NCRF

2018 Annual Report

North Carolina Reinsurance Facility

REINSURANCE FACILITY

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General Organizational Information

NCRF Main Phone Number. 919-783-9790

Facsimile. 919-783-0355

Website Address. . . . . www.ncrb.org/ncrf/

Physical Address . . . . . 2910 Sumner Blvd.
Raleigh, NC 27616

Management Contacts

NCRF Staff

Ray Evans . . . . . General Manager
919-783-9790 . . . . . rfe@ncrb.org

Terry Collins . . . . . Chief Operating Officer
919-582-1076 . . . . . tfc@ncrb.org

Tom Burns. . . . . Director, Auto Operations
919-719-3033 . . . . . tfb@ncrb.org

Jannet Barnes . . . . . Manager, Compliance Claims
919-582-1022 . . . . . jbb@ncrb.org

Andy Montano . . . . . Manager, Automobile
919-582-1021 . . . . . afm@ncrb.org

Donna Kallianos . . . . . Manager, Claims
919-582-1046 . . . . . dpk@ncrb.org

Edith Davis . . . . . Chief Financial Officer
919-582-1006 . . . . . etd@ncrb.org

Vicki Godbold . . . . . Chief Human Resources Officer
919-645-3170 . . . . . vcg@ncrb.org

Shelley Chandler . . . . . Chief Information Officer
919-582-1057 . . . . . src@ncrb.org

2018 Annual Meeting

The annual meeting of member companies of the North Carolina Reinsurance Facility will be held October 11, 2018, at the Grandover Resort and Conference Center, Greensboro, North Carolina.

GENERAL MANAGER'S REPORT

Ray Evans
General Manager

2018 has been a good year. Most significantly, we have made great progress towards financially "righting the ship" after four years of very poor loss experience. And, while responding to the Facility's financial position was the number one priority, we have also made good progress towards our other strategic objectives:

- A well-trained and professional workforce,
- A comprehensive electronic environment,
- Faithful compliance with statutes and regulations, and
- Continuing to fulfill the purpose of the Facility in enabling access to liability insurance for all eligible drivers.

The Facility's financial position improvement, which is detailed in following reports, is due to a number of factors. Extremely important is that loss experience appears to be no longer deteriorating due to a number of factors in the background: miles driven continues to increase, but at a reduced rate; distracted driving remains a problem if my unscientific surveys driving to work are accurate, but there are now constant reminders in the media of the effects, which are creating greater awareness; and, repair cost inflation is not quite as strong. The biggest impact on our financials, though, is due to rate changes and loss surcharges.

The most significant of these was a 10% increase in PPA liability rates approved by Commissioner Causey early in 2017 and effective last October. Almost as significant have been four commercial auto increases since 2015, with another on the way early in 2019. The clean risk surcharge and PPA "other than clean" rates are reviewed regularly and adjusted to actuarially correct levels when indicated. And now, effective October 1, 2018, there will be a commercial auto loss recoupment surcharge applicable to commercial auto policies.

The key to a successful Facility is a well-trained and professional workforce managed by good leaders. For the last year, this has been directed by Terry Collins, who, while dealing with financial concerns, has quickly learned the complexity of the Facility. To keep the Facility moving forward, he has hired several experts, including Tom Burns, a property casualty insurance veteran with considerable commercial auto experience. There have also been additions to our member analysts and compliance auditors in anticipation of increased activity due to the commercial auto loss recoupment.

Developing a comprehensive electronic environment is a moving target, with security concerns, constant upgrades to the 60 or so individual software programs we have, and near constant equipment upgrades. However, with the help of a sophisticated Information Services Department led by Shelley Chandler, our CIO, we have made great progress, even with a large project like the commercial auto loss recoupment. In fact, we recently purchased a new program enabling us to access more data and ultimately convert it into information displays that we believe will not only be useful to us, but also to carriers. Tom and Jannet Barnes will be using this to create the next level of compliance technology during 2019 to increase our effectiveness in verifying premiums and losses.

Faithful compliance with statutes and regulations has been made a little more difficult over the past few years as we do not lobby and we rely on insurance industry and other lobbyists to keep us "in the loop." In return, they use us as experts on the potential effects of proposed and pending legislation and regulatory changes. Over the past few years, in addition to Legislators experienced in insurance matters leaving the Legislature, many of the lobbyists we have been connected to have retired, leaving a void and damaging an "early warning" system, if you will, that enabled us to respond quickly, professionally, and appropriately to upcoming changes. While still maintaining our "no lobbying position," this is an issue we are trying to resolve before the long session of the Legislature begins in January 2019.

As I look back on 2018 and survey the progress, it is important to note how involved, concerned, and effective the Board, our committees, and task forces have been. Without their counsel, guidance, and willingness to meet with us, often at short notice, much of our progress would not have happened. So, from all of the Facility staff, a giant thank you to all of you who contribute so much of your time to the work of our committees and task forces.

MESSAGE FROM THE CHAIRMAN

Last year I mentioned "change" as the theme for 2017 — looking back I would say that dealing with change is the new norm for our industry. As I reflect on 2018, new themes come to mind: collaboration, flexibility, and discipline. The NCRF team has a great working relationship with the Department, has engaged associates and working committees, and has the respect of many industry leaders both in and out of NC. The team has worked swiftly and shown flexibility as market conditions continue to change and have executed on tough business decisions to improve members' equity throughout the course of the year. They have done this and a terrific job of taking care of associates and the business at hand.

Below are some of the highlights for the year:

- An improvement in our members' equity deficit of $65 million from June 2017 through June 2018 developed from continuing to "pull all levers" (clean risk recoupment, loss recoupment, and rate increases coupled with positive impacts from fraud legislation). Together these actions combined to drive the inflow of revenue to exceed outflow.
- The Facility witnessed another year of growth with ceded written premium once again eclipsing $1 billion. However, both cession activity and policies in force declined for the first time in several years, possibly indicating a slowing of growth.
- The first commercial auto loss recoupment since the late 1980s was implemented effective on October 1, 2018, to recover prior losses on ceded commercial auto risks. This all-important program required a great deal of collaboration, partnership, and communication between the Facility and member companies.
- After escalating for several years, Facility automobile loss trends have leveled out during the fiscal year. This halt in momentum coupled with clean risk and loss recoupments should provide the basis for continued improvement in the Facility results.
- As the Facility continues to evolve, we have welcomed another new associate in a key management position. Tom Burns joined the Facility in the newly created role of Director of Auto Operations, overseeing commercial auto rating and both private passenger auto and commercial auto compliance auditing.
- Through June 2018, our administrative expenses were just below budget. While the administrative expenses have remained very stable and consistent over the past few years, significant legal and advisory expenses and the onboarding of additional staff may result in the Facility slightly exceeding the budget by year's end.
- The book value of our investment portfolio has increased since June 2017 and has outperformed the benchmark.

I feel honored to have served with the NCRF team and board members. We lost several tenured board members in 2017, but gained new members with both the knowledge and determination to continue the great work of past Boards. Thank you to my peers for all that you do for the NCRF — it has truly been a pleasure working with each of you. And, to the NCRF team — you have shown unwavering discipline in positioning the Facility for success today and in the future. I look forward to working alongside each of you in the coming years as we continue to evolve to meet the needs of our customers and member companies.

Mendi Riddle
Nationwide Insurance Company, *Chairman*

BOARD OF GOVERNORS

Responsibility for management is vested in a 15-member Board of Governors. The Board includes 12 voting members, seven member insurance companies, and five agents appointed by the Insurance Commissioner; two nonvoting public members appointed by the Governor; and the Insurance Commissioner, who is a member of the Board ex-officio without vote. Six meetings of the Board were held during the year, including three telephone conferences.

Agent Members	Representative
Apptd. by the Commissioner of Insurance	Wortham M. Boyle
Apptd. by the Commissioner of Insurance	Justin Litaker
Auto Insurance Agents of North Carolina	Jeffrey W. Butler
Independent Insurance Agents of NC	John Miller
Independent Insurance Agents of NC	Andy Calvert

Members	Representative
Allstate Insurance Co.	Laura Hoffman
Atlantic Casualty Insurance Co.	Robbie Strickland
GEICO Indemnity Co.	Mindy Siebold
Integon Indemnity Corporation	Art Lyon
Nationwide Mutual Insurance Co.*	Mendi Riddle
NC Farm Bureau Mutual Insurance Co.	Roger N. Batdorff
Travelers Indemnity Co.	Kirsten Forbes

Public Members
J. David Walker
Reverend Dr. Mark R. Royster, Sr.

Ex-officio Member
Mike Causey, Commissioner of Insurance

STANDING ADVISORY COMMITTEES

The Plan of Operation establishes a number of advisory committees. These committees oversee the activities of the Facility and formulate recommendations for presentation to the Board of Governors. In addition, several other specialty advisory groups perform similar tasks for the Facility throughout the year.

Audit Committee

Members	Representative
Liberty Mutual Insurance Co.*	Judi Gonsalves
NC Farm Bureau Mutual Insurance Co.	Brian Top
Nationwide Mutual Insurance Co.	Eric Ryan
Pennsylvania Nat Mut Casualty Ins Co.	Jonathan S. Dillion
State Farm Mutual Automobile Ins Co.	Alan Bentley
Travelers Indemnity Co.	Jennifer Baurle
Agent	John Miller

Investment Committee

Members	Representative
Allstate Insurance Co.	Ronald Pullie
Nationwide Mutual Insurance Co.*	John G. Morris
State Farm Mutual Automobile Ins Co.	Robert Stephan

Rating Committee

Members	Representative
Atlantic Casualty Insurance Co.*	Mark Caughron
Integon Indemnity Corporation	Brian Rogers
Nationwide Mutual Insurance Co.	David Edwards
NC Farm Bureau Mutual Insurance Co.	Roger N. Batdorff
Stonewood Insurance Companies	Susan Richardson
Travelers Indemnity Co.	Edward A. Bosk
Agent	John Miller

Task Force on Expense Allowances

Members	Representative
Allstate Insurance Co.	Laura Hoffman
Nationwide Mutual Insurance Co.*	Nick Sizemore
Sentry Insurance A Mutual Co.	Peter Sampson
State Farm Mutual Automobile Ins Co.	Alan Bentley
GEICO Indemnity Co.	Maren Kench
Agent	Justin Litaker

Task Force on Recoupment

Members	Representative
Integon Indemnity Corporation	Art Lyon
Nationwide Mutual Insurance Co.	Nick Sizemore
NC Farm Bureau Mutual Insurance Co.	Roger N. Batdorff
Progressive Casualty Insurance Co.	Kevin McGee
State Farm Mutual Automobile Ins Co.*	Alan Bentley
Agent	Wortham M. Boyle

*Chair

MANAGEMENT REPORT

Terry Collins
Chief Operating Officer

Introduction

It is hard to believe I have already celebrated my one-year anniversary at the North Carolina Reinsurance Facility. I am amazed at how quickly the year passed — and how much I continue to enjoy the challenge and continual learning. I would be remiss not to thank the Board of Governors, the committees, member companies, and staff for their support during my transition. Your assistance, understanding, and patience has been very much appreciated.

I was fortunate to inherit a knowledgeable and skilled staff that never loses sight of our mandate. Each day we seek to support the overall health of the vibrant North Carolina automobile insurance marketplace by ensuring "… the availability of motor vehicle insurance to any eligible risk…." Some would argue this support is ultimately reflected in the premium ceded to the Facility. Thus, we consider this an important data point.

We concluded calendar year 2017 with over $1 billion of ceded liability written premium, which represented an 8.2% increase over calendar year 2016. This equates to a 28% market share of the statewide automobile liability written premium and remains well within our historical range. It is important to note this rise in written premium was primarily fueled by average premium per policy growth in both private passenger and other than nonfleet private passenger auto (commercial auto) as policies in force fell below the prior year.

As with any enterprise, the Facility is not immune to challenges. The primary challenge impacting our results is the ongoing loss pressure from the many external factors faced industrywide, such as

- Distracted driving
- More vehicles on the road
- Higher repair costs
- Increased fatalities
- Impaired driving
- More miles driven
- Medical inflation
- Heightened litigation

While the impact from these factors is ultimately manifested in our operating results, we are seeing undeniable improvement in our trends over the past year. Our operating results are not yet where we would prefer, but they are definitely headed in the right direction.

Possibly our most important objective this past year has been the development and implementation of the commercial auto loss recoupment program. This was a huge effort for both the Facility staff and the member companies. This program was effective on October 1, 2018.

Details on both of the above follow in this report.

Operating Results

Now, let's take a high level look at our results — specifically members' equity. Managing members' equity is always one of our highest priorities. Changes in these balances are monitored very closely by both staff and committees, and appropriate action is taken under the oversight of the Board of Governors and within the guidelines outlined in the governing statutes.

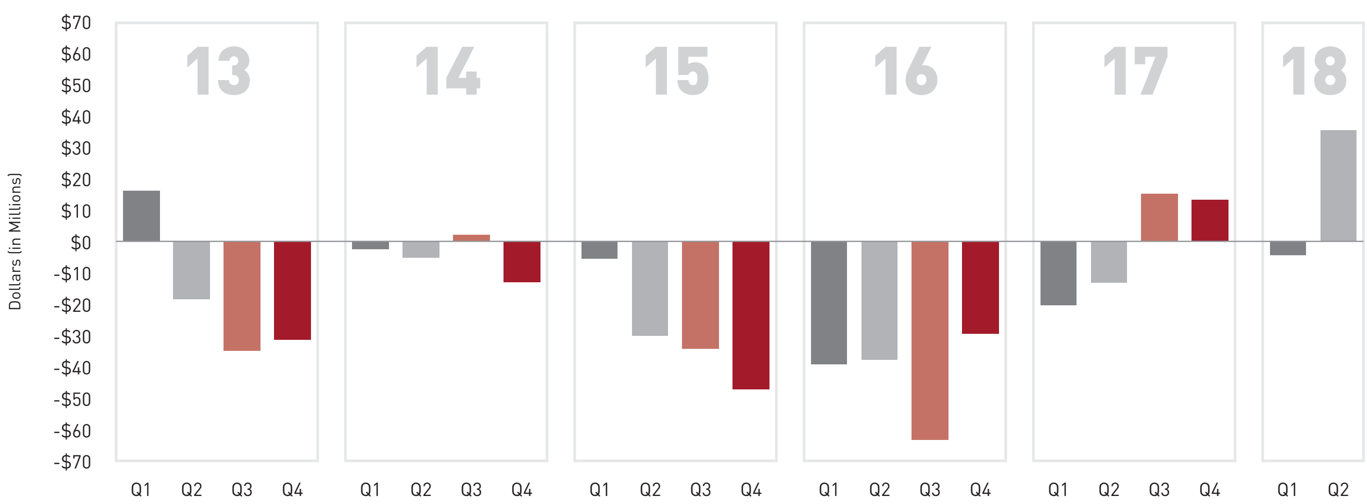
The total members' equity position has improved $65 million since bottoming in June 2017. Our current equity balance through June 2018 stands at -$260 million versus the prior year period of -$325 million. While members' equity does remain negative, the progress above is a positive reflection of prior actions taken by the Board.

At this point in time last year, the data indicated an improving result in private passenger auto was on the horizon. Thus far, all of the improvement shown above in members' equity has been in private passenger auto — largely the result of the inflow of loss recoupment revenue. In June 2017, the private passenger auto member's equity was -$231 million, and over the next four quarters, the deficit was cut by $89 million to -$140 million as of June 2018. Fueling this recovery was a combination of increases in rate where allowed and recoupment surcharges. While there is still a deficit, the current data leads us to believe that the worst results are behind us with

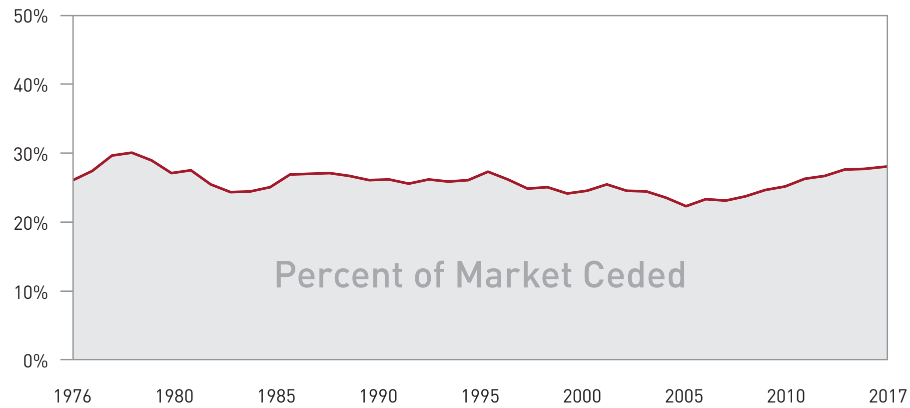
- written premiums still rising,
- stabilizing paid loss trends, and
- policies in force below the historical highs.

Commercial auto has been and continues to be a difficult line of business for the industry and the Facility. Members' equity remains unfavorable at -$121 million on a line of business that has slightly over $114 million in ceded written

Net Results of Operations (After Recoupments)



Share of NC Auto Liability Market Ceded — By Calendar Year



premium. Fortunately, the negative momentum has decelerated over the last several quarters. The intense pressure that swiftly arose last year has been blunted by the combined impact of multiple rate increases, changes in rating rules, and tightened eligibility requirements (anti-fraud measures) that are still working their way into the results. Average quarterly losses still exist today, but compared to last year, they are substantially improved. The aforementioned commercial auto loss recoupment and anticipated commercial auto rate change in early 2019 are still needed to help continue turning back the tide in this high exposure line.

Volume

The North Carolina Reinsurance Facility remains the largest residual market mechanism for automobile insurance in the United States. The Facility provides reinsurance for approximately one-quarter of the automobile liability business written in North Carolina. While this figure has remained notably stable since the Facility was created in 1973, as illustrated in a chart ABOVE, the market share has increased slightly in each of the last eight years.

Our distribution of ceded exposures has remained stable over the last several years. Segmenting our exposure base shows 77% as private passenger "clean risks" and 21% as private passenger "other-than-clean" risks, with the remaining 2% of ceded exposures commercial auto risks.

Overall, total cession notice volume has reversed from the 6% increase last year to a 6% reduction this year. Both private passenger auto and commercial auto have posted decreases in cession volume over the past year, and these decreases are also reflected in the policy in force counts.

As of June 2018, we had approximately 1.3 million total policies in force — generating over 30 million transactions annually. This policy count is a decrease of 5.3% from the prior year. Both auto lines are posting a decrease versus prior year with the drop off in commercial auto policies a little steeper than that of the larger private passenger auto policy base. However, the longer term policy in force trends for both auto lines appear to be leveling off somewhat.

Written premium for the fiscal year ending September 2018 is projected to exceed $1 billion, which will be approximately 6% higher than the previous fiscal year. Both private passenger and commercial auto are contributing to this increase. With the lower policy counts mentioned above, this increase in written premium is being driven by higher average premiums per policy. The distribution of written premium is roughly 90% private passenger auto and 10% commercial auto.

Rates, Rules and Forms

Personal Auto Program Changes

Effective October 1, 2017

The Facility implemented an average +10.1% auto liability rate change on "clean risks" in tandem with voluntary rates settled between the North Carolina Rate Bureau and the Department of Insurance. All liability coverages were impacted by this revision.

For "other-than-clean" private passenger risks, the Facility filed and implemented a +13.0% rate increase over the rates previously in effect. Bodily Injury, Property Damage, and Med Pay rates were each revised.

Motorcycle relativities were also adjusted to reflect the above changes in the auto base rates.

The Facility adopted revisions to the Safe Driver Insurance Plan to comply with the provisions of HB 287, which amended the property damage accident thresholds for private passenger auto. For at-fault accidents involving property damage, the thresholds for point assignments were increased for accidents occurring on or after October 1, 2017.

Effective October 1, 2018

The Facility filed and implemented an average +7.6% auto liability rate change on "other-than-clean" private passenger risks. The rates for Bodily Injury, Property Damage, and Med Pay were each revised.

Commercial Auto Program Changes

Effective October 1, 2017

For commercial auto risks, the Facility filed and implemented revised basic limits liability rates effective for trucks, tractors and trailers, and private passenger types not eligible for rating under the North Carolina Personal Automobile Manual and revised bodily injury and property damage increased limits factors for such coverages rated under the Facility's Commercial Automobile Manual. Reflecting the continued deterioration in commercial loss experience, the various rate level changes in this filing averaged +9.9% over the rates previously in effect.

Effective June and July 2018

In June 2018, the Legislature in House Bill 382 enacted revisions to the rate evasion and fraud provisions of G.S. 58-2-164. These revisions added additional items of "reliable proof of North Carolina residency or eligible risk status" for purposes of commercial auto insurance. As required in the revised G.S. 58-2-164, the Facility introduced the Certification of Ownership Form NCRF-47 on June 29, 2018. Shortly after that, the Facility revised the Standard Practice Manual and the Commercial Automobile Manual to include the revisions to G.S. 58-2-164.

Effective early 2019

A commercial auto rate revision is anticipated for early 2019. At the time of preparation of this report, neither the effective date nor the percentage change had been finalized.

Recoupment

North Carolina law allows carriers to cede to the Facility any eligible risks. While the Facility establishes actuarially sound rates for private passenger auto "other-than-clean" risks (except that no profit is included), the rates for "clean risks" are statutorily capped at the voluntary rate level, which has historically been inadequate to pay the losses and expenses of the clean risks ceded to the Facility. The shortfall between what this group pays and what it should pay is made up through the statutorily authorized *clean risk recoupment surcharge* applied to the liability premiums of all, and only, private passenger non-fleet policies.

North Carolina law also allows the Facility to recoup operating losses through the loss recoupment surcharge. This surcharge may be applied to either nonfleet private passenger auto policies or commercial auto policies to recoup prior operating losses on those separate lines of business.

Both clean risk and loss recoupment surcharges are reviewed at least annually and adjusted as deemed appropriate and necessary.

Private Passenger Auto

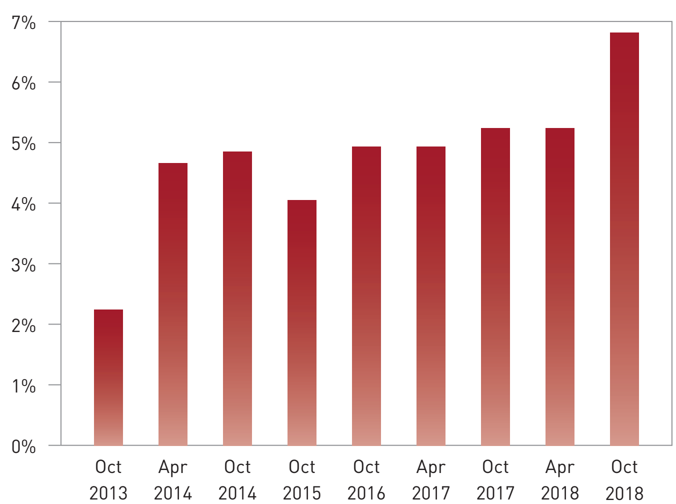
In June 2017, the Board of Governors implemented a new clean risk recoupment surcharge of 5.25% (before inclusion of agent compensation) and a private passenger auto loss recoupment surcharge of 5.06% (before inclusion of agent compensation), applicable to all new and renewal private passenger auto policies becoming effective on and after October 1, 2017, through March 31, 2018.

In December 2017, the Board of Governors authorized the continuance of the clean risk recoupment surcharge of 5.25% (before inclusion of agent compensation) and increased the private passenger auto loss recoupment surcharge to 6.67% (before inclusion of agent compensation), which became applicable to all new and renewal private passenger policies effective on and after April 1, 2018, through September 30, 2018. For the current fiscal year through June 2018, income from clean risk surcharges has generated approximately $156 million, and income from these private passenger auto loss surcharges has generated approximately $168 million.

In June 2018, the Board of Governors authorized a new clean risk recoupment surcharge of 6.82% (before inclusion of agent compensation) and a private passenger auto loss recoupment surcharge of 3.06% (before inclusion of agent compensation), applicable to all new and renewal private passenger auto policies becoming effective on and after October 1, 2018, through March 31, 2019.

To simplify the programming requirements for the member companies, the Facility continues to require companies to report the private passenger auto clean risk and loss recoupments on a combined basis, saving expense and effort for all private passenger carriers in the state.

Clean Risk Recoupment Surcharges



Commercial Auto

In October 2017, the Board of Governors authorized the implementation of a loss recoupment surcharge for commercial auto effective October 1, 2018. The surcharge was originally announced to be 14.61% but was subsequently revised by the Board of Governors to be 7.07% (before inclusion of agent compensation) and will be applicable through September 30, 2019. This loss recoupment surcharge will also be reviewed at least annually and adjusted as deemed appropriate and necessary.

The most recent prior commercial auto loss recoupment was 30 years ago in 1988. As such, there was extensive discussion by the Board of Governors before reaching the difficult decision to implement a commercial auto loss surcharge in October 2018. This recoupment surcharge was anticipated to require a significant programming effort by the member companies. For the Facility staff, this "new" loss recoupment resulted in the need for wide-ranging communications with member companies and trade groups requiring hundreds of phone calls, thousands of emails, numerous conference calls, and in-person meetings. The end result of everyone's efforts will be to uphold our statutory requirements as to recoupment, strengthen relationships with member companies, and support the continued availability of liability coverage in North Carolina.

Compliance Activity

Our compliance staff's focus is on compliance with statutes, rules, and regulations, as well as eligibility for ceded coverage and reimbursement, as part of our responsibility to ensure that the Facility collects the right premium and pays the right losses. In the various types of audits performed by the compliance staff, member company files are reviewed for, among other items, proper reporting of premiums and losses, claims handling, proper application of underwriting rules, eligibility, experience modification rating, and recoupment. The compliance staff also performs audits on non-ceding companies to ensure that recoupment amounts are correctly determined and collected.

With the recent addition of Tom Burns to our staff as the Director of Auto Operations, we have decided to take this opportunity and split the compliance team into two focused areas of responsibility. Jannet Barnes, a 30+ year operations veteran of the NCRF, is now the sole leader of our Claims Compliance team. Tom Burns, with his extensive 30 years of industry knowledge, is now leading all of our PPA and Commercial compliance associates. Together, this leadership team will allow the NCRF and our compliance programs to become more focused and efficient. As we continue to look to the future of our compliance operations, member companies can expect to experience even more team work, partnership, and accountability.

Legislative Changes

The Facility was created by the Legislature in 1973 and replaced an Assigned Risk Auto Plan. At that time, there was a perceived stigma of being included in a bad risk pool, so this new mechanism enabled drivers to select the company of their choice. The legislature has made alterations over time to address changing conditions in the marketplace.

The Facility is often asked to provide information to various groups that wish to study these complex matters. While we do not lobby for any one position, we are more than happy to be included in the discussion and to contribute suggestions that, it is hoped, lead to more complete solutions with the fewest unintended consequences. One bill of significant interest necessitates inclusion in this report.

House Bill 382 — This bill was enacted in June 2018. There are two sections impacting the Reinsurance Facility. The Facility manual rules were revised to reflect these statute changes.

- Section 4.9 — Amend Automobile Underwriting Procedure, requires that prior to the sale of a new motor vehicle insurance policy, records of convictions for moving traffic violations shall be obtained, unless access to such records are unavailable at the time. This change is effective January 1, 2019. Appropriate changes to the Personal Auto Manual have been made to reflect this statutory change.
- Section 4.10 — Add Additional Proofs Of Residency To Rate Evasion Statute, adds additional items of "reliable proof of North Carolina residency or eligible risk status" for purposes of commercial auto insurance. This revision became effective on June 28, 2018. Appropriate changes to the Standard Practice Manual and the Commercial Auto Manual have been made to reflect this statutory change, including the promulgation by the Facility of Certification of Ownership Form NCRF-47.

Conclusion

The 2017-2018 fiscal year was a very busy and successful time for the Facility and our member companies. There is still much to do in spite of all that was accomplished this past year. While there appears to be light at the end of the tunnel, we must continue to improve our private passenger and commercial auto results to return the members' equity to a break-even position as contemplated in the statutes. Many of our prior actions will bear fruit throughout the coming year, but again, it will be the combined efforts and partnership of the member companies and Facility staff that make the difference in our success.

Terry F. Collins
Chief Operating Officer, Reinsurance Facility

SHARED SERVICES

Finance

Edith Davis
Chief Financial Officer

Net Operating Results

As previously detailed in this report, the Facility has continued to experience net operating losses in both private passenger and other than private passenger (commercial) business over the report year, and those losses have totaled $112.9 million for the fiscal year to date as of June 30, 2018, compared to losses of $166.9 million for the same period in 2017, an improvement of $54 million over the prior period. As of June 30, 2018, the members' equity stood at -$261 million and consisted of -$140 million for private passenger business and -$120 million for other than private passenger business. The $65 million reduction in the deficit since June 30, 2017, was largely driven by the implementation of loss recoupments on private passenger policies effective on or after October 1, 2016. For the six months beginning April 1, 2018, the loss recoupment was anticipated to generate revenue of about $131.8 million to offset a portion of past private passenger losses. Unlike clean risk recoupment, loss recoupment funds are reported as a credit directly to members' equity, rather than being included in the determination of an operating gain or loss. Additional revenue is anticipated from loss recoupments to become effective on October 1, 2018, on both private passenger and commercial policies.

Investments

The additional revenue from loss recoupments has begun to generate contributions back into the Facility's investment account after several years of significant withdrawals. Those deposits have contributed to the increase of nearly $91 million in the book value of the Facility's portfolio from approximately $627 million to about $718 million over the 12 months ending June 30, 2018. As of that date, the market value of the account was $713 million, reflecting a net unrealized loss of about $5 million. The portfolio returned about .14% over the 12 months ending June 30, 2018, which outperformed the benchmark by 52 basis points over that period, and no "other than temporary impairment" of investments was recorded during the report year. The chart included in this report reflects the portfolio's performance compared to the benchmark for the 12 months ending at the respective periods.

Administrative Expenses

The Facility's administrative expenses totaled $6.4 million during calendar year 2017, which represented an increase of 1% from the prior year and approximately 101% of the approved budget for the respective period. The table and chart on this page show a summary of the direct and allocated expenses for the prior two years and the first half of 2018. While the administrative expenses have remained very stable and consistent over the past few years, significant legal and advisory expenses and the onboarding of additional staff may result in the Facility slightly exceeding the budget by year's end.

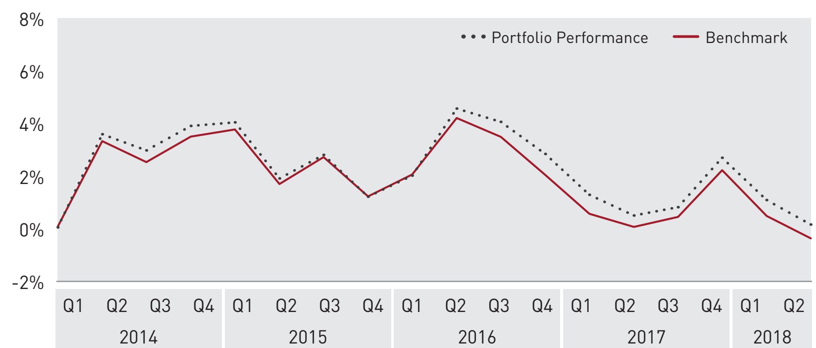
Audit

Johnson Lambert performed the annual audit of the fiscal year ended September 30, 2017, and presented its report to the Audit Committee in February 2018. The audit firm issued a clean opinion on the Facility's audited financial statements and conducted the required communications to the Committee, noting there were no misstatements or internal control weaknesses identified during the audit and that the significant accounting policies had been consistently applied during the current year. An excerpt of those audited financial statements is included in this report.

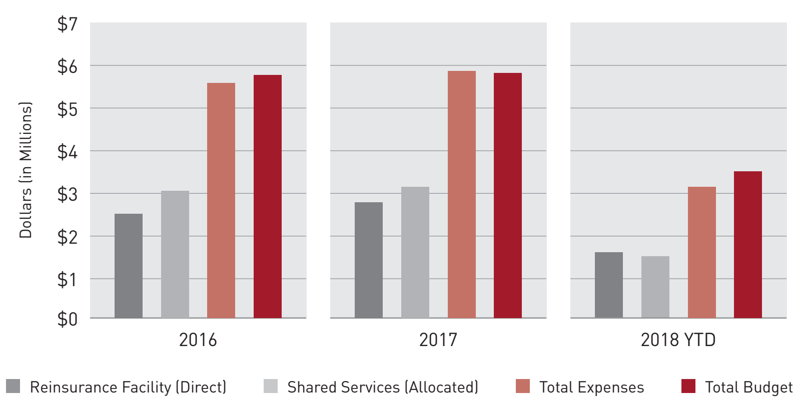
Other Initiatives

Our other initiatives for the current and next year include an increased focus on risk management, a review of our vendor relationships, and opportunities to leverage more technology to increase our efficiency. As part of our risk management initiatives, the Facility, in conjunction with its sister organizations, put in place a significantly more robust cyber liability insurance program in early 2018. Additional efforts include increasing our electronic interface with member companies to provide better and faster service as we continue to build on the solid foundation left by my predecessor.

Investment Portfolio Performance
Annualized Total Returns vs. Benchmark



Administrative Expenses



Administrative Expenses	2016	2017	Thru June 2018
Reinsurance Facility (Direct)	$ 2,737,893	$ 3,031,061	$ 1,768,240
Shared Services (Allocated)	$ 3,338,757	$ 3,402,964	$ 1,632,348
Total Expenses	$ 6,076,650	$ 6,434,025	$ 3,400,588
Total Budget	$ 6,345,720	$ 6,384,257	$ 3,773,097

Information Services

Shelley Chandler
Chief Information Officer

The Information Services group continues to leverage technology advances to enhance our business processes and to fulfill the needs of our customers. Through daily operations and project work, it is our duty not only to support the organization, but to introduce innovative strategies that guarantee robust systems and applications, and allow for expansion in areas where progress is desired.

A significant amount of effort is spent resolving daily issues that impact productivity and that keep essential processes moving forward. Extensive planning goes into resource allocation for IT staff; however, we remain flexible in our commitment to provide our customers with the highest level of efficiency wherever the need arises.

Project work also contributes to our goal of promoting efficiency. From an infrastructure standpoint, we've implemented projects that continually improve our environment and our security posture. In 2018, some of the most significant upgrades we performed were to our storage network, increasing our Internet bandwidth, upgrading our server and desktop operating systems, and modernizing Enterprise Services to current releases and versions.

Our Portfolio Management Office continues to review projects from the business on a regular basis to ensure that project needs align with business goals and have compelling business value to substantiate the resources needed to execute and implement. The NC Reinsurance Facility is built upon systems, tools, and applications, so there is always a challenge to select the right projects. We have to evaluate requests that improve existing system functionality and those that advance the business process to a higher level. We feel strongly that our project submission process takes the guess work out of these critical decisions. Some projects of note for 2018 are modernizing our website, introducing help videos for commercial auto loss recoupment, and investigating performance enhancements for the EDGE processing system.

With reported data breaches around the country and world increasing approximately 45% from 2015 to 2016 and again from 2016 to 2017, we continue to have an increased focus on security.

We work to protect our environment and prevent breaches by continuing to adhere to the belief that the best defense against security risks is employee training. We provide monthly security training and routine phishing simulations to teach employees how to defend against common and emerging threats and to ensure our associates are educated on how to protect the data they are entrusted with to execute their jobs. We also continue to harden and isolate our systems by upgrading perimeter security and limiting system permissions to only those users that require access to perform their job duties.

In order to predict and prevent security breaches, we continued to work with professional security experts to conduct regular risk assessments that alert us to any risks (or threats) in advance so that we can remediate promptly and appropriately. In addition to network testing, we also conducted penetration testing for some of our custom web applications to provide further insight into our security posture.

While we have never experienced a major business interruption, it is important that we are prepared to detect and respond to potential events. In early 2018, we changed our Cyber Security Insurance Policy to include significant response resources in the event of a breach. Our outside security consultant also conducted a Cyber Readiness Review to provide strategic guidance on effectively detecting, containing, eradicating, and remediating suspected incidents and their impact on our business. This provides reassurance to our customers that we are aware and prepared to facilitate business recovery should an incident occur.

We look forward to expanding our capabilities for enhancing our customer experience through technology while ensuring security of the data we protect.

Human Resources and Facility Services

Vicki Godbold
Chief Human Resources Officer

"Unleash the potential that is in another and you unleash the potential that is in you."

— Matshona Dhliwayo

Our Human Resources is the strategic and comprehensive approach committed to our Organization's most valued assets — our people. Facility Services provide a secure and comfortable work environment along with mail services and receptionist services. In HR, beginning in 2016, we based our Performance Evaluations on individual associate job descriptions, which included a comprehensive review and update by associates in 2017. We also added three new associates in staff and are in the process of recruiting two additional members of staff.

Our Wellness Program consists of

- a partnership with WakeMed Hospital,
- a partnership with the Performance Athletic Center (EXOS),
- a partnership with the NC Prevention Partners,
- annual participation in the Wellness Council of America's (WELCOA) Step-By-Step program of walking 10k steps a day,
- flu shots provided for associates on-site, and
- certification in First Aid, CPR and AED, for a third of our workforce through the American Red Cross.

On-site training this year consisted of wellness seminars, and we conducted off-site training for new management staff. Community Service involvement by our associates this year included the United Way and the NC Food Bank.

NCRF MANAGEMENT STAFF

Andy Montano
Manager, Automobile

Donna Kallianos
Manager, Claims

Jannet Barnes
Manager, Compliance Claims

Tom Burns
Director, Auto Operations

Balance Sheet

As of	June 30, 2018	June 30, 2017
Assets		
Cash (Checking Account)	$13,420,895	$21,890,693
Cash Restricted (Including Escrow)	-	-
Investments	717,844,418	627,210,511
Accounts Receivable	38,807,069	29,427,732
Accrued Interest Receivable	4,300,734	3,720,571
Other Assets	92	92
Total Assets	**$774,373,208**	**$682,249,600**
Liabilities & Members' Equity		
Accounts Payable	28,489,287	42,668,555
Loss Reserves	659,929,573	642,593,013
Unearned Premium Reserves	346,630,159	321,663,232
Provision for Premium Refunds	-	-
Other Liabilities	211,004	915,875
Total Liabilities	**$1,035,260,022**	**$1,007,840,676**
Members' Equity	(260,886,814)	(325,591,076)
Total Liabilities & Members' Equity	**$774,373,208**	**$682,249,600**

Income Statement

Fiscal Year through	June 30, 2018	June 30, 2017
Income		
Earned Premiums	$792,937,296	$748,743,374
Clean Risk Recoupment	150,917,370	127,291,883
Investment Income	14,653,028	15,872,715
Membership Fee Income	$54,700	54,100
Other Income	119,572	123,388
Total Income	**$958,681,966**	**$892,085,460**
Expenses		
Losses Incurred	$738,223,961	$756,736,346
Ceding & Claims Expenses	328,461,854	296,633,310
Premiums Escrowed	-	-
Other Underwriting Deductions	(236,826)	716,239
Salaries & Administration Expenses	1,727,470	1,867,082
Outside Services Expenses	2,042,617	1,810,784
Other Operating Expenses	1,328,135	1,232,060
Total Expenses	**$1,071,547,210**	**$1,058,995,820**
Net Income / (Loss) Before Loss Recoupments	**$(112,865,244)**	**$(166,910,360)**
Loss Recoupments	**162,130,099**	**102,393,572**
Net Income / (Loss) After Loss Recoupments	**$49,264,855**	**$(64,516,788)**

Special Purpose Balance Sheet

Year Ending	Sept 30, 2017	Sept 30, 2016
Assets		
Cash and Short-Term Investments	$57,157,647	$78,563,154
Investments, at Amortized Cost	588,675,210	587,690,678
Accrued Interest Receivable	4,001,126	4,019,550
Settlements Receivable From Member Companies	40,067,516	15,968,345
Total Assets	**$689,901,499**	**$686,241,727**
Liabilities & Members' Equity		
Loss and Loss Adjustment Expense Reserves		
• In Course of Settlement	$481,599,441	$462,950,390
• Incurred But Not Reported	154,908,099	132,477,009
Total Loss and Loss Adjustment Expense Reserves	**636,507,540**	**595,427,399**
Unearned Premium Reserves	333,018,787	306,861,057
Advance Clean Risk Subsidies	3,706,820	3,067,784
Premium Deficiency Reserve	235,493	32,606
Settlements Payable to Member Companies	29,999,261	44,866,311
Other Liabilities	292,087	128,642
Total Liabilities	**1,003,759,988**	**950,383,799**
Members' Equity	(313,858,489)	(264,142,072)
Total Liabilities and Members' Equity	**$689,901,499**	**$686,241,727**

Special Purpose Statement of Operations

Year Ending	Sept 30, 2017	Sept 30, 2016
Premiums Earned	$1,006,836,403	$941,370,465
Clean Risk Subsidies	172,409,982	137,391,524
Total Underwriting Income	**1,179,246,385**	**1,078,761,989**
Losses Incurred	991,034,336	935,809,231
Ceding Expense Allowances	264,468,343	245,321,886
Claims Expense Allowances	136,513,340	109,359,990
Change in Premium Deficiency Reserve	202,887	(266,562)
Total Underwriting Expenses	**1,392,218,906**	**1,290,224,545**
Net Underwriting Loss	**(212,972,521)**	**(211,462,556)**
Other Income (Expense)		
Net Investment Income	16,691,116	19,002,944
Net Realized Investment Gains	3,199,820	3,295,048
Late Premium Charges and Penalties	178,863	80,224
Membership Fees	54,300	54,300
General and Administrative Expense	(5,571,993)	(5,234,300)
Total Other Income — Net	**14,552,106**	**17,198,216**
Net Operating Loss	**$(198,420,415)**	**$(194,264,340)**

NCRF

North Carolina Reinsurance Facility

2910 Sumner Blvd. Raleigh, NC 27616 www.ncrb.org/ncrf