KEMI's intent and ability to retain such investments until the fair value recovers. If it is determined that the decline in fair market value is other-than-temporary, the carrying amount of the investment is written down to fair value as its new basis and the amount of the write-down is recorded as a realized loss.

2. Summary of Significant Accounting Policies, continued

Investments, continued

For loan-backed or structured securities, factors considered by management in determining whether an other-than-temporary impairment exists include: KEMI's stated intent to not sell, KEMI's ability to hold such investments until the fair value recovers, and the discounted cash flows of the security based on the yield at the date of acquisition. If KEMI intends to sell or if KEMI does not have the ability and intent to hold the security for a period of time sufficient to recover its amortized cost basis, an other-than-temporary impairment exists, and the security is written down to fair value with the amount of the write-down recorded as a realized loss. If KEMI does not intend to sell the security and has the ability and intent to hold the security for a period of time sufficient to recover the amortized cost basis, KEMI calculates the cash flows expected to be collected. In this calculation, KEMI compares the present value of cash flows expected to be collected, discounted at the security's effective interest rate at date of purchase, to the amortized cost basis. If the present value of cash flows is less than the amortized cost basis, a realized loss is recorded for the difference. The present value of cash flows then becomes the new cost basis.

KEMI uses the prospective method to accrete the amortized cost basis to the ultimate expected cash flows.

Premiums

Premiums are earned on the daily pro-rata method over the policy period and are stated after deduction for reinsurance. Unearned premiums represent the portion of initial premiums written that are applicable to the unexpired terms of policies in force. Initial premiums are recorded as premiums written on the policy effective date except for certain premiums that are recorded on an installment basis. Any subsequent additional premiums or refunds that occur as a result of policy audits are recorded as written premiums at the time the policy audits are finalized. Earned but unbilled premiums represent management's estimate of future audit premiums and are included in premiums booked but deferred and not yet due.

Premiums in course of collection which are customer obligations due under normal terms requiring payment by the policy due date, and premiums booked but deferred and not yet due are valued at their carrying amount, which approximates fair value. Receivables over 90 days outstanding are not admitted to the statutory basis financial statements.

Unpaid Losses and Loss Adjustment Expenses

The estimated liability for losses is based on the accumulation of case estimates for claims and incidents reported, net of applicable policy deductibles and deduction of amounts for reinsurance ceded on reported claims and incidents. Also included in the liability are estimates of incurred but not reported losses based on historical experience adjusted for current trends. The reserves for unpaid losses are net of anticipated subrogation. The liability for LAE is provided by estimating future expenses to be incurred in settlement of the claims provided for in the reserve for losses, net of reinsurance ceded.

2. Summary of Significant Accounting Policies, continued

Unpaid Losses and Loss Adjustment Expenses, continued

To reflect the time value of money, KEMI began discounting the indemnity portion of federal black lung reserves effective December 31, 2017. Both case reserves and incurred but not reported (IBNR) reserves have been discounted on a tabular basis at a rate of 3.5% using the following tables: Milliman Male Black Lung Mortality table, 2013 U.S. Lives Female table, and Society of Actuaries 2015 Female Smoker Distinct table. See Methodologies and Assumptions Used in Calculating the Liability at Note 5.

Management believes that the provisions for losses and LAE are adequate to cover the net cost of claims incurred and incidents reported; however, the provisions are necessarily based upon estimates and, therefore, the ultimate liability may be less than or exceed such estimates. As adjustments become necessary in these estimates, such adjustments are reflected in the results of operations in the period in which they are determined.

Reinsurance

Reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums, losses, and loss adjustment expenses are reported net of reinsured amounts. KEMI evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. KEMI holds collateral as security under reinsurance agreements in the form of letters of credit for any reinsurers not subject to the regulation of the Kentucky Commissioner of Insurance. In the opinion of management, all amounts due from reinsurers at December 31, 2018 and 2017 are recoverable.

Cash, Cash Equivalents, and Short-Term Investments

Cash, cash equivalents, and short-term investments consist of cash on deposit with financial institutions and investments with original maturities of: cash equivalents - less than three months, short-term investments - less than one year. These investments are carried at cost, which approximates fair value.

Concentrations of Geographic and Credit Risk

All of KEMI's total direct gross written premiums of $162,765,283 for the year ended December 31, 2018 were for insureds in Kentucky.

2. Summary of Significant Accounting Policies, continued

Concentrations of Geographic and Credit Risk, continued

The credit quality of the long-term bond portfolio at December 31, 2018 is presented as follows:

	Carrying Value	Percentage
Class 1 - highest quality	$ 662,793,867	79.1 %
Class 2 - high quality	148,464,963	17.7
Class 3 - medium quality	26,762,820	3.2
Total	$ 838,021,650	100 %

Bonds with ratings from AAA to BBB as assigned by Standard & Poor's Corporation are generally considered as investment grade securities. Some securities issued by the U.S. government or an agency thereof are not rated but are considered to be investment grade. The NAIC regards U.S. Treasuries and agencies and all A ratings as Class 1 (highest quality), BBB ratings as Class 2 (high quality), BB ratings as Class 3 (medium quality), B ratings as Class 4 (low quality), C ratings as Class 5 (lower quality), and D ratings as Class 6 (in or near default).

Property and Equipment

Electronic data processing equipment, including operating software, is stated at cost less accumulated depreciation. Depreciation expense on such property was $50,792 and $104,946 in 2018 and 2017, respectively. Furniture, office equipment, and application software are non-admitted assets under statutory accounting practices. Depreciation expense on such property was $43,468 and $122,904 in 2018 and 2017, respectively.

Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. Gains and losses on the sale of property and equipment are recorded in the year of disposition. Maintenance and repairs are expensed as incurred; replacements and betterments are capitalized.

Advertising

KEMI expenses advertising costs as they are incurred. Advertising expense for the years ended December 31, 2018 and 2017, was $204,889 and $455,202, respectively.

2. Summary of Significant Accounting Policies, continued

Subsequent Events

All of the effects of subsequent events that provide additional evidence about conditions that existed at the statement of admitted assets, liabilities and policyholder surplus date, including the estimates inherent in the process of preparing the statutory basis financial statements, are recognized in the statutory basis financial statements. KEMI does not recognize subsequent events that provide evidence about conditions that did not exist at the statement of admitted assets, liabilities and policyholder surplus date but arose after, but before the statutory basis financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the statutory basis financial statements from being misleading.

Management has evaluated subsequent events for accounting and disclosure requirements through March 28, 2019, the date that the statutory basis financial statements were available to be issued. Except as disclosed in Note 7, there were no events during the evaluation period that require recognition or disclosure in the financial statements.

3. Investments

Long-Term Bonds

The statement value, gross unrealized gains, gross unrealized losses, and the estimated fair value of investments in long-term bonds are summarized as follows:

	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of December 31, 2018:				
U.S. government securities	$ 46,685,738	$ 178,541	$ (422,044)	$ 46,442,235
U.S. agency residential mortgage-backed securities	345,357	13,060	(1,439)	356,978
U.S. special revenue bonds	154,835,632	978,417	(3,980,708)	151,833,341
Commercial mortgage-backed securities	48,266,283	151,049	(674,408)	47,742,924
Commercial asset-backed securities	99,590,814	96,192	(1,231,505)	98,455,501
Corporate bonds ($26,762,820 carried at fair value)	478,384,507	1,057,511	(11,966,164)	467,475,854
All other bonds	9,913,319	184,767	(98,173)	9,999,913
	$ 838,021,650	$ 2,659,537	$ (18,374,441)	$ 822,306,746

3. Investments, continued

Long-Term Bonds, continued

	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of December 31, 2017:				
U.S. government securities	$ 61,189,117	$ 229,185	$ (957,742)	$ 60,460,560
U.S. agency residential mortgage-backed securities	465,486	25,101	(1,299)	489,288
U.S. special revenue bonds	213,366,753	2,611,198	(1,686,822)	214,291,129
Commercial mortgage-backed securities	56,479,771	668,940	(84,785)	57,063,926
Commercial asset-backed securities	46,326,624	50,095	(184,658)	46,192,061
Corporate bonds ($493,630 carried at fair value)	419,993,214	6,615,672	(1,597,892)	425,010,994
All other bonds	6,149,608	263,978	-	6,413,586
	$ 803,970,573	$ 10,464,169	$ (4,513,198)	$ 809,921,544

The carrying value and estimated fair value of long-term bonds at December 31, 2018, by contractual maturity, are as follows. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Statement Value	Estimated Fair Value
Less than one year	$ 32,757,565	$ 32,649,569
One year through five years	292,071,872	289,632,394
Six years through ten years	259,526,246	252,626,027
After ten years	253,665,967	247,398,756
	$ 838,021,650	$ 822,306,746

Proceeds from sales of bonds during 2018 and 2017 were $150,635,712 and $122,028,624, respectively. Gross gains of $339,362 and $3,474,020, and gross losses of $4,196,851 and $1,670,057 were realized on those sales in 2018 and 2017, respectively.

3. Investments, continued

Long-Term Bonds, continued

During 2018 and 2017, bonds which were previously rated as NAIC level 1 or level 2 investments were downgraded to NAIC level 3 investments. KEMI believed these downgrades to be temporary and as such they have reported these bonds at their estimated fair value and recorded unrealized losses in the amount of $639,968 and $10,482, as of December 31, 2018 and 2017, respectively.

Common Stock

Gross unrealized capital gains and losses on common stock are included in policyholder surplus as follows:

	2018	2017
Cost	$ 73,600,590	$ 49,378,870
Gross unrealized capital gains	3,323,159	12,546,047
Gross unrealized capital losses	(6,223,752)	(1,382,256)
Net unrealized capital (loss) gain	(2,900,593)	11,163,791
Fair value	$ 70,699,997	$ 60,542,661

Proceeds from the sales of common stocks during 2018 and 2017 were $67,043,915 and $28,734,927, respectively. Gross gains of $12,454,397 and $4,964,062, and gross losses of $2,790,493 and $1,463,291 were realized on those sales in 2018 and 2017, respectively.

Real Estate

In September of 2016, KEMI purchased a parcel of land upon which it plans to construct a home office building. This parcel of land is reported at cost plus capitalized legal and professional fees.

Other Invested Assets

During 2016, KEMI purchased a limited partnership interest in Elmtree U.S. Net Lease Fund III, L.P. (the Fund) for $8,972,414, with a total commitment of $20 million. The Fund was formed on August 29, 2016 in order to construct and invest in real estate development. As of December 31, 2018, KEMI had made capital contributions totaling $13,082,901 leaving a remaining commitment of $6,917,099. KEMI is reporting the investment at cost until such time as the funding and acquisition phase is complete. KEMI receives an 8% dividend, which is paid quarterly.

3. Investments, continued

Other-Than-Temporary Impairment

The following tables illustrates the gross unrealized losses and fair value of investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment type and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2018 and 2017:

	December 31, 2018					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. government	$ 1,480,500	$ (8,976)	$ 22,056,070	$ (413,068)	$ 23,536,570	$ (422,044)
U.S. agency mortgage-backed	-	-	117,201	(1,439)	117,201	(1,439)
U.S. special revenue	32,498,315	(483,766)	92,632,861	(3,496,942)	125,131,176	(3,980,708)
Commercial mortgage-backed	26,565,777	(253,757)	13,309,251	(420,651)	39,875,028	(674,408)
Commercial asset-backed	59,118,311	(970,850)	23,037,630	(260,655)	82,155,941	(1,231,505)
Corporate bonds	235,719,699	(6,741,050)	130,263,277	(5,225,114)	365,982,976	(11,966,164)
All other bonds	2,451,876	(87,039)	1,228,034	(11,134)	3,679,910	(98,173)
Common stock	44,341,613	(6,223,752)	-	-	44,341,613	(6,223,752)
Total	$ 402,176,091	$ (14,769,190)	$ 282,644,324	$ (9,829,003)	$ 684,820,415	$ (24,598,193)

3. Investments, continued

Other-Than-Temporary Impairment, continued

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. government	$ 23,665,040	$ (146,020)	$ 26,060,470	$ (811,722)	$ 49,725,510	$ (957,742)
U.S. agency mortgage-backed	190,473	(1,299)	-	-	190,473	(1,299)
U.S. special revenue	80,615,819	(553,899)	48,682,592	(1,132,923)	129,298,411	(1,686,822)
Commercial mortgage-backed	17,211,900	(84,785)	-	-	17,211,900	(84,785)
Commercial asset-backed	29,716,687	(114,476)	7,453,508	(70,182)	37,170,195	(184,658)
Corporate bonds	125,776,019	(740,897)	34,983,436	(856,995)	160,759,455	(1,597,892)
Common stock	13,335,484	(893,633)	574,374	(488,623)	13,909,858	(1,382,256)
Total	$ 290,511,422	$ (2,535,009)	$ 117,754,380	$ (3,360,445)	$ 408,265,802	$ (5,895,454)

KEMI evaluates impairment at each reporting period for each of the securities whereby the fair value of the investment is less than its amortized cost. It is expected that the securities would not be settled at a price less than the amortized cost of the investment, as KEMI has the ability and intent to hold the investment until there is not an unrealized loss on the investment. For valuing loan-backed and structured securities, KEMI's asset manager uses a proprietary model for loss assumptions and widely accepted models for prepayment assumptions with inputs from major third party data providers. Model assumptions are specific to asset class and collateral types and are regularly evaluated and adjusted where appropriate.

KEMI evaluated the credit ratings of these holdings, noting neither a significant deterioration since purchase nor other factors which may indicate an other-than-temporary impairment, such as the length of time and extent to which fair value has been less than cost, the financial condition and near-term prospects of the issuer as well as specific events or circumstances that may influence the operations of the issuer, and KEMI's intent and ability to hold the investment for a sufficient time in order to enable recovery of cost. KEMI does not consider these investments to be other-than-temporarily impaired as of December 31, 2018 and 2017.

3. Investments, continued

Other-Than-Temporary Impairment, continued

KEMI continues to review its investment portfolio under its impairment review policy. Given the fluctuating market conditions and the significant judgment involved, there is a continuing risk that further declines in fair value may occur and additional other-than-temporary impairments may be recorded in future periods.

4. Fair Value Measurements

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2018 and 2017. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these statutory basis financial statements since that date, and current estimates of fair value may differ significantly from the amounts presented herein.

The following methods and assumptions were used to estimate the fair value of each significant class of financial instruments for which it is practical to estimate that value:

Cash, cash equivalents, and short-term investments: Valued at cost. The carrying amounts reported in the statements of admitted assets, liabilities and policyholder surplus approximate their fair value due to their short maturity.

Bonds, loan-backed and structured securities, and common stock: Valued at fair value by reference to identical trades in active markets and by a third party portfolio manager. Fair values are based on values published by the SVO, quoted market prices, or dealer quotes. For bonds not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting the expected future cash flows using current market rates applicable to the yield, credit, and maturity of the investment.

KEMI's financial assets carried at fair value have been classified, for disclosure purposes, based on a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The hierarchy gives the highest priority to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest priority to fair values determined using unobservable inputs (Level 3). An asset's classification is determined based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets that KEMI has the ability to access at the measurement date.

4. Fair Value Measurements, continued

Level 2 – Valuations derived from inputs other than quoted market prices included within Level 1 that are observable for the asset, either directly or indirectly, such as:

(a) Quoted prices for similar assets in active markets.

(b) Quoted prices for identical or similar assets in markets that are not active.

(c) Inputs other than quoted prices that are observable for the asset.

(d) Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Valuations are derived from techniques that require significant unobservable inputs. The unobservable inputs reflect KEMI's own assumptions about the assumptions that market participants would use in pricing the asset.

KEMI holds common stocks and other securities that are measured at fair value on a recurring basis. In addition, KEMI sometimes holds certain financial assets, primarily certain bonds valued at the lower of cost or fair value in accordance with NAIC reporting guidelines and assets that are impaired during the current reporting period and carried at fair value, that are considered to be measured at fair value on a recurring basis.

For informational purposes, the following table summarizes the fair value of all of KEMI's financial instruments whether or not they are carried at fair value on the statement of admitted assets, liabilities and policyholder surplus – statutory basis. Management has elected not to further disaggregate the investments displayed below as additional risk information is not deemed material to the financial statements.

4. Fair Value Measurements, continued

	Fair Value	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
December 31, 2018				
Investments:				
U.S. government securities	$ 46,442,235	$ -	$ 46,442,235	$ -
U.S. agency residential mortgage-backed securities	356,978	-	356,978	-
U.S. special revenue bonds	151,833,341	-	151,833,341	-
Commercial mortgage-backed securities	47,742,924	-	47,742,924	-
Commercial asset-backed securities	98,455,501	-	98,455,501	-
Corporate bonds ($26,762,820 carried at fair value)	467,475,854	-	467,475,854	-
All other bonds	9,999,913	-	9,999,913	-
Total assets at fair value	$ 822,306,746	$ -	$ 822,306,746	$ -

	Fair Value	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
December 31, 2017				
Investments:				
U.S. government securities	$ 60,460,560	$ -	$ 60,460,560	$ -
U.S. agency residential mortgage-backed securities	489,288	-	489,288	-
U.S. special revenue bonds	214,291,129	-	214,291,129	-
Commercial mortgage-backed securities	57,063,926	-	57,063,926	-
Commercial asset-backed securities	46,192,061	-	46,192,061	-
Corporate bonds ($493,630 carried at fair value)	425,010,994	-	425,010,994	-
All other bonds	6,413,586	-	6,413,586	-
Total assets at fair value	$ 809,921,544	$ -	$ 809,921,544	$ -

5. Losses and Loss Adjustment Expenses

As of December 31, 2018 and 2017, the following table provides a reconciliation of the beginning and ending reserve balances for losses and loss adjustment expenses (LAE):

	2018	2017
Gross reserves for losses and LAE - beginning of year	$ 624,276,751	$ 608,519,462
Less reinsurance recoverables	22,391,336	20,894,610
Net reserves for losses and LAE - beginning of year	601,885,415	587,624,852
Provision for claims, related to:		
Current year	127,659,352	135,536,166
Prior years	2,690,177	(4,422,205)
Total incurred	130,349,529	131,113,961
Payments for claims, related to:		
Current year	(36,037,119)	(37,134,010)
Prior years	(62,915,314)	(79,719,388)
Total paid	(98,952,433)	(116,853,398)
Net reserves for losses and LAE - end of year	633,282,511	601,885,415
Plus reinsurance recoverables	22,973,450	22,391,336
Gross reserves for losses and LAE - end of year	$ 656,255,961	$ 624,276,751

As a result of changes in estimates of insured events in prior years, the liability for unpaid losses and loss adjustment expenses (net of reinsurance recoverables) increased by $2,690,177 and decreased by $4,422,205 in 2018 and 2017, respectively. Estimated subrogation recoverable on unpaid losses was $3,000,000 as of both December 31, 2018 and 2017.

5. Losses and Loss Adjustment Expenses, continued

Methodologies and Assumptions Used in Calculating the Liability

KEMI has experienced an increase in the number of federal coal occupational disease (black lung) claims reported. This increase is the result of both a decrease in the coal mining industry's workforce as well as recent amendments to the Federal Coal Mine Health and Safety Act. In an effort to better understand its potential exposure to federal black lung claims, KEMI hired an actuarial firm with expertise in this area. As of December 31, 2017, KEMI's actuaries segregated federal black lung claims from non-coal and coal traumatic claims to provide for a more in-depth analysis of KEMI's federal black lung experience. This change in the methodology of valuing unpaid losses and loss adjustment expenses resulted in an increase to losses and loss adjustment expenses incurred of $73.7 million on an undiscounted basis, or $37.2 million on a discounted basis, as of December 31, 2017.

KEMI began discounting its federal black lung indemnity claims effective December 31, 2017. Both case reserves and incurred but not reported (IBNR) reserves have been discounted on a tabular basis at a rate of 3.5% using the following tables: Milliman Male Black Lung Mortality table, 2013 U.S. Lives Female table, and Society of Actuaries 2015 Female Smoker Distinct table. The change from not discounting its reserves to using tabular discounting for federal black lung indemnity claims was made to better match KEMI's liability with its expected claims payments. Tabular discounting of indemnity reserves is a permitted practice of the NAIC and the Department of Insurance of the Commonwealth of Kentucky, and it is a common industry practice to discount the indemnity portion of federal black lung claim reserves given the long-term nature of the payment pattern. KEMI does not discount indemnity claims other than federal black lung, nor does it discount any medical or loss expense reserves.

KEMI determined that it is impractical to determine the cumulative effect of applying this change retrospectively due to the cost involved and the limited benefit that would be received. For 2017, this change affected both surplus and net income by reducing the expense of recording additional federal black lung indemnity reserves by $36.5 million.

Tabular discounts were $57.3 million and $36.5 million as of December 31, 2018 and 2017, respectively. KEMI recognized discount accretion of $1.2 million and $0 for 2018 and 2017, respectively, through direct losses incurred on the statement of income.

6. Reinsurance

KEMI limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risks with various reinsurers under excess of loss agreements. These agreements cede premium on an earned basis. Ceded reinsurance is treated as the risk and liability of the assuming companies; however, these reinsurance contracts do not relieve KEMI from its original obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to KEMI; consequently, allowances are established for amounts deemed uncollectible, if any. KEMI evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

KEMI maintains Excess of Loss reinsurance coverage (including terrorism) with unaffiliated reinsurers for losses and loss adjustment expenses in excess of $3 million per occurrence and up to $125 million per occurrence. The Excess of Loss reinsurance agreements apply to KEMI's net retained liability, covering direct and assumed business in force as of each effective date, as well as business new or renewed from the effective date through the end of the contract term. Unpaid losses and loss adjustment expenses as of December 31, 2018 and 2017 included estimated reinsurance recoverables under the Excess of Loss agreements of $22,678,758 and $22,338,714, respectively.

Effective November 1, 2017, KEMI entered into a quota share reinsurance treaty with Automobile Dealers Management Insurance Company (ADMIC) under which KEMI cedes to ADMIC 50% of the premiums, losses and loss adjustment expenses for a group of approximately forty car dealerships. The agreement is renewable annually, and each contract year may be commuted no sooner than five years after expiration. Ceded premiums earned under the agreement were $563,048 and $81,420 in 2018 and 2017, respectively. Unpaid losses and loss adjustment expenses as of December 31, 2018 and 2017 included estimated reinsurance recoverables of $294,692 and $52,622, respectively, under the agreement. The ADMIC quota share contracts are secured by funds withheld accounts and collateral deposits totaling $866,624 and $459,642 as of December 31, 2018 and 2017, respectively.

KEMI offers multi-state coverage to its policyholders through the use of assumptive reinsurance agreements, under which unaffiliated cedents write certain policies for which KEMI assumes 100% of the business. This coverage is only available to Kentucky-based businesses that have similar operations in other states. KEMI's liability for unpaid losses and loss adjustment expenses as of December 31, 2018 and 2017 includes $2,581,912 and $4,314,923, respectively, related to these agreements. The cedents require KEMI to maintain standby letters of credit totaling $12.9 million. The letters of credit are collateralized by U.S. Treasury Bonds.

KEMI had no unsecured net reinsurance recoverables outstanding for losses and loss adjustment expenses, paid and unpaid, including IBNR and unearned premium that individually exceeded 3% of policyholder surplus at December 31, 2018 or 2017.

6. Reinsurance, continued

The effects of KEMI's assumed and ceded reinsurance transactions for 2018 and 2017 are summarized as follows:

	2018	2017
Written premiums:		
Direct	$ 162,765,283	$ 156,661,942
Assumed	3,200,292	3,062,735
Ceded	(5,224,908)	(5,066,815)
Net	$ 160,740,667	$ 154,657,862
Earned premiums:		
Direct	$ 159,779,512	$ 155,029,740
Assumed	3,058,135	3,332,996
Ceded	(5,085,545)	(4,661,047)
Net	$ 157,752,102	$ 153,701,689
Incurred losses and LAE:		
Direct	$ 131,574,125	$ 128,538,884
Assumed	1,099,593	4,326,914
Ceded	(2,324,189)	(1,751,837)
Net	$ 130,349,529	$ 131,113,961
Unearned premiums:		
Direct	$ 73,766,837	$ 70,418,589
Assumed	1,616,921	1,474,763
Ceded	(545,131)	(405,768)
Net	74,838,627	71,487,584
Adjustment for earned but unbilled premiums	(3,391,729)	(3,029,251)
Net	$ 71,446,898	$ 68,458,333

KEMI has evaluated its assumed and ceded reinsurance arrangements and believe they appropriately transfer risk in accordance with SSAP No. 62R, *Property and Casualty Reinsurance,* and have therefore accounted for them as prospective reinsurance.

7. Loss Portfolio Transfers

Kentucky School Boards Insurance Trust Loss Portfolio Transfer

Effective October 31, 2014, KEMI entered into a loss portfolio transfer agreement with the Commissioner of Insurance of the Commonwealth of Kentucky, Rehabilitator of the Kentucky School Boards Insurance Trust (KSBIT) Workers' Compensation Self Insurance Fund. Pursuant to this loss portfolio transfer, approximately $35 million in workers' compensation claims liabilities for the period July 7, 1978 through June 30, 2013, were transferred to KEMI by KSBIT's Rehabilitator. In exchange for assuming responsibility for these claim liabilities and the handling thereof, KEMI received $35 million in cash and guaranteed receivables. The individual school boards were given the option of paying their entire assessment as a lump sum, or paying 25% in cash and financing the remainder in interest free installments over a period not to exceed six years. Under the terms of the agreements signed by the individual school boards, in the event of nonpayment, the Kentucky Department of Education will be instructed to withhold the unpaid portion of the assessments from appropriations otherwise due to the school boards from the Commonwealth of Kentucky.

In March 2019, KEMI, relying on the work of its actuary, has determined that it is appropriate to refund approximately $4.8 million to the KSBIT Rehabilitator as total liabilities under the loss portfolio transfer agreement are expected to be less than originally projected.

The net liability for KSBIT unpaid claims and the receivable for retroactive reinsurance assumed activity for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Net liability for KSBIT unpaid claims - beginning of year	$ 29,112,034	$ 30,965,008
Losses and LAE paid, net	(1,245,823)	(1,852,726)
Other direct expenses paid	(2,474)	(248)
Net liability for KSBIT unpaid claims - end of year	$ 27,863,737	$ 29,112,034
Receivable for retroactive reinsurance reserve assumed - beginning of year	$ 8,736,249	$ 11,932,933
Assessment installments received	(3,055,116)	(3,196,684)
Receivable for retroactive reinsurance reserve assumed - end of year	$ 5,681,133	$ 8,736,249

7. Loss Portfolio Transfers, continued

Kentucky Workers' Compensation Funding Commission Loss Portfolio Transfer

Effective July 7, 2017, KEMI entered into a loss portfolio transfer agreement with the Kentucky Workers' Compensation Funding Commission (the Funding Commission). Pursuant to this loss portfolio transfer, approximately $40 million in workers' compensation claims liabilities for claims incurred on or after December 12, 1996, which were filed on or before June 30, 2017 (known as the Kentucky Coal Workers' Pneumoconiosis Fund, or KCWPF), were transferred from the Funding Commission to KEMI. In exchange for assuming responsibility for these claim liabilities and the handling thereof, KEMI received approximately $19.3 million in cash. In addition the Funding Commission will continue to impose assessments, due to KEMI within 50 days of each quarter, until both the Funding Commission and KEMI agree that the liabilities are fully funded.

The net liability for KCWPF unpaid claims and the receivable for retroactive reinsurance assumed activity for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Net liability for KCWPF unpaid claims - beginning of year	$ 39,911,414	$ -
Net liability for KCWPF unpaid claims assumed	-	40,000,000
Adjustments to estimated losses and LAE	9,321,034	3,941,432
Net investment income earned	534,107	92,867
Losses and LAE paid, net	(6,816,393)	(4,113,075)
Other direct expenses paid	(79,297)	(9,810)
Net liability for KCWPF unpaid claims - end of year	$ 42,870,865	$ 39,911,414
Receivable for retroactive reinsurance reserve assumed - beginning of year	$ 17,879,380	$ -
Receivable for retroactive reinsurance reserve assumed	-	20,690,278
Assessments imposed	9,241,737	3,941,432
Assessment installments received	(17,750,414)	(6,752,330)
Receivable for retroactive reinsurance reserve assumed - end of year	$ 9,370,703	$ 17,879,380

8. Adverse Development Coverage

Effective December 31, 2015, KEMI entered into an agreement for adverse development coverage with an unaffiliated reinsurer, Munich Reinsurance America, Inc. This agreement relates to direct and assumed business, excluding the KSBIT and KCWPF loss portfolios, providing KEMI with reinsurance protection against unfavorable development arising from existing and/or newly reported claims for accident years 1995 through 2014. In exchange for a total premium of $40 million, KEMI ceded $32 million of existing loss reserves as well as obtaining $45.25 million of additional protection against unfavorable development for those accident years. The agreement provides for a loss corridor of $20 million (for which KEMI is responsible) between the first and second layers of coverage, and it includes a provision wherein KEMI may share in the reinsurer's ultimate profit, if any. Under the terms of the agreement, KEMI maintains a Funds Withheld balance which is secured by a Trust Account equal to no less than 105% of Funds Withheld. As of December 31, 2018 and 2017, retroactive reinsurance reserves ceded were $14,115,842 and $22,982,011, respectively.

As of December 31, 2018 and 2017, Funds Withheld on retroactive reinsurance ceded consisted of the follow:

	2018	2017
Funds Withheld	$ 39,412,223	$ 38,062,450
Profit sharing receivable	(21,384,158)	(12,517,989)
Total	$ 18,028,065	$ 25,544,461

9. Leases

KEMI leases space for its main office under a noncancellable operating lease which expires December 31, 2020. KEMI has two options to extend the lease, each for an additional 60 months following its expiration. Rental expense under this lease was $1,044,242 and $1,008,449 for 2018 and 2017, respectively. KEMI also leases space for a satellite office under a noncancellable operating lease which expires May 31, 2022. Rental expense under this lease was $132,129 and $125,953 for 2018 and 2017, respectively. The following is a summary of future minimum rental commitments for these leases:

2019	$ 1,124,477
2020	1,127,340
2021	128,550
2022	53,562
	$ 2,433,929

10. Retirement Plans

Defined Benefit Pension and Postretirement Benefit Plans

Prior to July 1, 2016, all full-time KEMI employees were enrolled in a mandatory defined benefit pension plan regulated by Kentucky Retirement Systems (KRS) as described at Kentucky Employees Retirement Systems. KRS administers three governmental pension funds, including the Kentucky Employees Retirement System (KERS) of which KEMI was a participating agency. KEMI's application to voluntarily cease participation in KRS, effective June 30, 2016, received final approval in April 2017.

Effective July 1, 2016, KEMI established a contributory 401(a) defined benefit pension plan for which it is the plan sponsor. The plan provides pension benefits and a partial subsidy of retiree health insurance premiums for eligible KEMI employees who have chosen to participate in the plan. Benefit amounts are determined based on retirement age, salary history, participation date and years of service. Participating employees are required to contribute 6% of their salary to the defined benefit pension plan. The employer contribution rate was 17% in 2017 and 20% in 2018. During 2018, KEMI contributed an additional $2 million to the defined benefit pension plan to cover a shortfall in the initial funding of prior service cost. KEMI also contributes $12,000 per pay period to the retiree health insurance plan. These employer contribution rates will be evaluated as deemed necessary to ensure the financial soundness of the plan.

As of December 31, 2018 and 2017, KEMI recorded the actuarially determined liabilities, nonadmitted assets and net periodic costs for both the defined benefit pension plan and the retiree health insurance plan. A summary of assets, obligations and assumptions of these plans are as follows:

	Pension Benefits		Postretirement Benefits	
	2018	2017	**2018**	2017
Change in Benefit Obligation				
Benefit obligation at beginning of year	**$ 31,019,544**	$ 24,390,354	**$ 4,366,813**	$ 4,536,706
Service cost	**1,247,943**	1,023,708	**289,305**	301,742
Interest cost	**1,071,976**	967,281	**159,234**	189,115
Contribution by plan participants	**425,559**	430,799	**-**	-
Actuarial (gain) loss	**(2,273,477)**	4,399,058	**(813,618)**	(657,970)
Benefits paid	**(100,154)**	(191,656)	**(4,553)**	(2,780)
Benefit obligation at end of year	**$ 31,391,391**	$ 31,019,544	**$ 3,997,181**	$ 4,366,813

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

	Pension Benefits		Postretirement Benefits	
Change in Plan Assets	2018	2017	2018	2017
Fair value of plan assets at beginning of year	$ 18,117,845	$ 9,271,271	$ 3,731,247	$ 3,025,356
Actual return on plan assets	(1,330,260)	1,549,372	(240,215)	396,671
Reporting entity contribution	3,586,234	1,390,755	312,000	312,000
Plan participants' contributions	464,088	6,098,103	-	-
Benefits paid	(100,154)	(191,656)	(4,553)	(2,780)
Fair value of plan assets at end of year	$ 20,737,753	$ 18,117,845	$ 3,798,479	$ 3,731,247
Funded Status				
Overfunded:				
Assets (nonadmitted):				
Prepaid benefits costs	$ 9,814,583	$ 10,078,762	$ 2,013,924	$ 2,234,968
Underfunded:				
Liabilities recognized:				
Liability for pension benefits	$ (10,653,638)	$ (12,901,699)	$ (198,702)	$ (635,566)
Components of Net Periodic Benefit Cost				
Service cost	$ 1,247,943	$ 1,023,708	$ 289,305	$ 301,742
Interest cost	1,071,976	967,281	159,234	189,115
Expected return on plan assets	(940,690)	(637,973)	(194,150)	(158,989)
Recognized gains and losses	-	-	(95,325)	(25,896)
Prior service cost recognized	2,935,272	2,935,272	373,980	373,980
Total net periodic benefit cost	$ 4,314,501	$ 4,288,288	$ 533,044	$ 679,952

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

	Pension Benefits		Postretirement Benefits	
	2018	2017	**2018**	2017
Amounts in Unassigned Funds (Surplus) Recognized as Components of Net Periodic Benefit Cost				
Items not yet recognized as a component of net periodic cost - prior year	**$ 22,980,461**	$ 21,997,275	**$ 2,870,534**	$ 4,114,270
Net prior service cost or credit recognized	**(2,935,272)**	(2,935,272)	**(373,980)**	(373,980)
Net gain and loss arising during the year	**423,032**	3,918,458	**(379,253)**	(895,652)
Net gain or loss recognized	**-**	-	**95,325**	25,896
Items not yet recognized as a component of net periodic cost - current year	**$ 20,468,221**	$ 22,980,461	**$ 2,212,626**	$ 2,870,534
Amounts in Unassigned Funds (Surplus) Expected to be Recognized in the Next Fiscal Year as Components of Net Periodic Benefit Cost				
Net prior service cost or credit	**$ 2,935,272**	$ 2,935,272	**$ 373,980**	$ 373,980
Net recognized gains and losses	**-**	-	**(126,373)**	(95,325)

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Amounts in Unassigned Funds (Surplus) That Have Not Yet Been Recognized as Components of Net Periodic Benefit Cost				
Net prior service cost or credit	$ 18,345,446	$ 21,280,718	$ 4,166,735	$ 4,540,715
Net recognized gains or losses	2,122,775	1,699,743	(1,954,109)	(1,670,181)

Weighted-average assumptions used to determine net periodic benefit cost as of December 31, 2018 and 2017:

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Weighted average discount rate	4.09 %	3.48 %	4.24 %	3.65 %
Expected long-term rate of return on plan assets	5.00 %	5.00 %	5.00 %	5.00 %
Rate of compensation increase	3.00 %	3.00 %	N/A	N/A

The amount of the accumulated benefit obligation for defined benefit pension plan was $26,529,352 and $25,435,633 as of December 31, 2018 and 2017, respectively.

Measurement of postretirement health care benefits requires the use of certain assumptions about future health care costs. For retirees under the age of 65, a maximum benefit of $500 per month was assumed for 2018 and thereafter. For Medicare eligible retirees age 65 and older, a 5% annual rate of increase was assumed for 2018; this rate of increase is assumed to gradually decrease to 3% over six years and to remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total service and interest cost components	$ 11,823	$ (18,022)
Effect on postretirement benefit obligation	140,477	(214,256)

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

The following estimated future payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

	Pension Benefits	Postretirement Benefits
2019	$ 472,094	$ 22,051
2020	490,595	22,047
2021	265,106	22,001
2022	293,444	20,833
2023	2,593,294	49,572
2024 through 2028	16,289,519	729,547

KEMI does not have any regulatory contribution requirements for 2019, however, KEMI currently intends to make voluntary contributions of approximately $1.4 million to the defined benefit pension plan and approximately $312,000 to the postretirement benefits plan in 2019.

Fair Value Measurements of Plan Assets as of December 31, 2018:

Defined Benefit Pension Plan	Level 1	Level 2	Level 3	Total
Assets (mutual funds)				
Short-term bonds	$ 2,488,530	$ -	$ -	$ 2,488,530
Intermediate-term bonds	5,391,816	-	-	5,391,816
Large-cap stocks	6,013,948	-	-	6,013,948
Mid-cap stocks	1,659,020	-	-	1,659,020
Small-cap stocks	622,133	-	-	622,133
Foreign stocks	3,525,418	-	-	3,525,418
Global infrastructure funds	1,036,888	-	-	1,036,888
Total Plan Assets	$ 20,737,753	$ -	$ -	$ 20,737,753

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

Postretirement Benefit Plan	Level 1	Level 2	Level 3	Total
Assets (mutual funds)				
Short-term bonds	$ 455,818	$ -	$ -	$ 455,818
Intermediate-term bonds	987,605	-	-	987,605
Large-cap stocks	1,101,559	-	-	1,101,559
Mid-cap stocks	303,878	-	-	303,878
Small-cap stocks	113,954	-	-	113,954
Foreign stocks	645,741	-	-	645,741
Global infrastructure funds	189,924	-	-	189,924
Total Plan Assets	$ 3,798,479	$ -	$ -	$ 3,798,479

Fair Value Measurements of Plan Assets as of December 31, 2017:

Defined Benefit Pension Plan	Level 1	Level 2	Level 3	Total
Assets (mutual funds)				
Short-term bonds	$ 2,339,046	$ -	$ -	$ 2,339,046
Intermediate-term bonds	6,295,906	-	-	6,295,906
Balanced	550,003	-	-	550,003
Large-cap stocks	3,837,271	-	-	3,837,271
Mid-cap stocks	1,477,012	-	-	1,477,012
Small-cap stocks	366,513	-	-	366,513
Foreign stocks	2,736,751	-	-	2,736,751
Real estate	515,343	-	-	515,343
Total Plan Assets	$ 18,117,845	$ -	$ -	$ 18,117,845

10. Retirement Plans, continued

Defined Benefit Pension and Postretirement Benefit Plans, continued

Postretirement Benefit Plan	Level 1	Level 2	Level 3	Total
Assets (mutual funds)				
Short-term bonds	$ 472,519	$ -	$ -	$ 472,519
Intermediate-term bonds	1,296,856	-	-	1,296,856
Balanced	113,454	-	-	113,454
Large-cap stocks	792,737	-	-	792,737
Mid-cap stocks	301,993	-	-	301,993
Small-cap stocks	74,526	-	-	74,526
Foreign stocks	574,726	-	-	574,726
Real estate	104,436	-	-	104,436
Total Plan Assets	$ 3,731,247	$ -	$ -	$ 3,731,247

Defined Contribution Plans

Effective July 1, 2016, KEMI established a 401(a) defined contribution plan for which it is the plan sponsor. Participation in the plan is not mandatory; however, employees who elect to participate are required to contribute 6% of their salary to the plan. Employees who have chosen to participate in the 401(a) defined benefit pension plan are not eligible to participate in the 401(a) defined contribution plan except to the extent of matching employer funds on their 457(b) elective deferrals, as described later in this paragraph. KEMI provides matching funds of 6% for participants hired on or after July 1, 2016; an enhanced match is provided for participants hired prior to July 1, 2016 who were previously members of KERS. KEMI also established a 457(b) plan effective July 1, 2016, for which it is the plan sponsor and to which employees may elect to contribute additional elective deferrals. Employees hired prior to July 1, 2016 are eligible to receive matching employer funds of 50% of their elective deferrals, up to a maximum match of 3%. Employees hired on or after July 1, 2016 may contribute elective deferrals to the 457(b) plan, but are not eligible to receive matching funds. During 2018 and 2017, KEMI contributed matching funds of $1,326,783 and $1,490,867, respectively, to the defined contribution plans. Participants are fully vested after sixty months of service.

Kentucky Employees Retirement Systems

Prior to July 1, 2016, all full-time KEMI employees participated in KERS, a mandatory defined benefit pension plan administered by KRS. KERS is a contributory defined benefit plan to which both employees and employers are required to contribute.

10. Retirement Plans, continued

Kentucky Employees Retirement Systems, continued

On December 3, 2015, the Governor of Kentucky signed an emergency administrative regulation which authorized certain participating employers to voluntarily cease participation in KERS if they paid the full actuarial cost of benefits calculated on current and former employees for which they are responsible. KEMI applied for withdrawal from KERS effective June 30, 2016, and established alternative retirement plans which became effective July 1, 2016. Substantially all of KEMI's active employees elected to transfer their service history and account balances from KERS to KEMI's new retirement plans.

KEMI's application to voluntarily cease participation in KRS effective June 30, 2016 received final approval in April of 2017, at which time KRS notified KEMI that the final actuarially determined cost of benefits for which KEMI was responsible totaled $14,524,203. Payments of $7,143,617 were made by KEMI from July 2016 through April 2017; KEMI paid the remaining balance of $7,380,586 in May 2017. Total payments made to KERS during 2017 were $10,247,084.

11. Federal Income Taxes

As described in Note 1, KEMI is a political subdivision of the Commonwealth and was created by legislation to serve as the insurer of last resort as well as a competitive force to stabilize the workers' compensation market in Kentucky. The Commonwealth provided KEMI's initial funding and continues to influence KEMI through Governor appointed board members and through the role of oversight. The Internal Revenue Service has determined that KEMI is a tax-exempt entity pursuant to Internal Revenue Code section §501(c)(27) and therefore is not subject to federal income taxes. Accordingly, the statutory basis financial statements do not include a provision for federal income taxes.

12. Contingencies

KEMI is involved in litigation and may become involved in potential litigation arising in the ordinary course of business. Additionally, KEMI may be impacted by adverse regulatory actions and adverse court decisions where insurance coverages are expanded beyond the scope of originally contemplated policies. In the opinion of management, the effects, if any, of such litigation and published court decisions are not expected to be material to the statutory basis financial statements.

13. Statutory Requirements

Under the insurance regulations of the Commonwealth of Kentucky, the amount of dividends that KEMI may pay to its policyholders is limited to the excess of actuarially determined minimum policyholder surplus requirements. Actuarially determined minimum policyholder surplus takes into consideration the company's present liabilities as well as management's expectation of future business volumes, claims activity and investment performance. The Commonwealth of Kentucky's statutory minimum policyholder surplus requirement is $1,500,000.

DEAN DORTON
DEAN DORTON ALLEN FORD, PLLC

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*

Independent Auditors Report

Board of Directors
Kentucky Employers' Mutual Insurance Authority dba
Kentucky Employers' Mutual Insurance
Lexington, Kentucky

We have audited, in accordance with the 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, the statutory basis financial statements of Kentucky Employers' Mutual Insurance Authority dba Kentucky Employers' Mutual Insurance (KEMI), as of and for the year ended December 31, 2018, and the related notes to the statutory basis financial statements, which collectively comprise KEMI's basic statutory basis financial statements, and have issued our report thereon dated March 28, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the statutory basis financial statements, we considered KEMI's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the statutory basis financial statements, but not for the purpose of expressing an opinion on the effectiveness of KEMI's internal control. Accordingly, we do not express an opinion on the effectiveness of KEMI'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 control 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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether KEMI's statutory basis 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 determination of statutory basis financial statement amounts. 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 KEMI's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KEMI's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
March 28, 2019

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DEAN DORTON ALLEN FORD PLLC

Awareness Letter

Board of Directors
Kentucky Employers' Mutual Insurance Authority dba
Kentucky Employers' Mutual Insurance
Lexington, Kentucky

We were engaged by Kentucky Employers' Mutual Insurance Authority dba Kentucky Employers' Mutual Insurance (KEMI) to perform annual audits, 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, of KEMI's statutory basis financial statements. In connection therewith, we acknowledge the following:

> We are aware of the provisions relating to the accounting and financial reporting matters in the Insurance Code of the Commonwealth of Kentucky and the related rules and regulations of the Department of Insurance of the Commonwealth of Kentucky that are applicable to audits of statutory basis financial statements of insurance entities. Also, after completion of our audits, we expect that we will issue our report on the statutory basis financial statements of KEMI as to their conformity with accounting practices prescribed or permitted by the Department of Insurance of the Commonwealth of Kentucky.

This letter is intended solely for the information and use of the board of directors and management of KEMI and the Department of Insurance of the Commonwealth of Kentucky and is not intended to be, and should not be, used for anyone other than these specified parties.

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
March 28, 2019

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DEAN DORTON ALLEN FORD, PLLC

Qualification Letter

Board of Directors
Kentucky Employers' Mutual Insurance Authority dba
Kentucky Employers' Mutual Insurance
Lexington, Kentucky

To the Board of Directors of Kentucky Employers' Mutual Insurance:

We have audited, 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, the statutory basis financial statements of Kentucky Employers' Mutual Insurance Authority dba Kentucky Employers' Mutual Insurance (KEMI) for the years ended December 31, 2018 and 2017, and have issued our report thereon dated March 28, 2019. In connection therewith, we advise you as follows:

a) We are independent certified public accountants with respect to KEMI and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants, and the Rules of Professional Conduct of the Kentucky State Board of Accountancy.

b) The engagement partner and the engagement manager, who are certified public accountants, have over 19 years and 11 years, respectively, of experience in public accounting and are experienced in auditing insurance entities. Members of the engagement team, most of whom have had experience in auditing insurance entities and approximately 70% of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.

c) We understand that KEMI intends to file its audited statutory basis financial statements and our report thereon with the Department of Insurance of the Commonwealth of Kentucky (the Department) and that the commissioner of the Department will be relying on that information in monitoring and regulating the statutory financial condition of KEMI.

Although we understand that an objective of issuing a report on the statutory basis financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of insurance regulators. In this context, KEMI and the Department should understand that the objective of an audit of statutory basis financial statements 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*, is to form an opinion and issue a report on whether the statutory basis financial statements present fairly, in all material respects, the admitted assets, liabilities, policyholder surplus, as well as results of operations and cash flows in conformity with accounting practices prescribed or permitted by the Department. Consequently, under auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the statutory basis financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on statutory basis financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Department.

It is the responsibility of the management of KEMI to adopt sound accounting policies, to maintain an adequate and effective system of accounts and to establish and maintain an internal control that will, among other things, provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of statutory basis financial statements in conformity with accounting practices prescribed or permitted by the Department.

The Department should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the statutory financial position of insurers and should not rely solely upon the report of independent auditors.

d) We will retain audit working papers (including those kept in a hard copy or electronic medium) prepared in compliance with professional standards, for seven years from the date that we grant permission to use our report in connection with the issuance of the KEMI's financial statements (report release date). After notification to KEMI, we will make the audit working papers available for review by the Insurance Department of the Commonwealth of Kentucky or its delegates, at the offices of the insurer, at our offices, at the insurance department, or at any other reasonable place designated by the insurance commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Insurance Department of the Commonwealth of Kentucky, photocopies of pertinent audit working papers may be made (under the control of the accountant) and such copies may be retained by the Insurance Department of the Commonwealth of Kentucky. In addition, to the extent requested, we may provide the Department with copies of certain of our audit working papers (such as unlocked electronic copies of Excel spreadsheets that do not contain password protection or encryption). As such, these audit working papers will be subject to potential modification by the Department or by others. We are not responsible for any modifications made to the copies, electronic or otherwise, after they are provided to the Department and we are likewise not responsible for any effect that any such modifications, whether intentional or not, might have on the process, substance or outcome of your regulatory examination.

e) The engagement partner has served in that capacity with respect to KEMI since 2018, is licensed by the Kentucky State Board of Accountancy and is a member in good standing of the American Institute of Certified Public Accountants.

f) To the best of our knowledge and belief, we are in compliance with the requirements of section 7 of the NAIC *Annual Financial Reporting Model Regulation Model Rule (Regulation) Requiring Annual Audited Financial Reports* regarding qualifications of independent certified public accountants.

This letter is intended solely for the information and use of the Department of Insurance of the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than this specified party.

Dean Dorton Allen Ford, PLLC

Lexington, Kentucky
March 28, 2019

SUPPLEMENTARY INFORMATION

SUMMARY INVESTMENT SCHEDULE

Investment Categories	Gross Investment Holdings 1 Amount	2 Percentage	Admitted Assets as Reported in the Annual Statement 3 Amount	4 Securities Lending Reinvested Collateral Amount	5 Total (Col. 3 + 4) Amount	6 Percentage
1. Bonds:						
1.1 U.S. treasury securities	46,685,738	4.9	46,685,738		46,685,738	4.9
1.2 U.S. government agency obligations (excluding mortgage-backed securities):						
1.21 Issued by U.S. government agencies		0.0			0	0.0
1.22 Issued by U.S. government sponsored agencies		0.0			0	0.0
1.3 Non-U.S. government (including Canada, excluding mortgage-backed securities)	3,778,083	0.4	3,778,083		3,778,083	0.4
1.4 Securities issued by states, territories and possessions and political subdivisions in the U.S.:						
1.41 States, territories and possessions general obligations	1,164,971	0.1	1,164,971		1,164,971	0.1
1.42 Political subdivisions of states, territories and possessions and political subdivisions general obligations	2,870,341	0.3	2,870,341		2,870,341	0.3
1.43 Revenue and assessment obligations	17,458,042	1.8	17,458,042		17,458,042	1.8
1.44 Industrial development and similar obligations		0.0			0	0.0
1.5 Mortgage-backed securities (includes residential and commercial MBS):						
1.51 Pass-through securities:						
1.511 Issued or guaranteed by GNMA	226,717	0.0	226,717		226,717	0.0
1.512 Issued or guaranteed by FNMA and FHLMC	108,781,087	11.3	108,781,087		108,781,087	11.3
1.513 All other		0.0			0	0.0
1.52 CMOs and REMICs:						
1.521 Issued or guaranteed by GNMA, FNMA, FHLMC or VA	30,673,260	3.2	30,673,260		30,673,260	3.2
1.522 Issued by non-U.S. Government issuers and collateralized by mortgage-based securities issued or guaranteed by agencies shown in Line 1.521		0.0			0	0.0
1.523 All other	48,266,283	5.0	48,266,283		48,266,283	5.0
2. Other debt and other fixed income securities (excluding short-term):						
2.1 Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	453,243,583	47.1	453,243,583		453,243,583	47.1
2.2 Unaffiliated non-U.S. securities (including Canada)	124,873,544	13.0	124,873,544		124,873,544	13.0
2.3 Affiliated securities		0.0			0	0.0
3. Equity interests:						
3.1 Investments in mutual funds		0.0			0	0.0
3.2 Preferred stocks:						
3.21 Affiliated		0.0			0	0.0
3.22 Unaffiliated		0.0			0	0.0
3.3 Publicly traded equity securities (excluding preferred stocks):						
3.31 Affiliated		0.0			0	0.0
3.32 Unaffiliated	70,699,997	7.3	70,699,997		70,699,997	7.3
3.4 Other equity securities:						
3.41 Affiliated		0.0			0	0.0
3.42 Unaffiliated		0.0			0	0.0
3.5 Other equity interests including tangible personal property under lease:						
3.51 Affiliated		0.0			0	0.0
3.52 Unaffiliated		0.0			0	0.0
4. Mortgage loans:						
4.1 Construction and land development		0.0			0	0.0
4.2 Agricultural		0.0			0	0.0
4.3 Single family residential properties		0.0			0	0.0
4.4 Multifamily residential properties		0.0			0	0.0
4.5 Commercial loans		0.0			0	0.0
4.6 Mezzanine real estate loans		0.0			0	0.0
5. Real estate investments:						
5.1 Property occupied by company	5,020,818	0.5	5,020,818		5,020,818	0.5
5.2 Property held for production of income (including $.........0 of property acquired in satisfaction of debt)		0.0			0	0.0
5.3 Property held for sale (including $.........0 property acquired in satisfaction of debt)		0.0			0	0.0
6. Contract loans		0.0			0	0.0
7. Derivatives		0.0			0	0.0
8. Receivables for securities		0.0			0	0.0
9. Securities lending (Line 10, Asset Page reinvested collateral)		0.0		XXX	XXX	XXX
10. Cash, cash equivalents and short-term investments	35,224,679	3.7	35,224,679		35,224,679	3.7
11. Other invested assets	13,082,901	1.4	13,082,901		13,082,901	1.4
12. Total invested assets	962,050,045	100.0	962,050,045	0	962,050,045	100.0

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SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES

For the year ended December 31, 2018

(To be filed by April 1)

Of KENTUCKY EMPLOYERS' MUTUAL INSURANCE AUTHORITY

Address (City, State, Zip Code): Lexington KY 40507-1724

NAIC Group Code.....0 NAIC Company Code.....10320 Employer's ID Number.....61-1275981

The Investment Risks Interrogatories are to be filed by April 1. They are also to be included with the Audited Statutory Financial Statements.

Answer the following interrogatories by reporting the applicable U.S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments.

1. Reporting entity's total admitted assets as reported on Page 2 of this annual statement. $...1,043,037,071

2. Ten largest exposures to a single issuer/borrower/investment.

	1 Issuer	2 Description of Exposure	3 Amount	4 Percentage of Total Admitted Assets
2.01	Federal National Mortgage Association	MBS, CMO	$......77,476,152	7.4 %
2.02	Federal Home Loan Mortgage Corporation	MBS, CMO	$......56,900,849	5.5 %
2.03	First American Funds, Inc	MMFund	$......21,421,380	2.1 %
2.04	Elmtree U.S. Net Lease Fund III GP LLC	Sch BA-Joint Venture	$......13,082,901	1.3 %
2.05	JPMorgan Chase & Co	Bonds, Equity	$........6,603,464	0.6 %
2.06	Morgan Stanley	Bonds, MBS	$........5,784,427	0.6 %
2.07	Cisco Systems, Inc	Bonds, Equity	$........5,187,561	0.5 %
2.08	National Rural Utilities Cooperative Finance Corp	Bonds	$........5,046,268	0.5 %
2.09	Pfizer Inc	Bonds, Equity	$........4,561,014	0.4 %
2.10	The Charles Schwab Corporation	Bonds	$........4,496,199	0.4 %

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC designation.

	Bonds	1	2
3.01	NAIC 1	$....662,793,867	63.5 %
3.02	NAIC 2	$....148,464,963	14.2 %
3.03	NAIC 3	$......26,762,820	2.6 %
3.04	NAIC 4	$	0.0 %
3.05	NAIC 5	$	0.0 %
3.06	NAIC 6	$	0.0 %
	Preferred Stocks	3	4
3.07	P/RP-1	$	0.0 %
3.08	P/RP-2	$	0.0 %
3.09	P/RP-3	$	0.0 %
3.10	P/RP-4	$	0.0 %
3.11	P/RP-5	$	0.0 %
3.12	P/RP-6	$	0.0 %

4. Assets held in foreign investments:

4.01 Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 4.01 above is yes, responses are not required for interrogatories 5-10.

4.02	Total admitted assets held in foreign investments	$....116,987,587	11.2 %
4.03	Foreign-currency-denominated investments	$	0.0 %
4.04	Insurance liabilities denominated in that same foreign currency	$	0.0 %

5. Aggregate foreign investment exposure categorized by NAIC sovereign designation:

		1	2
5.01	Countries designated NAIC 1	$....112,500,042	10.8 %
5.02	Countries designated NAIC 2	$........4,487,545	0.4 %
5.03	Countries designated NAIC 3 or below	$	0.0 %

6. Largest foreign investment exposures by country, categorized by the country's NAIC sovereign designation:

		1	2
	Countries designated NAIC 1:		
6.01	Country 1: United Kingdom	$......21,838,730	2.1 %
6.02	Country 2: Cayman Islands	$......14,501,798	1.4 %
	Countries designated NAIC 2:		
6.03	Country 1: Mexico	$........2,071,973	0.2 %
6.04	Country 2: Spain	$........1,995,352	0.2 %
	Countries designated NAIC 3 or below:		
6.05	Country 1:	$	0.0 %
6.06	Country 2:	$	0.0 %

		1	2
7.	Aggregate unhedged foreign currency exposure	$	0.0 %

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign designation:

	1	2
8.01 Countries designated NAIC 1	$	0.0 %
8.02 Countries designated NAIC 2	$	0.0 %
8.03 Countries designated NAIC 3 or below	$	0.0 %

9. Largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign designation:

	1	2
Countries designated NAIC 1:		
9.01 Country 1:	$	0.0 %
9.02 Country 2:	$	0.0 %
Countries designated NAIC 2:		
9.03 Country 1:	$	0.0 %
9.04 Country 2:	$	0.0 %
Countries designated NAIC 3 or below:		
9.05 Country 1:	$	0.0 %
9.06 Country 2:	$	0.0 %

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

	1 Issuer	2 NAIC Designation	3	4
10.01	American Honda Finance Corporation	1FE	$3,089,984	0.3 %
10.02	Shell International Finance B.V.	1FE	$3,054,555	0.3 %
10.03	Anheuser-Busch InBev Finance Inc	2FE	$2,993,710	0.3 %
10.04	UBS AG	1FE	$2,699,658	0.3 %
10.05	BP Capital Markets P.L.C.	1FE	$2,505,654	0.2 %
10.06	HSBC Holdings PLC	1FE	$2,503,127	0.2 %
10.07	Svenska Handelsbanken AB	1FE	$2,502,311	0.2 %
10.08	Macquarie Group Limited	1FE	$2,500,000	0.2 %
10.09	National Australia Bank Limited	1FE	$2,498,404	0.2 %
10.10	B. A. T. Capital Corporation	2FE	$2,000,000	0.2 %

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 11.01 is yes, detail is not required for the remainder of Interrogatory 11.

11.02 Total admitted assets held in Canadian Investments	$	0.0 %
11.03 Canadian currency-denominated investments	$	0.0 %
11.04 Canadian-denominated insurance liabilities	$	0.0 %
11.05 Unhedged Canadian currency exposure	$	0.0 %

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions.

12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 12.01 is yes, responses are not required for the remainder of Interrogatory 12.

1	2	3
12.02 Aggregate statement value of investments with contractual sales restrictions	$	0.0 %
Largest three investments with contractual sales restrictions:		
12.03	$	0.0 %
12.04	$	0.0 %
12.05	$	0.0 %

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

13.01 Are assets held in equity interest less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 13.01 above is yes, responses are not required for the remainder of Interrogatory 13.

1 Name of Issuer	2	3
13.02 Elmtree U.S. Net Lease Fund III G.P., L.L.C.	$13,082,901	1.3 %
13.03 Broadcom Inc.	$1,772,586	0.2 %
13.04 AFLAC Incorporated	$1,648,452	0.2 %
13.05 Air Products and Chemicals, Inc.	$1,646,434	0.2 %
13.06 Kimberly-Clark Corporation	$1,634,355	0.2 %
13.07 AbbVie Inc.	$1,618,395	0.2 %
13.08 Qualcomm Incorporated	$1,616,642	0.2 %
13.09 The Procter & Gamble Company	$1,609,611	0.2 %
13.10 Merck & Co., Inc.	$1,593,836	0.2 %
13.11 Walmart Inc.	$1,578,706	0.2 %

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 14.01 above is yes, responses are not required for the remainder of Interrogatory 14.

1	2	3
14.02 Aggregate statement value of investments held in nonaffiliated, privately placed equities	$	0.0 %
Largest three investments held in nonaffiliated, privately placed equities:		
14.03	$	0.0 %
14.04	$	0.0 %
14.05	$	0.0 %

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 15.01 above is yes, responses are not required for the remainder of Interrogatory 15.

	1	2	3
15.02	Aggregate statement value of investments held in general partnership interests	$	0.0 %
	Largest three investments in general partnership interests:		
15.03		$	0.0 %
15.04		$	0.0 %
15.05		$	0.0 %

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 16.01 above is yes, responses are not required for the remainder of Interrogatory 16 and Interrogatory 17.

	1 Type (Residential, Commercial, Agricultural)	2	3
16.02		$	0.0 %
16.03		$	0.0 %
16.04		$	0.0 %
16.05		$	0.0 %
16.06		$	0.0 %
16.07		$	0.0 %
16.08		$	0.0 %
16.09		$	0.0 %
16.10		$	0.0 %
16.11		$	0.0 %

Amount and percentage of the reporting entity's total admitted assets held in the following categories of mortgage loans:

		Loans	
16.12	Construction loans	$	0.0 %
16.13	Mortgage loans over 90 days past due	$	0.0 %
16.14	Mortgage loans in the process of foreclosure	$	0.0 %
16.15	Mortgage loans foreclosed	$	0.0 %
16.16	Restructured mortgage loans	$	0.0 %

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

	Loan-to-Value	Residential		Commercial		Agricultural	
		1	2	3	4	5	6
17.01	above 95%	$	0.0 %	$	0.0 %	$	0.0 %
17.02	91% to 95%	$	0.0 %	$	0.0 %	$	0.0 %
17.03	81% to 90%	$	0.0 %	$	0.0 %	$	0.0 %
17.04	71% to 80%	$	0.0 %	$	0.0 %	$	0.0 %
17.05	below 70%	$	0.0 %	$	0.0 %	$	0.0 %

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

18.01 Are assets held in real estate reported less than 2.5% of the reporting entity's total admitted assets? Yes [X] No [ ]

If response to 18.01 above is yes, responses are not required for the remainder of Interrogatory 18.

Largest five investments in any one parcel or group of contiguous parcels of real estate:

	Description	2	3
18.02		$	0.0 %
18.03		$	0.0 %
18.04		$	0.0 %
18.05		$	0.0 %
18.06		$	0.0 %

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans.

19.01 Are assets held in investments held in mezzanine real estate loans less than 2.5% of the reporting entity's admitted assets? Yes [X] No [ ]

If response to 19.01 is yes, responses are not required for the remainder of Interrogatory 19.

	1	2	3
19.02	Aggregate statement value of investments held in mezzanine real estate loans	$	0.0 %
	Largest three investments held in mezzanine real estate loans:		
19.03		$	0.0 %
19.04		$	0.0 %
19.05		$	0.0 %

20. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

		At Year-End		At End of Each Quarter		
				1st Qtr	2nd Qtr	3rd Qtr
		1	2	3	4	5
20.01	Securities lending agreements (do not include assets held as collateral for such transactions)	$	0.0 %	$	$	$
20.02	Repurchase agreements	$	0.0 %	$	$	$
20.03	Reverse repurchase agreements	$	0.0 %	$	$	$
20.04	Dollar repurchase agreements	$	0.0 %	$	$	$
20.05	Dollar reverse repurchase agreements	$	0.0 %	$	$	$

21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps and floors:

	Owned		Written	
	1	2	3	4
21.01 Hedging	$	0.0 %	$	0.0 %
21.02 Income generation	$	0.0 %	$	0.0 %
21.03 Other	$	0.0 %	$	0.0 %

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:

	At Year-End		At End of Each Quarter		
			1st Qtr	2nd Qtr	3rd Qtr
	1	2	3	4	5
22.01 Hedging	$	0.0 %	$	$	$
22.02 Income generation	$	0.0 %	$	$	$
22.03 Replications	$	0.0 %	$	$	$
22.04 Other	$	0.0 %	$	$	$

23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:

	At Year-End		At End of Each Quarter		
			1st Qtr	2nd Qtr	3rd Qtr
	1	2	3	4	5
23.01 Hedging	$	0.0 %	$	$	$
23.02 Income generation	$	0.0 %	$	$	$
23.03 Replications	$	0.0 %	$	$	$
23.04 Other	$	0.0 %	$	$	$

REINSURANCE INTERROGATORIES

7.1 Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? Yes [X] No [ ]

7.2 If yes, indicate the number of reinsurance contracts containing such provisions. 1

7.3 If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? Yes [X] No [ ]

8.1 Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured? Yes [ ] No [X]

8.2 If yes, give full information

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

(a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;

(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

(c) Aggregate stop loss reinsurance coverage;

(d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

(f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity? Yes [ ] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:

(a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract. Yes [ ] No [X]

9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for General Interrogatory 9:

(a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;

(b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and

(c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

9.4 Except for transactions meeting the requirements of paragraph 31 of *SSAP No. 62R, Property and Casualty Reinsurance*, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

(a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or

(b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [ ] No [X]