California Casualty Management Co.

# ANNUAL REPORT TO SHAREHOLDERS

# 2018

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"People who commit to make a difference for our communities deserve financial protection with the highest levels of care, service, compassion and understanding…

***Which is Why We Exist."***

For the second year in a row, California wildfires left a large number of California Casualty customers with no possessions and no home. Windy and dry conditions in Paradise, Redding and Malibu/Agoura Hills/Thousand Oaks produced unprecedented fast-moving fires that killed 97 people, including three firefighters, and destroyed more than 15,000 homes. We thank the first responders who risked their lives to rescue residents by entering areas completely engulfed in flames, and we recognize the brave educators and nurses who also risked everything to evacuate students and patients.

Once again, employees across all California Casualty Management Company (CCMC) departments rose to the occasion to help. Service and Partner Relations called to check on customers in the impacted areas. Claims management assigned adjusters to customers suffering losses as soon as their claims were reported, with adjusters moving quickly to make initial contact, promptly advance additional living expense funds and schedule face-to-face meetings. And while many employees did not directly talk to customers in the aftermath of these disasters, all CCMC employees did their part to support what was a company-wide team effort to fulfill California Casualty's promises.

## DELIVERING AGAIN FOR CUSTOMERS IN DEVASTATED AREAS

Jim Kauffman, Senior Vice President – Claims, has always emphasized that we must handle each catastrophe differently depending on its unique circumstances. Having so many long-tenured, experienced employees in the Claims department enables us to customize our response to each catastrophe. We have contracts with valued partners like Crawford & Company to bolster our catastrophe response, but our preference is to assign California Casualty employees to home total loss claims.

Given our volume of open home total loss claims from the 2017 Santa Rosa/Wine Country fires, we called on senior internal claims adjusters to take on field assignments after the Camp (Paradise) and Woolsey (Malibu/Agoura Hills/Thousand Oaks) fires in November. Jim and his Claims leadership team arranged for these senior internal adjusters to have a training meeting with our field adjusters to promote knowledge transfer, knowing that the relationships developed face-to-face would pay back greatly.

Our adjusters have met with customers and are starting the complex rebuild process. We are demonstrating that we have the depth to deal with the two largest wildfire catastrophes in California history without compromising the exceptional level of service and the commitment to fulfill our promises that we celebrate as two of our PRIDE in the Code core values. Adjusting a home total loss claim is a difficult process that always involves complexities. We are very proud of our response to the 2017 and 2018 California fires, and we thank all of our employees who have given so much of themselves to serve our customers.

## CCMC FINANCIAL PERFORMANCE

CCMC net income in 2018 was $11.2 million, compared to negative $3.8 million in 2017. 2018 pre-tax income was $14.4 million, compared to 2017 pre-tax income of $6.4 million. CCMC investment income was $13.0 million in 2018, compared to $5.8 million in 2017. Both 2018 pre-tax income and 2017 pre-tax income were higher than in prior years, due to investment income from realized gains on the sale of investments. In 2018, investment income included $9.9 million in realized gains from the sale-leaseback of the Colorado Service Center, which had appreciated significantly in value since CCMC exercised an option to purchase the building in June 2008, as well as $2.5 million in realized gains from the sale of investment securities. The after-tax net gain on the sale of the Colorado Service Center was $7.8 million. CCMC's 2017 investment income included $4.8 million in realized gains from the sale of investment securities.

CCMC's 2018 revenue of $121.9 million was higher than 2017 revenue of $118.0 million. CCMC did not earn an incentive fee in 2018 because California Casualty Group (CCG) produced a pre-tax loss.

With the favorable impact of the sale of the Colorado

Service Center, CCMC's 2018 return on adjusted beginning shareholders' equity of $43.0 million was 26.0 percent. Last year, CCMC's 2017 return on adjusted beginning shareholders' equity of $44.9 million was negative 8.4 percent, due to a write down of deferred tax assets as a result of tax reform. CCMC's 26.0 percent rate of return on equity in 2018 is significantly higher compared to CCMC's 10-year and 20-year historical averages of 8.8 percent and 11.6 percent, respectively. Absent the sale of the Colorado Service Center, CCMC's return on adjusted beginning shareholders' equity would have been lower than historical averages due to CCMC's decision in 2018 to reduce its return on operating capital for a sixth straight year in order to support management's efforts to lower the CCG expense ratio. This reduction benefitted CCG's combined ratio by approximately 0.8 - 0.9 percentage points in 2013, 2014, 2015, 2016, 2017 and 2018.

Total shareholder return of 22.4 percent on an adjusted basis was lower than the 26.0 percent return on adjusted beginning shareholders' equity due to other comprehensive losses of $1.6 million. The components included a $3.2 million decrease in net unrealized gains on investment securities, partially offset by a favorable $1.6 million adjustment resulting from the accounting impact of higher interest rates on CCMC's non-qualified pension plan. This 22.4 percent rate of adjusted total return is higher than CCMC's 10-year and 20-year historical averages of 9.8 percent and 11.4 percent, respectively. At December 31, 2018, the adjusted book value of CCMC common stock was $46.58, up $5.06 from $41.52 at December 31, 2017. CCMC paid $4.2 million in dividends in 2018. Dividend payments were $4.00 per share.

On a Generally Accepted Accounting Principles (GAAP) basis, CCMC had shareholders' equity of negative $5.3 million and a book value per share of negative $5.02 at December 31, 2018, compared to shareholders' equity at December 31, 2017, of negative $9.1 million and a book value per share of negative $8.79. Notes 9 and 11 of CCMC's financial statements explain how cumulative charges, resulting from recognition of the funded status of employee benefit plans in the balance sheet as required by pension accounting standards implemented at December 31, 2007, are removed to generate CCMC's adjusted book value of $46.58. Note 2 explains how the impact of tax reform required a write-down of deferred tax assets in 2017, negatively affecting GAAP shareholders' equity by approximately $9.2 million.

CCMC maintained a solid liquidity position, with $30.3 million in cash and marketable securities at December 31, 2018, down from $33.3 million at December 31, 2017. CCMC's investment in Guidewire (which is recoverable starting in late 2019 when the capitalized asset begins to depreciate), pension income, reduced CCMC markup and dividend payments of $4.2 million decreased cash and marketable securities, while the sale of the Colorado Service Center generated cash to partially offset these factors.

CCMC did not make a contribution to the qualified defined benefit pension plan in 2018, 2017 or 2016. In 2013, 2014 and 2015, CCMC made contributions totaling $39.0 million to the qualified defined benefit pension plan. This plan, which ceased accruing additional benefits as of December 31, 2015, was 88.9 percent funded at December 31, 2018 (relative to 89.0 percent at December 31, 2017), with $190.0 million in assets compared to $213.8 million in liabilities. Since this plan is now frozen, all employees are participating in CCMC's service-based contribution plan going forward.

## CCG OPERATING AND FINANCIAL PERFORMANCE

California wildfires have contributed to poor profitability results for California Casualty Group in 2015, 2017 and 2018, negatively impacting CCG's surplus by $65 million. In 2017 and 2018, record-setting hailstorms in Colorado and surrounding states further impacted profitability. Our biggest challenge is to replenish CCG's surplus and return CCG to profitability. CCG's 2018 personal lines combined ratio was 114.4 percent, compared to 114.5 percent in 2017.

For the 2018 year, CCG will collect approximately $22 million from reinsurers above our $20 million retention, given losses and loss adjustment expenses of approximately $42 million in the Camp and Woolsey fires. Starting in 2019, we have added a new layer of reinsurance protection to provide an additional $8 million of coverage for large catastrophe events starting at a lower retention point: $10 million. This additional layer of 2019 reinsurance gives CCG $63 million of reinsurance protection above its $10 million retention. It is expensive to purchase reinsurance attaching at lower levels. Because our losses in both the 2017 and 2018 fires, as a proportion of total industry losses, were significantly below what we would have expected given our 0.5 percent homeowners insurance market share in the state, reinsurer price increases were such that we were able to put together a program with reasonable terms and higher limits of $63 million rather than $55 million, at a lower retention, for an additional $2.0 million in reinsurance premium.

CCG's accident year 2018 gross catastrophe losses were $54.3 million before approximately $22 million in reinsurance recoveries, and its 2017 gross catastrophe losses were $49.6 million before approximately $8 million in reinsurance recoveries. During the 10-year period from 2007 – 2016, CCG's gross catastrophe losses averaged $9.9 million. CCG's personal lines incurred loss ratio was flat, decreasing slightly from 73.1 percent in 2017 to 73.0 percent in 2018, with both years including 8-9 percentage points of catastrophe losses in excess of the catastrophe load of approximately $10 million included in our forecast.

CCG's 2018 home incurred loss ratio was 94.2 percent, compared to 88.4 percent in 2017. CCG's 2018 home net earned premium was $82.9 million, compared to $83.1 million in 2017, a decrease of 0.21 percent. CCG's auto incurred loss ratio of 66.9 percent was 0.2 percentage points better than our 2018 target of 67.1 percent. This 2018 result of 66.9 percent was 1.5 percentage points better than our 2017 result of 68.4 percent, which was 1.7 points better than our 2016 result of 70.1 percent. CCG's 2018 auto net earned premium was $283.7 million compared to $269.2 million in 2017, an increase of 5.4 percent. Given that over three-quarters of our premium comes from the auto line, improving auto results have been a major driver of our core profitability improvement over the past four years.

We define core profitability as our overall combined ratio excluding catastrophe losses in excess of the forecast's catastrophe load, and also excluding certain expenses and IBNR bulk reserve funding for personal lines. Core profitability in 2018, represented by a core combined ratio of 105.4 percent, took a small step backward from our 105.3 percent result for 2017 due to non-catastrophe home losses higher than plan. However, CCG's core results for 2017 and 2018 are improved relative to core results of 109.8% in 2015 and 108.2% in 2016.

Contributing to this improvement and in line with our strategy to improve underwriting to boost profitability and support more competitive prices in a broader set of markets, Underwriting Operations has instituted a self-audit program and has started tracking quality and production over time for each representative, in addition to embracing employee continuing education spanning a wide variety of designations and courses. They have also deployed the ViewSpection mobile app for customer auto and home self-inspections. Claims has posted outstanding subrogation results again this year and has embraced job rotations and a wide range of training opportunities. Claims has also adopted exciting new technologies like the CarPix mobile app, as well as innovative digital payment applications in conjunction with J.P. Morgan Chase.

Service has contributed by consistently achieving its target metrics for speed-of-answer, abandon rate and customer service satisfaction. Actuarial has analyzed and re-analyzed our rates and competitive position in key markets, achieving more granular pricing that is more competitive in more situations. Human Resources has implemented creative new ways to attract great employees in a tight job market across all of our office locations. And many others, in both customer-facing and support departments, have contributed to our core profitability improvement over the past few years.

Direct written premium grew from $360.8 million in 2017 to $378.9 million in 2018, a result that was $3.3 million better than plan. Direct written premium has increased for the past seven years, and with consistently outstanding cross-selling results, policies-in-force have increased in ten of the past eleven years. For 2018, we forecasted an increase in total customer retention from 92.2 percent to 92.3 percent. Our year-end total customer retention blew through our goal to end the year at a record 92.7%, a half-point higher than where we started the year. Retention drove growth of 847 customers, resulting in an above-plan customers-in-force result of 165,524 at 12/31/18, compared to 164,677 customers-in-force at 12/31/17. Customer Service satisfaction at 99.8 percent and Claims satisfaction at 96.4 percent in 2018 compare favorably to 99.6 percent and 95.6 percent, respectively, for 2017.

CCG produced a net loss of $37.1 million in 2018 compared to a net loss of $34.6 million in 2017. CCG surplus decreased by $50.0 million, dropping from $241.6 million at December 31, 2017, to $191.6 million at December 31, 2018. CCG's 2018 total expense ratio, as a percentage of net earned premium, is 42.1 percent, compared to 42.2 percent for 2017. CCG's personal lines underwriting expense ratio, as a percent of net written premium, increased slightly from 26.1 percent in 2017 to 26.2 percent in 2018. CCG's 2018 operating cash flow ratio was 91.3 percent while its underwriting cash flow ratio was 87.9 percent. In comparison, CCG's 2017 operating and underwriting cash flow ratios were 99.9 percent and 96.1 percent, respectively.

In May 2018, A.M. Best Company changed CCG's rating to B++ (Good).

If California Casualty Indemnity Exchange (CCIE) exercised its right to put 186,000 shares back to CCMC, CCG's surplus would increase by approximately $26.5 million based on 2018 year-end values. If CCIE should exercise that put option, CCMC would be required to purchase the shares at an 85% premium to adjusted book value. That would produce a corresponding decline in adjusted book value for all other shareholders of approximately 18.1%. Note 3 of CCMC's financial statements, "Related Party Transactions", describes the details of CCIE's investment in CCMC.

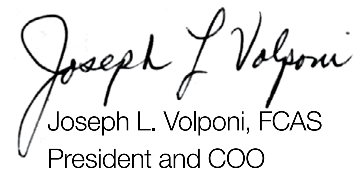
## GUIDEWIRE IMPLEMENTATION

In June, we plan to put all Guidewire components into production for our first pilot state, Indiana, so we can begin processing renewals effective September 1, 2019. It was incredibly ambitious to tackle Guidewire's policy, billing, account management, quoting and data modules all at once, and it is a credit to the CCMC and EY Guidewire teams that have worked so hard on this project that we are at this point. We thank all of CCMC's employees, especially those in Information Technology and other technical and system-focused departments, who have passionately contributed to this project.

## WORKING AS A TEAM

In our WHY Statement, we commit to providing our policyholders with the highest levels of care, service, compassion and understanding. These simple goals set a high bar for all CCMC employees. Our customer retention results suggest that we are meeting these goals, and we are doing it while responding to the two largest wildfire catastrophes in California history. We are also doing this while implementing the full suite of Guidewire's policy system components, a monumental undertaking. Many CCMC employees have stepped out of their normal routines to serve impacted California customers or to assist with the Guidewire implementation effort. At the same time, when some have stepped out of their normal roles, others have filled in. Working as a Team is one of California Casualty's PRIDE in the Code core values. We thank our employees for pulling together in 2018 to achieve so much, and most importantly, to serve our policyholders in their greatest time of need.

Carl B. (Beau) Brown, CPCU
Chairman and CEO



Joseph L. Volponi, FCAS
President and COO

# INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
California Casualty Management Company

**Report on the Financial Statements**

We have audited the accompanying financial statements of California Casualty Management Company, which comprise the balance sheet as of December 31, 2018, and the related statements of income (loss) and comprehensive income (loss), changes in shareholders' equity (deficit), and cash flows for the year then ended, and the related notes to 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 accounting principles generally accepted in the United States of America; this includes 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California Casualty Management Company as of December 31, 2018, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matter***

The financial statements of California Casualty Management Company as of December 31, 2017, were audited by other auditors whose report dated April 9, 2018, expressed an unmodified opinion on those statements.

Crowe LLP

Simsbury, Connecticut
April 4, 2019

# BALANCE SHEETS

## DECEMBER 31, 2018 AND 2017

(DOLLARS IN THOUSANDS)

| | 2018 | 2017 |
|---|---|---|
| | *(In thousands)* | |
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $ 6,207 | $ 7,922 |
| Investment securities | 24,088 | 25,382 |
| Receivables | 2,815 | 2,298 |
| Income taxes recoverable | 14 | 5 |
| Prepaid expenses and other | 5,108 | 4,476 |
| Total current assets | 38,232 | 40,083 |
| Property and equipment, net | 40,080 | 33,801 |
| Leased assets | 32,570 | - |
| Deferred income taxes, net | 12,854 | 15,033 |
| Other noncurrent assets | 1,080 | 785 |
| Total assets | $ 124,816 | $ 89,702 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 3,679 | $ 3,840 |
| Accrued employee compensation | 15,976 | 13,951 |
| Accrued benefit liability | 3,318 | 3,317 |
| Taxes payable | 537 | 401 |
| Operating lease obligations | 4,107 | - |
| Finance lease obligations and other | 1,113 | 2,852 |
| Total current liabilities | 28,730 | 24,361 |
| Operating lease obligations | 32,199 | - |
| Finance and capital lease obligations | 1,099 | 1,471 |
| Accrued benefit liability | 66,375 | 71,275 |
| Noncurrent employee compensation | 1,446 | 1,409 |
| Other noncurrent liabilities | 277 | 279 |
| Total liabilities | 130,126 | 98,795 |
| Shareholders' equity (deficit) | | |
| Common stock - no par value | 16,016 | 15,001 |
| Common stock with put right (Note 3) | 16,030 | 14,287 |
| Accumulated other comprehensive loss | (64,035) | (59,923) |
| Retained earnings | 26,679 | 21,542 |
| Total shareholders' equity (deficit) | (5,310) | (9,093) |
| Total liabilities and shareholders' equity (deficit) | $ 124,816 | $ 89,702 |

The accompanying notes are an integral part of these financial statements.

# STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

## YEARS ENDED DECEMBER 31, 2018 AND 2017
(DOLLARS IN THOUSANDS)

| | 2018 | 2017 |
|---|---|---|
| | (In thousands) | |
| **Revenue:** | | |
| Management fee | $ 120,391 | $ 116,653 |
| Other | 1,474 | 1,370 |
| Total revenue | 121,865 | 118,023 |
| **Operating expenses** | | |
| Personnel | 77,193 | 73,634 |
| Acquisition and professional services | 19,967 | 20,465 |
| Facility and equipment | 14,508 | 13,398 |
| Communications | 6,677 | 6,779 |
| Other | 1,981 | 2,906 |
| Total operating expenses | 120,326 | 117,182 |
| Operating income | 1,539 | 841 |
| Investment income (includes reclassification of $1,962 and $3,198, net of tax of $522 and $1,648, for 2018 and 2017, respectively from other comprehensive loss for net gain on investments) | 13,018 | 5,799 |
| Interest expense | (118) | (262) |
| Income before provision for income taxes | 14,439 | 6,378 |
| Provision for income taxes | 3,270 | 10,160 |
| Net income (loss) | 11,169 | (3,782) |
| **Other comprehensive income (loss), net of tax** | | |
| Unrealized net (loss) gain on investments (net of tax of ($319) and $1,035 for 2018 and 2017, respectively) | (1,202) | 2,008 |
| Less: Reclassification adjustment for net gain included in net income (net of tax of $522 and $1,648 for 2018 and 2017, respectively) | (1,962) | (3,198) |
| Change in employee retirement benefit plans (net of tax of $252 and $1,181 for 2018 and 2017, respectively) (Note 11) | (948) | (5,634) |
| Other comprehensive loss | (4,112) | (6,824) |
| Comprehensive income (loss) | $ 7,057 | $ (10,606) |

The accompanying notes are an integral part of these financial statements.

# STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

## YEARS ENDED DECEMBER 31, 2018 AND 2017

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AND SHARE AMOUNTS)

ALIFORNIA CASUALTY MANAGEMENT COMPANY
TEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

| *(in thousands of dollars except per share and share amounts)* | Common Stock | Common Stock with Put Right | Accumulated Other Comprehensive Loss | Retained Earnings | Total |
|---|---|---|---|---|---|
| Balances at January 1, 2017 | $ 15,250 | $ 14,849 | $ (44,211) | $ 20,044 | $ 5,932 |
| Net loss | - | - | - | (3,782) | (3,782) |
| Change in carrying value of common stock with put right (Note 3) | - | (562) | - | 562 | - |
| Common stock retired (28,119 shares) | (1,253) | - | - | 67 | (1,186) |
| Dividends paid to shareholders ($4.00 per share) | - | - | - | (4,237) | (4,237) |
| Stock issued in long-term executive incentive plan (15,063 shares) | 650 | - | - | - | 650 |
| Stock issued in executive stock plan (8,193 shares) | 354 | - | - | - | 354 |
| Change in unrealized net gain on investments, net of deferred tax of ($613) | - | - | (1,190) | - | (1,190) |
| Change in employee retirement benefit plans, net of deferred tax of ($1,181) (Note 11) | - | - | (5,634) | - | (5,634) |
| Reclassification due to tax rate change related to employee retirement benefit plans | - | - | (9,660) | 9,660 | - |
| Reclassification due to tax rate change related to investments | - | - | 772 | (772) | - |
| Balances at December 31, 2017 | 15,001 | 14,287 | (59,923) | 21,542 | (9,093) |
| Net income | - | - | - | 11,169 | 11,169 |
| Change in carrying value of common stock with put right (Note 3) | - | 1,743 | - | (1,743) | - |
| Common stock retired (3,782 shares) | (124) | - | - | (50) | (174) |
| Dividends paid to shareholders ($4.00 per share) | - | - | - | (4,239) | (4,239) |
| Stock issued in long-term executive incentive plan (18,772 shares) | 780 | - | - | - | 780 |
| Stock issued in executive stock plan (8,652 shares) | 359 | - | - | - | 359 |
| Change in unrealized net gain on investments, net of deferred tax of ($841) | - | - | (3,164) | - | (3,164) |
| Change in employee retirement benefit plans, net of deferred tax of ($252) (Note 11) | - | - | (948) | - | (948) |
| Balances at December 31, 2018 | $ 16,016 | $ 16,030 | $ (64,035) | $ 26,679 | $ (5,310) |

The accompanying notes are an integral part of these financial statements.

| | 2018 | 2017 |
|---|---|---|
| | *(In thousands)* | |
| **Cash flows from operating activities** | | |
| Net income (loss) | $ 11,169 | $ (3,782) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | | |
| Depreciation and amortization on property and equipment including leased assets | 6,807 | 5,839 |
| Amortization on bonds | 46 | 150 |
| Gain on sale of real estate | (10,037) | (412) |
| Net gain on sale and disposal of property and equipment | (62) | (60) |
| Net realized gain on investment securities | (2,484) | (4,846) |
| Provision for deferred income taxes | 3,272 | 10,148 |
| Changes in: | | |
| Receivables and other assets | 606 | 793 |
| Payables, accrued expenses, and other liabilities | (2,986) | (5,585) |
| Net cash provided by operating activities | 6,331 | 2,245 |
| **Cash flows from investing activities** | | |
| Proceeds from sale of property and equipment | 22,565 | 98 |
| Purchase of property and equipment | (24,055) | (9,023) |
| Proceeds from sale and maturities of investment securities | 15,520 | 19,295 |
| Purchase of investment securities | (15,794) | (3,909) |
| Net cash (used in) provided by investing activities | (1,764) | 6,461 |
| **Cash flows from financing activities** | | |
| Payments on finance lease obligations | (1,869) | (3,589) |
| Common stock retired | (174) | (1,186) |
| Dividends paid to shareholders | (4,239) | (4,237) |
| Net cash used in financing activities | (6,282) | (9,012) |
| Net change in cash and cash equivalents | (1,715) | (306) |
| Cash and cash equivalents at the beginning of the year | 7,922 | 8,228 |
| Cash and cash equivalents at the end of the year | $ 6,207 | $ 7,922 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid (received) during the year for income taxes | $ 4 | $ (6) |
| Cash received during the year for lease commencement | $ (2,820) | $ - |
| **Supplemental schedule of noncash investing and financing activities** | | |
| Lease obligations arising from right-of-use assets from leases | $ 36,306 | $ - |
| Property and equipment purchased but not yet paid for | $ 1,147 | $ 1,136 |
| Common stock issued through employee stock plans | $ 1,139 | $ 1,004 |

The accompanying notes are an integral part of these financial statements.

## NOTE 1 - NATURE OF OPERATIONS

California Casualty Management Company ("CCMC") is the attorney-in-fact for the California Casualty Indemnity Exchange ("CCIE"), a reciprocal insurance exchange, and manager for CCIE's wholly owned subsidiaries. CCIE and its subsidiaries are collectively referred to as the California Casualty Group ("CCG").

CCMC operates in the insurance services segment. CCG is a personal lines insurance group headquartered in San Mateo, California, writing nonassessable full coverage automobile and homeowner insurance policies. Some directors and officers of CCMC are nonvoting members of the Boards and/or are officers of CCG.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: The accompanying financial statements are prepared and presented in conformity with accounting principles generally accepted in the United States of America ("GAAP").

Use of Estimates: GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

Cash Equivalents: Cash equivalents are certain highly liquid investments with insignificant interest rate risk which have original maturities of three months or less. CCMC's cash equivalents are stated at cost which approximates fair value and generally consist of money market funds and high quality short-term fixed income securities.

Investment Securities: CCMC classifies its marketable investment securities as available-for-sale. Accordingly, investment securities are reported at fair value. Investment securities are classified as current assets in the balance sheets as they represent funds available for current operations. Unrealized gains and losses on securities are recorded, net of tax, as a separate component of shareholders' equity (deficit) under accumulated other comprehensive income ("AOCI"). Gains and losses on investment securities that were realized and included in net income of the current period that also had been included in other comprehensive income ("OCI") as unrealized holding gains and losses in the period in which they arose are deducted through OCI in the current period as reclassification adjustments. Realized gains and losses on sales of investments are recognized on a first-in, first-out basis.

The amortized cost of debt securities are adjusted for amortization of premiums and accretion of discounts. Such amortization and accretion are included in investment income.

CCMC reviews its investment portfolio for reductions in fair value below cost that, in the opinion of CCMC, represent an other-than-temporary impairment ("OTTI"). Management reviews several factors to determine whether a loss is other than temporary, such as the length of time a security is in an unrealized loss position, the extent to which fair value is less than amortized cost, the impact of changing interest rates in the short and long term and the potential impact of credit–related losses.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

For bonds, the amount of an OTTI related to a credit loss is recognized in investment income as a realized loss. Similarly, an impairment on a bond which CCMC has the intent, at the balance sheet date, to sell or will more likely than not be required to sell before recovery of cost, is also recognized in investment income as a realized loss. This OTTI is also reflected as a reduction in the cost basis of the bond. The amount of an unrealized loss on bonds related to other factors is recorded, net of tax, as a component of shareholders' equity (deficit) in AOCI with no change to the cost basis of the security. For stocks, an OTTI is recognized in investment income and reflected as a reduction of the cost basis of the security based on the extent and duration that fair value is below cost, in addition to issuer-specific events.

Fair Value Option: CCMC has adopted current authoritative accounting guidance which permits entities to elect to measure eligible items at fair value at specified dates. CCMC did not elect to apply the fair value option to any eligible financial assets or financial liabilities upon adoption, or during the years ended December 31, 2018 and 2017. CCMC may elect to account for selected financial assets and financial liabilities at fair value. Such an election could be made at the time an eligible financial asset, financial liability or firm commitment is recognized or when certain specified reconsideration events occur.

Disclosures About Fair Value of Financial Instruments: The fair value of investment securities is based upon quoted market prices, where available, or fair values quoted by an independent pricing service based on sales of similar securities. The carrying amounts of cash and short-term investments are reasonable estimates of fair value.

Property and Equipment: Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is recognized principally using a straight-line method over the estimated useful lives of the assets. Estimated lives range from three to ten years for equipment and automobiles and up to thirty nine years for property. Leasehold improvements are amortized over the useful life of the improvement or the applicable lease term, whichever is shorter. Cost of property and equipment retired or otherwise disposed of and the related accumulated depreciation and amortization are removed from the accounts, and the resulting gains or losses are included in statement of income in the period disposed.

Computer software developed or obtained for internal use is capitalized. Upon project completion, these costs are amortized over the estimated useful life, ranging from three to ten years, of the software on a straight-line basis.

Revenue Recognition: Revenue from management fee and other services are recognized as earned when the underlying services are performed because such services are rendered under contracts, the price is determinable, and collectability is reasonably assured.

Other revenue is comprised of commissions earned on premiums for specialty types of insurance coverage provided to CCG's policyholders through CCMC's strategic underwriting partners. Commissions are earned at the later of the bill date or inception date of the policies.

Income Taxes: CCMC accounts for income taxes using a balance sheet approach. Under this method, the provision for income taxes is based on pretax financial statement income and includes amounts that are deferred. Deferred income tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts using enacted rates.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

On December 22, 2017, the Tax Cuts and Jobs Act ("the 2017 Act") was signed into law by the President. The 2017 Act changes existing United States tax law and includes numerous provisions that will affect businesses. The 2017 Act reduced the U.S. corporate tax rate to 21%, includes several base broadening provisions, as well as, reforms to the US international tax system.

The reduction in tax rate required CCMC to revalue its deferred tax assets and liabilities as of December 31, 2017 to reflect the enacted tax rate of 21% which is expected to apply when the deferred tax assets and liabilities will be settled or realized. The change in net deferred tax assets due to the re-measurement is $8,036 which was recorded in the provision for income taxes for 2017. Furthermore, CCMC has evaluated and considered the impacts of the 2017 Act to the realizability of deferred tax assets and have concluded that no change as of December 31, 2017 is necessary. CCMC's provision for income taxes for the period ended December 31, 2017 is based in part on a reasonable estimate of the effects on existing deferred tax balances and of certain provisions of the 2017 Act. To the extent a reasonable estimate of the impact of certain provisions was determinable CCMC recorded provisional estimates as a component of provision of income taxes. To the extent a reasonable estimate of the impact of certain provisions was not determinable, CCMC has not recorded any adjustments and continued accounting for them in accordance with ASC 740 on the basis of the tax laws in effect before enactment of the 2017 Act.

On February 14, 2018, the FASB issued a new Accounting Standards Update (ASU) 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive income. The update permits a company to reclassify the income tax effects of the 2017 Act on items within AOCI to retained earnings. The FASB refers to these amounts as "stranded tax effects." Early adoption is permitted. CCMC adopted this guidance as of December 31, 2017 and reclassified $9,660 of tax effects related to employee benefits plans and ($772) of tax effects related to unrealized net gains related investment securities from accumulated other comprehensive income to retained earnings.

Accounting for Unrecognized Tax Benefits: Current authoritative accounting guidance for unrecognized tax benefits requires a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. CCMC records a liability for the difference between the benefit recognized and measured pursuant to the guidance that is more likely than not to be sustained upon settlement and the tax position taken or expected to be taken on CCMC's tax return. A liability is established when CCMC believes that certain tax return positions may be challenged despite CCMC's belief that the positions are fully supportable. The liability may be adjusted in light of revised assessments of a tax return position, or in the case of changing facts and circumstances, such as the outcome of a tax audit. Adjustments to the liability are recorded in the period in which the determination is made. The provision for income taxes includes the impact of initial liability recognition and any subsequent adjustments to those liabilities that are considered appropriate. Accrued interest and penalties related to unrecognized tax benefits are also recognized in the provision for income tax.

Variable Interest Entities: Current authoritative accounting guidance for the consolidation of variable interest entities ("VIEs") requires a qualitative assessment of whether an entity has the power to direct the VIE's activities and, whether the entity has the obligation to absorb losses or the right to receive benefits that could be significant to the VIE. The guidance also requires an ongoing reassessment of whether an entity is the primary beneficiary of a VIE. CCMC has evaluated its relationship with CCG to determine whether or not consolidation is required under this guidance.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Management's assessment included consideration of CCG's surplus, which is more than adequate to finance its ongoing operations, as well as the governance and organizational structure of both CCMC and CCG. CCMC's Board of Directors and CCG's Advisory Board have no overlapping authorities or responsibilities. Management concluded that CCG's Advisory Board holds and exercises the power to direct the activities that most significantly impact the economic performance of CCG, therefore CCMC is not the primary beneficiary and consolidation is not required.

CCMC has no loss exposure as a result of its relationship with CCG (Note 1, Note 3).

Recently Adopted Accounting Standards: On February 25, 2016, the FASB issued a new Accounting Standard, Leases (ASC 842). According to the new standard, lessees will need to recognize all leases (other than short-term leases) on the balance sheet, by recording a right-of-use (ROU) asset and lease liability, equal to the present value of lease payments. The expense recognition and amortization of the leased assets will vary depending on the classification of the lease as either operating lease or finance lease. For operating leases, the standard requires recognizing a single lease expense on a straight-line basis. For finance leases, interest expense and a straight-line amortization expense are required to be reflected separately in the income statement, with the total expense declining throughout the lease term. The standard adds new disclosure requirements regarding the nature and terms of the leases. For non-public companies, the standard is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. CCMC has adopted this guidance as of January 1, 2018.

CCMC adopted the guidance using the cumulative effect transition approach. The cumulative effect transition approach provides a method for recording existing leases at adoption and not restated comparative periods; rather the effect of the change is recorded at the beginning of the year of adoption. In addition, CCMC elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed CCMC to carry forward the historical lease classification.

Adoption of the new standard resulted in the recording of additional net lease assets and lease liabilities of approximately $32,570 and $36,306, respectively, as of December 31, 2018, primarily for the leases CCMC entered into during 2018. The standard had a material impact in CCMC's balance sheets, but did not have an impact in CCMC's income statements. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while CCMC's accounting for finance leases remained substantially unchanged.

At the inception of an arrangement, management determines whether the arrangement is or contains a lease based on the unique facts and circumstances present. Operating and finance leases are included in leased assets and lease liabilities in our balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As our leases do not provide an implicit rate, CCMC has elected to use the practical expedient provided by ASC 842 and utilize a U.S. Treasury rate with a similar duration to the lease at commencement date in determining the present value of lease payments. CCMC uses the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that CCMC will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Although separation of lease and non-lease components is required, certain practical expedients are available to entities. CCMC has lease agreements with lease and non-lease components, which are generally accounted for separately. Operating expenses and property taxes due for leased facilities are accounted for as non-lease components.

Most leases with a term greater than one-year are recognized on the balance sheet as ROU assets, lease liabilities and, if applicable, long-term lease liabilities. CCMC has elected not to recognize on the balance sheet leases with terms of one-year or less.

Recent Accounting Standards Not Yet Adopted: In March 2017, the FASB issued new guidance which impacts CCMC's accounting for defined benefit pension and postretirement benefit costs to improve the presentation of net periodic pension costs and net periodic postretirement benefit costs that requires entities to (1) disaggregate the current service cost component from the other components of net benefit cost and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations if that subtotal is presented. The ASU also requires disclosures of the income statement lines used to present the other components if these components are not presented separately in the income statement. This ASU is effective for CCMC for year ending December, 31, 2019 on a retrospective basis. The reason and nature for the change in accounting principle in the year of adoption must also be disclosed. CCMC is currently assessing the impact of adopting this new standard.

In June 2016, the FASB issued new guidance that amends the accounting for credit losses on most financial instruments. For financial assets measured at amortized cost such as trade receivable and any other financial assets not excluded from the scope that have the contractual right to receive cash, guidance requires the use of expected credit loss model to estimate losses expected throughout the life of the financial asset and record an allowance that, when deducted from amortized cost basis, presents the net amount expected to be collected on the financial asset. The guidance also modifies the other-than-temporary impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods. This ASU is effective for the year ending December 31, 2021. Early adoption is permitted. CCMC is currently assessing the impact of adopting this new standard.

In January 2016, the FASB issued new guidance that amends presentation and accounting for certain financial instruments, including liabilities measured at fair value under the fair value option and equity investments. The guidance also updates fair value presentation and disclosure requirements for financial instruments measured at amortized cost. The ASU is effective for the year ending December 31, 2019. CCMC is currently assessing the impact of adopting this new standard.

In May 2014, the FASB issued new guidance that outlines the principles an entity must apply to measure and recognize revenue and the related cash flows on contracts with customers. Subsequently in August 2015, the FASB issued ASU 2015-14: Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09. The new revenue standard is effective for CCMC beginning January 1, 2019 either on a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. CCMC is currently assessing the impact of adopting this new standard.

**NOTE 3 - RELATED PARTY TRANSACTIONS**

Management Fee and Reimbursements: CCMC is the attorney-in-fact for CCIE and manager for CCIE's wholly owned subsidiaries under various management agreements. CCMC is paid a fee consisting of expenses incurred on behalf of CCG plus a markup not to exceed 25% of expenses. In establishing the markup, CCMC's management considers several factors, including CCG's financial strength, operating results and the competitiveness of CCG's insurance products. CCG's 2018 premium and surplus are approximately $366,600 and $191,600, respectively. An annual incentive fee of up to 10% of CCG's calendar year pre-tax income, calculated after giving effect to such incentive fee, may also be paid to CCMC. No incentive fee was earned by CCMC in 2018 and 2017. CCMC reimburses CCG for the annual savings in state income taxes that are attributable to managing CCG's operations, or charges CCG for any adjustments to true-up prior years.

The management fee earned and state income tax adjustments for the years ended December 31 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Expenses incurred | $ 120,391 | $ 116,042 |
| Markup taken | - | 611 |
| Incentive fee | - | - |
| State income tax adjustments | - | - |
| Net management fee | $ 120,391 | $ 116,653 |
| | | |
| Maximum markup allowed (25% of expenses incurred) | $ 30,098 | $ 29,011 |
| Markup taken | - | (611) |
| Markup allowed but not taken | $ 30,098 | $ 28,400 |

Other Transactions: In accordance with the management agreements, generally all expenses incurred by CCMC that relate to the management of CCG shall be paid by CCMC and reimbursed through the management fee. Exceptions include the following, which shall be paid by CCG or if paid by CCMC, reimbursed separately from the management fee: losses, allocated claims expense, governmental charges, premium taxes, federal and all other taxes of CCG, reinsurance, CCG Directors' expenses and specific expenses authorized by the Advisory Board of CCIE. CCMC billed CCG $596 and $633 for expenses incurred under this provision in 2018 and 2017, respectively. These transactions are shown as a reduction of CCMC expense, rather than revenue.

At December 31, 2018 and 2017, CCMC had a receivable due from CCG of $2,614 and $2,034, respectively, included in receivables on the balance sheet. Related party balances are settled monthly.

**NOTE 3 - RELATED PARTY TRANSACTIONS** (Continued)

CCIE Investment in CCMC: In 2004, CCIE purchased 186,000 shares of CCMC common stock from existing shareholders (158,722 Series A and 27,278 Series B) at a price of $99.09 per share. CCIE's interest in CCMC is 17.6% and 18.0% at December 31, 2018 and 2017, respectively. In accordance with the acquisition agreement, CCIE has the right to put the shares back to CCMC at a purchase price equal to the CCMC adjusted book value per share (Note 9) at the time the put right is exercised, multiplied by the same book value multiple used in the original purchase, 1.85. If CCIE were to exercise its put right on the 186,000 shares, at its ownership level as of December 31, 2018 and 2017, the resulting adjusted book value to the remaining shareholders will be reduced by approximately 17.8% and 18.6%, respectively. At December 31, 2018 and 2017, the carrying value of the common stock with put rights was $16,030 and $14,287, respectively, and is reported as a separate component of shareholders' equity (deficit). There is a corresponding reduction to retained earnings and, therefore, no net impact to total shareholders' equity (deficit). CCMC paid dividends to CCIE of $744 in 2018 and 2017.

**NOTE 4 - INVESTMENT SECURITIES**

Current authoritative accounting guidance applies to all assets and liabilities measured at fair value on a recurring or nonrecurring basis, and establishes a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value.

The guidance clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. Fair value measurements assume the asset or liability is exchanged in an orderly manner; the exchange is in the principal market for that asset or liability (or in the most advantageous market when no principal market exists); and the market participants are independent, knowledgeable, able and willing to transact an exchange. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value.

CCMC has categorized its financial instruments into a fair value hierarchy of three levels, as follows:

Level 1 When available, CCMC uses unadjusted, quoted prices in active markets for identical instruments at the measurement date. An active market is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 includes active exchange-traded equity and certain U.S. Treasury securities.

Level 2 When quoted market prices in active markets are not available, CCMC uses quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and inputs other than quoted prices that are derived principally from or corroborated by observable market data by correlation or other means. These quotes come from independent pricing vendors and may be based on recently reported trading activity and other relevant information including benchmark yields, market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable. Level 2 includes certain corporate, municipal and asset backed bonds.

Level 3 Valuations are derived principally from inputs that are unobservable in the market. These unobservable inputs reflect CCMC's own subjective estimates of assumptions that market participants would use in pricing the instrument.

**NOTE 4 - INVESTMENT SECURITIES** (Continued)

Certain assets held by the Defined Benefit Pension Plan (Note 11) are measured at Net Asset Value.

The following table presents available-for-sale investments measured at fair value on a recurring basis classified by the fair value hierarchy:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2018 | | | | |
| Bonds | | | | |
| U.S. Government | $ 2,187 | $ 755 | $ - | $ 2,942 |
| Municipal agencies | - | 2,852 | - | 2,852 |
| Asset backed | - | 2,466 | - | 2,466 |
| Industrial and miscellaneous | - | 6,416 | - | 6,416 |
| Total bonds | 2,187 | 12,489 | - | 14,676 |
| Stocks | | | | |
| Large cap | 6,542 | - | - | 6,542 |
| Mid cap | 2,003 | - | - | 2,003 |
| Small cap | 867 | - | - | 867 |
| Total stocks | 9,412 | - | - | 9,412 |
| Total | $ 11,599 | $ 12,489 | $ - | $ 24,088 |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Bonds | | | | |
| U.S. Government | $ 795 | $ 503 | $ - | $ 1,298 |
| Municipal agencies | - | 5,818 | - | 5,818 |
| Asset backed | - | 2,571 | - | 2,571 |
| Industrial and miscellaneous | - | 5,341 | - | 5,341 |
| Total bonds | 795 | 14,233 | - | 15,028 |
| Stocks | | | | |
| Large cap | 7,469 | - | - | 7,469 |
| Mid cap | 1,967 | - | - | 1,967 |
| Small cap | 918 | - | - | 918 |
| Total stocks | 10,354 | - | - | 10,354 |
| Total | $ 11,149 | $ 14,233 | $ - | $ 25,382 |

CCMC currently has no material financial liabilities that would require classification.

**NOTE 4 - INVESTMENT SECURITIES** (Continued)

The cost and fair values of investment securities are as follows:

| | Cost or Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| December 31, 2018 | | | | |
| Bonds | | | | |
| U.S. Government | $ 2,936 | $ 11 | $ (6) | $ 2,941 |
| Municipal agencies | 2,821 | 57 | (27) | 2,851 |
| Asset backed | 2,506 | 4 | (44) | 2,466 |
| Industrial and miscellaneous | 6,406 | 24 | (12) | 6,418 |
| Total bonds | 14,669 | 96 | (89) | 14,676 |
| Stocks | | | | |
| Large cap | 5,092 | 1,993 | (543) | 6,542 |
| Mid cap | 1,600 | 590 | (187) | 2,003 |
| Small cap | 798 | 188 | (119) | 867 |
| Total stocks | 7,490 | 2,771 | (849) | 9,412 |
| Total | $ 22,159 | $ 2,867 | $ (938) | $ 24,088 |

| | Cost or Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Bonds | | | | |
| U.S. Government | $ 1,306 | $ - | $ (8) | $ 1,298 |
| Municipal agencies | 5,726 | 131 | (39) | 5,818 |
| Asset backed | 2,637 | 7 | (73) | 2,571 |
| Industrial and miscellaneous | 5,274 | 77 | (10) | 5,341 |
| Total bonds | 14,943 | 215 | (130) | 15,028 |
| Stocks | | | | |
| Large cap | 3,081 | 4,392 | (4) | 7,469 |
| Mid cap | 897 | 1,070 | - | 1,967 |
| Small cap | 527 | 392 | (1) | 918 |
| Total stocks | 4,505 | 5,854 | (5) | 10,354 |
| Total | $ 19,448 | $ 6,069 | $ (135) | $ 25,382 |

**NOTE 4 - INVESTMENT SECURITIES** (Continued)

The amortized cost and fair value of bonds at contractual maturities at December 31, 2018 are as follows:

| | Amortized Cost | Fair Value |
|---|---|---|
| Less than one year | $ 1,449 | $ 1,446 |
| One to five years | 8,236 | 8,301 |
| Five to ten years | 2,642 | 2,627 |
| Over ten years | 2,342 | 2,302 |
| Total bonds | $ 14,669 | $ 14,676 |

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

Proceeds from sales of stocks during 2018 and 2017 were $4,845 and $9,071, respectively. Proceeds from sales and maturities of bonds during 2018 and 2017 were $10,675 and $10,224, respectively. Gross realized gains and losses pertaining to investment securities sold and realized losses recognized for declines in the fair value of stocks which were determined to be OTTI were as follows:

| | Gains | Losses | OTTI | Net |
|---|---|---|---|---|
| December 31, 2018 | | | | |
| Bonds | | | | |
| U.S. Government | $ 1 | $ (14) | $ - | $ (13) |
| Municipal agencies | 9 | (30) | - | (21) |
| Asset backed | - | (89) | - | (89) |
| Industrial and miscellaneous | 13 | (49) | - | (36) |
| Total bonds | 23 | (182) | - | (159) |
| Stocks | | | | |
| Large cap | 2,088 | (27) | (30) | 2,031 |
| Mid cap | 468 | (28) | - | 440 |
| Small cap | 209 | (20) | (17) | 172 |
| Total stocks | 2,765 | (75) | (47) | 2,643 |
| Total | $ 2,788 | $ (257) | $ (47) | $ 2,484 |

**NOTE 4 - INVESTMENT SECURITIES** (Continued)

| | Gains | Losses | OTTI | Net |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Bonds | | | | |
| U.S. Government | $ - | $ (6) | $ - | $ (6) |
| Municipal agencies | 21 | (11) | - | 10 |
| Asset backed | 18 | - | - | 18 |
| Industrial and miscellaneous | 9 | (7) | - | 2 |
| Total bonds | 48 | (24) | - | 24 |
| Stocks | | | | |
| Large cap | 3,631 | (7) | (20) | 3,604 |
| Mid cap | 996 | (22) | (1) | 973 |
| Small cap | 318 | (27) | (46) | 245 |
| Total stocks | 4,945 | (56) | (67) | 4,822 |
| Total | $ 4,993 | $ (80) | $ (67) | $ 4,846 |

Unrealized losses and related market value of investment securities are as follows:

| | Less than 12 months | | 12 months or greater | |
|---|---|---|---|---|
| | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| December 31, 2018 | | | | |
| Bonds | | | | |
| U.S. Government | $ - | $ 350 | $ 6 | $ 395 |
| Municipal agencies | - | - | 27 | 968 |
| Asset backed | 2 | 357 | 42 | 1,065 |
| Industrial and miscellaneous | 10 | 2,417 | 2 | 497 |
| Total bonds | 12 | 3,124 | 77 | 2,925 |
| Stocks | | | | |
| Large cap | 540 | 2,426 | - | - |
| Mid cap | 187 | 749 | - | - |
| Small cap | 122 | 428 | - | - |
| Total stocks | 849 | 3,603 | - | - |
| Total | $ 861 | $ 6,727 | $ 77 | $ 2,925 |

**NOTE 4 - INVESTMENT SECURITIES** (Continued)

| | Less than 12 months | | 12 months or greater | |
|---|---|---|---|---|
| | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| December 31, 2017 | | | | |
| Bonds | | | | |
| U.S. Government | $ 4 | $ 999 | $ 4 | $ 296 |
| Municipal agencies | - | - | 39 | 1,668 |
| Asset backed | 6 | 799 | 67 | 1,397 |
| Industrial and miscellaneous | 9 | 2,269 | 1 | 500 |
| Total bonds | 19 | 4,067 | 111 | 3,861 |
| Stocks | | | | |
| Large cap | 3 | 56 | 1 | 67 |
| Mid cap | - | - | - | - |
| Small cap | 1 | 11 | - | - |
| Total stocks | 4 | 67 | 1 | 67 |
| Total | $ 23 | $ 4,134 | $ 112 | $ 3,928 |

The number of securities in an unrealized loss position at December 31, 2018 and 2017 were 227 and 35, respectively.

CCMC believes the unrealized losses, other than those that were determined to be OTTI, are temporary in nature and has not recorded a realized investment loss in its statement of income related to these securities. Given the size of its investment portfolio and anticipated future earnings, CCMC has the ability and intent to hold these securities until the fair value recovers the unrealized loss. Additionally CCMC did not incur a material credit loss and does not have the intent to sell these bonds in an unrealized loss position.

The components of investment income for the years ended December 31 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Interest and dividends | $ 583 | $ 641 |
| Net realized gains | 2,484 | 4,846 |
| Gain on sale of real estate | 10,037 | 412 |
| Investment expense | (86) | (100) |
| Investment income | $ 13,018 | $ 5,799 |

## NOTE 5 - PROPERTY AND EQUIPMENT

A summary of property and equipment at December 31 is as follows:

| | 2018 | 2017 |
|---|---|---|
| Cost: | | |
| Home office building held under capital lease | $ - | $ 32,407 |
| Capitalized software | 34,703 | 35,008 |
| Work in progress | 24,767 | 7,869 |
| EDP equipment | 10,633 | 10,474 |
| Building | - | 14,120 |
| Office equipment | 4,797 | 7,023 |
| Leasehold improvements | 6,997 | 3,222 |
| Building improvements | - | 2,487 |
| Automobiles | 1,328 | 1,386 |
| Equipment held under finance and capital leases | 1,581 | 2,945 |
| Land | - | 1,400 |
| Land improvements | - | 244 |
| | 84,806 | 118,585 |
| Less: Accumulated amortization under capital lease | - | (32,548) |
| Less: Accumulated amortization on capitalized software | (28,681) | (26,842) |
| Less: Other accumulated depreciation and amortization | (16,045) | (25,394) |
| Property and equipment, net | $ 40,080 | $ 33,801 |
| Depreciation and amortization expense on property and equipment | $ 5,145 | $ 5,839 |

In 2017, CCMC commenced implementation of the underwriting, policy center, data hub and billing software for CCG. Software development costs of $24,767 have been capitalized through 2018 and added to Work in Progress account until implementation is completed, which is expected during the year ending December 31, 2019.

In 2018, CCMC sold the property located at 1650 Telstar Drive, Colorado Springs, CO, 80920 and leased it back from the buyer, Oak Real Estate Capital, for 12 years. The primary purpose of the transaction was to raise approximately $20 million in cash for CCMC. CCMC recognized a pre-tax gain on sale of $9,932. The amount of rent payments due over 12 years is approximately $20,561. CCIE is a guarantor on the lease for CCMC. If CCMC is unable to honor its future lease payments, then CCIE would be liable to pay these obligations.

## NOTE 6 - CREDIT ARRANGEMENT

The previous home office complex lease amendment required CCMC to secure a letter of credit which may be used by the landlord to compensate for any loss due to CCMC's failure to fulfill its monetary obligations under the amended lease. A bank has an irrevocable $304 letter of credit in favor of Hines REIT Properties, L.P. This letter of credit expires on August 11, 2019. Although CCMC no longer occupies this space the letter of credit has not been cancelled as of December 31, 2018.

**NOTE 6 - CREDIT ARRANGEMENT** (Continued)

On June 1, 2018, CCMC entered into a lease agreement for a new home office. The lease requires CCMC to secure a letter of credit which may be used by the landlord to compensate for any loss due to CCMC's failure to fulfill its monetary obligations under the lease. A bank has an irrevocable $249 letter of credit in favor of BCSP Crossroads Property LLC.

A bank holds two standby letters of credit, totaling $109, which are held to secure future monetary obligations under expired large deductible workers' compensation insurance policies.

**NOTE 7 - LEASE COMMITMENTS**

CCMC has various lease agreements for office buildings, equipment and software. Certain leases have renewal options and certain office buildings and equipment have purchase options. Leases with an initial term of 12 months or less are not recorded on the balance sheet; CCMC recognizes lease expense on these leases on a straight-line basis over the lease term.

In 1998, CCMC entered into a sale-leaseback agreement for its home office building and the related land located in San Mateo, California. The leaseback has been accounted for as a capital lease for the building and an operating lease for the land. CCMC recognized a gain of $8,308 from the sale, which was deferred and is being amortized to income over the lease term using the straight-line method. In 2005, the home office lease was amended pursuant to the landlord's sale of the property. The amendment did not change the classification of the lease. Interest expense recorded in 2018 and 2017 for capital lease obligations was $117 and $261, respectively. The home office lease amendment included an incentive payment of $949 paid to CCMC in January 2006, which is recognized on a straight-line basis over the remaining term of the lease. This lease ended May 31, 2018.

CCMC commenced a lease on a new home office on June 1, 2018. The term of the lease is 7 years and 10 months, with one option to extend the lease for a period of 5 years. The rent is abated during the first 10 months of the lease term. CCMC received a lease incentive of $2,820 associated with this lease.

In 2018, CCMC sold the property located at 1650 Telstar Drive, Colorado Springs, CO, 80920 and leased it back from the buyer, Oak Real Estate Capital, for 12 years, with 4 options to extend the lease for a period of 5 years each.

In 2017, CCMC entered into a capital lease agreement with IBM Credit LLC for equipment. The term of the lease is 5 years, with a purchase option of one dollar at the end of the lease term. With the adoption of ASC 842 this lease has been accounted for as a finance lease.

CCMC rents or subleases space in its offices to third parties. CCMC has one sublease in its Colorado Springs office, with the expected payments of $3,537 over the next 5 years.

**NOTE 7 - LEASE COMMITMENTS** (Continued)

A summary of lease asset and liabilities at December 31, 2018 is as follows:

| | | |
|---|---|---|
| Assets | | |
| Operating lease assets | $ | 32,570 |
| Finance lease assets | | 1,581 |
| Total lease assets | $ | 34,151 |
| Liabilities | | |
| Current | | |
| Operating | $ | 4,107 |
| Finance | | 372 |
| Non-current | | |
| Operating | | 32,199 |
| Finance | | 1,099 |
| Total lease liabilities | $ | 37,777 |

CCMC's finance leases have been recorded within property and equipment, net on the balance sheet consistent with the presentation of capital leases in 2017.

Lease costs for the year ended December 31, 2018 is as follows:

| | | |
|---|---|---|
| Operating lease cost | $ | 4,662 |
| Finance lease cost | | |
| Amortization of leased assets | | 1,223 |
| Interest on lease liabilities | | 117 |
| Sublease income | | (877) |
| Net lease cost | $ | 5,125 |

Rent expense under operating and capital leases was $8,859 in 2017.

A summary of maturities for operating and finance leases at December 31, 2018 is as follows:

| | | Operating Leases | | Finance Leases |
|---|---|---|---|---|
| 2019 | $ | 5,070 | $ | 444 |
| 2020 | | 4,778 | | 444 |
| 2021 | | 4,534 | | 444 |
| 2022 | | 4,604 | | 295 |
| 2023 | | 4,677 | | - |
| Thereafter | | 17,659 | | - |
| Total lease payments | | 41,322 | | 1,627 |
| Less: Amount representing interest | | (5,016) | | (156) |
| Present value of lease liabilities | $ | 36,306 | $ | 1,471 |

**NOTE 7 - LEASE COMMITMENTS** (Continued)

A summary of remaining lease terms and discount rates at December 31, 2018 is as follows:

| | |
|---|---|
| Weighted-average remaining lease term (years): | |
| Operating leases | 10 years |
| Finance leases | 4 years |
| Weighted-average discount rate: | |
| Operating leases | 2.84% |
| Finance leases | 5.31% |

Supplemental cash flow information related to leases for the year ended December 31, 2018 is as follows:

| | | |
|---|---|---|
| (Gains) and losses on sale and leaseback transactions, net | $ | (10,037) |
| Cash paid for amounts included in the measurement of lease liabilities | | |
| Operating cash flows from operating leases | | (3,000) |
| Operating cash flows from finance leases | | (444) |
| Financing cash flows from finance leases | | (1,869) |
| Leased assets obtained in exchange for new finance lease liabilities | | - |
| Leased assets obtained in exchange for new operating lease liabilities | | 36,306 |

**NOTE 8 - INCOME TAXES**

A reconciliation of CCMC's effective income tax rate for each year is as follows:

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Amount | Percentage | Amount | Percentage |
| U.S. federal tax (statutory tax rate) | $ 3,032 | 21.0 % | $ 2,168 | 34.0 % |
| Tax-exempt income | (32) | (0.2) | (85) | (1.3) |
| Tax rate change | - | - | 8,037 | 126.0 |
| All other items | 270 | 1.2 | 40 | 0.6 |
| Provision for income taxes (effective tax rate) | $ 3,270 | 22.0 % | $ 10,160 | 159.3 % |

**NOTE 8 - INCOME TAXES** (Continued)

The significant components of the provision for income taxes for years ended December 31 are summarized below:

| | 2018 | 2017 |
|---|---|---|
| Current benefit | $ (7) | $ (1) |
| Deferred provision, noncurrent | 3,277 | 10,161 |
| Provision for income taxes | $ 3,270 | $ 10,160 |

The provision for income taxes was increased by $4 of accrued interest and penalties related to unrecognized tax benefits for the year ended December 31, 2018.

Income taxes recoverable recorded on the balance sheets as of December 31, 2018 is reported net of a $47 liability for interest and penalties related to unrecognized tax benefits. CCMC does not expect any material changes in the liability for unrecognized tax benefits in 2018.

The significant components of the net deferred tax assets (liabilities) recorded on the balance sheets at December 31 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Deferred tax assets: | | |
| Employee benefits | $ 15,785 | $ 16,772 |
| Deferred gain on sale of real estate | - | 36 |
| Building leases | 762 | 137 |
| Rent expense | 58 | 41 |
| Net operating loss | 2,621 | 872 |
| Fed charitable contributions carryforward | 85 | 63 |
| AMT credit carryforward | 108 | 215 |
| Realized book losses on OTTI securities | 30 | 58 |
| All other | 55 | 67 |
| Total deferred income tax assets | 19,504 | 18,261 |
| Deferred tax liabilities: | | |
| Unrealized appreciation on investments | (405) | (1,247) |
| Depreciation | (1,447) | (1,904) |
| Prepaid expenses | (75) | (77) |
| Internally developed computer software | (4,723) | - |
| Total deferred income tax liabilities | (6,650) | (3,228) |
| Net deferred income tax assets | $ 12,854 | $ 15,033 |

**NOTE 8 - INCOME TAXES** (Continued)

Realization of these assets is primarily dependent upon generating sufficient future taxable income to utilize these assets. CCMC will establish a valuation allowance if it is more likely than not that these items will either expire before CCMC is able to realize their benefits, or that future deductibility is uncertain. There was no valuation allowance required at December 31, 2018 and 2017.

CCMC adjusts its tax liabilities when our judgment changes as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which they are determined. CCMC has no material uncertain tax positions at December 31, 2018 and 2017.

CCMC files income tax returns in the United States federal jurisdiction (Internal Revenue Service, or IRS) and various state jurisdictions. In the normal course of business, CCMC is subject to examination by taxing authorities from any of these jurisdictions. With few exceptions, CCMC is no longer subject to income tax examinations for years before 2015. CCMC is not currently under a federal income tax audit by the IRS.

**NOTE 9 - SHAREHOLDERS' EQUITY (DEFICIT)**

CCMC has authorized 1,800,000 and 1,000,000 shares of Series A and Series B common stock, respectively. Shares issued and outstanding, book value per share, and common stock issued and outstanding at December 31 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Shares issued and outstanding | | |
| Series A | 788,977 | 790,184 |
| Series B | 269,276 | 244,427 |
| Total shares issued and outstanding | 1,058,253 | 1,034,611 |
| Book value per share | $ (5.02) | $ (8.79) |

| | 2018 | 2017 |
|---|---|---|
| Common stock issued and outstanding | | |
| Series A | $ 3,701 | $ 3,825 |
| Series B | 12,315 | 11,176 |
| Total common stock | $ 16,016 | $ 15,001 |

**NOTE 9 - SHAREHOLDERS' EQUITY (DEFICIT)** (Continued)

Adjusted book value per share is calculated as follows: total shareholders' equity (deficit) as determined under GAAP, plus the shareholder equity charges resulting from pension accounting (Note 11), divided by total outstanding shares of common stock. The calculation is as follows:

| | 2018 | 2017 |
|---|---|---|
| Total shareholders' equity (deficit) | $ (5,310) | $ (9,093) |
| AOCI balance related to pension plan | 54,608 | 52,051 |
| Adjusted shareholders' equity | $ 49,298 | $ 42,958 |
| Total shares issued and outstanding | 1,058,253 | 1,034,611 |
| Adjusted book value per share | $ 46.58 | $ 41.52 |

CCMC expects to recover employee retirement benefit plan funding shortfalls over time as pension expense is recognized in accordance with GAAP and reimbursed by CCG through the management fee. (Note 3).

The rights, privileges and restrictions of Series A and B are identical except holders of Series A shares have exclusive voting rights and power to vote upon election of Directors or upon any other matters. CCIE's put right is discussed in Note 3.

**NOTE 10 - STOCK-BASED COMPENSATION PLANS**

CCMC has two stock-based compensation plans: the Long Term Executive Incentive Plan ("LTEIP") and the Executive Stock Plan ("ESP"). The key provisions of each plan are described below. Both written plan documents are subject to review and approval by the California Department of Insurance, which requires, among other things, that CCMC annually report on all transactions made under the plans. Under both plans, if a plan participant's employment terminates because of death, disability, or retirement, CCMC has the right to repurchase that participant's shares at the most recently computed adjusted book value at the expiration of ten years after the termination of employment. If a plan participant's employment terminates for any other reason, CCMC has the right to repurchase that participant's shares for a period of 60 days after termination of employment. With the exception of ESP shares subject to a five-year holding period, plan participants have the right at any time to cause CCMC to repurchase all or any portion of their shares at adjusted book value by providing written notice to CCMC. Generally, to be eligible to receive an award under either plan, a participant must be a CCMC employee at the end of a plan performance period. However, under both plans, participants or their successors receive a prorated award if the participant dies, becomes disabled or retires during a performance period. The fair value of the restricted shares of common stock issued under both plans is considered equal to adjusted book value, as described in Note 9.

**NOTE 10 - STOCK-BASED COMPENSATION PLANS** (Continued)

Key Provisions of LTEIP: The LTEIP provides key executives, all of whom are members of CCMC's Operating Committee, with incentive awards consisting of common stock and/or cash compensation, based on the attainment of specific annual profitability and other measures over a three-year performance period. A new three-year performance period commences on January 1st of each year. In order for participants to be eligible for an award, CCMC must meet its threshold performance measures. The LTEIP requires that participants elect to receive at least 50% of their earned LTEIP award in shares of common stock, with the remainder paid in cash. The number of shares of common stock to be issued to each plan participant is based on the adjusted book value as of December 31 of the year prior to the date the stock is issued.

Awards are paid annually and are based on the preceding three-year performance period. Shares of stock are issued immediately following the award, so there are no shares awarded but un-issued. Stock is issued prior to March 15th each year. Compensation expense under the LTEIP is measured during the performance period based on a best estimate of performance against the goals. Compensation expense under the LTEIP was $1,460 and $1,402 in 2018 and 2017, respectively. CCMC assumes no forfeitures during the payout period when determining compensation expense over the performance period. During 2018 and 2017 there were no forfeitures of earned awards. Under the LTEIP, 300,000 shares of Series B common stock have been reserved for issuance. Total shares issued under the LTEIP were 18,772 and 15,063 in 2018 and 2017, respectively.

The accrued liability for the LTEIP is comprised of $1,423 in current employee compensation liability and $1,446 in noncurrent employee compensation liability on the balance sheet at December 31, 2018. The accrued liability for the LTEIP is comprised of $1,302 in current employee compensation liability and $1,409 in noncurrent employee compensation liability on the balance sheet at December 31, 2017.

Key Provisions of ESP: The ESP provides all officers on the executive payroll with common stock and/or cash compensation based on the attainment of specific profitability and other measures over a one-year performance period, with a new performance period commencing on January 1st of each year. In order for participants to be eligible for an award, CCMC must meet its threshold performance measures. The ESP requires that participants elect to receive at least 60% of their earned ESP awards in shares of common stock, with the remainder paid in cash. The number of shares of common stock to be issued to each plan participant is based on the adjusted book value as of December 31 of the year prior to the date the stock is issued.

Awards are made annually, and are based on the preceding one-year performance period. Shares of stock are issued immediately following the award, so there are no shares awarded but un-issued. Stock is issued prior to March 15th each year. Participants are required to hold all shares of common stock issued under the ESP for a minimum of five years from the date of issuance before exercising repurchase rights.

Compensation expense under the ESP was $549 and $512 in 2018 and 2017, respectively. Under the ESP, 150,000 shares of Series B common stocks have been reserved for issuance. Total shares issued under the ESP were 8,652 and 8,193 in 2018 and 2017, respectively. The accrued liability for the ESP was $549 and $511 at December 31, 2018 and 2017, respectively. These balances are included in current employee compensation liability on the balance sheets.

## NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS

CCMC provides defined contribution plans as well as both funded and unfunded noncontributory defined benefit pension plans. Substantially all of its employees participate in one or more of these plans. The funded plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”). All plans are described below.

Savings Investment Plans (the “SIPs”): CCMC sponsors a plan for hourly employees and a plan for salaried employees. The SIPs are qualified under section 401(k) of the Internal Revenue Code (the “Code”). Participating employees may elect to contribute a percentage of their annual compensation to the applicable SIP, limited to a maximum annual dollar amount as provided by the Code. These employees are eligible to receive a matching contribution from CCMC. Those matching contributions were $1,572 and $1,513 for the years ended December 31, 2018 and 2017, respectively.

Effective January 1, 2004, the SIPs were amended to add a new defined contribution feature. Employees hired, or employees rehired following a break in service of 12 months or more, on or after January 1, 2004 receive an annual service-based CCMC contribution of 3% to 7% of annual compensation depending on length of service. The expense for the defined contribution portion of the SIPs was $2,476 and $2,843 in 2018 and 2017, respectively.

Matching contributions and service-based contributions are vested to the employee on the following schedule:

| Years of service | Vested Percentage |
|---|---|
| Less than two | 0 % |
| Two | 25 % |
| Three | 50 % |
| Four | 75 % |
| Five | 100 % |

Defined Benefit Pension Plan (the “Pension Plan”): The Pension Plan is qualified under Section 401(a) of the Code. The Pension Plan was amended in 2003 to exclude employees hired on or after January 1, 2004. Employees rehired on or after January 1, 2004, following a break in service of 12 months or more, are also excluded. Generally, benefits are based on length of service and the average of the highest earnings for five consecutive calendar years, or sixty months, whichever is greater. A participant is 100% vested after completion of five years of service.

Effective December 31, 2015, the Board of Directors adopted an amendment instituting a “hard freeze” of the Pension Plan so that no further benefits will accrue under the plan. All Pension Plan participants were enrolled in the Service-Based Contribution feature of the Savings Investment Plans (the “SIP”) effective January 1, 2016.

Given the Pension Plan’s freeze to future benefit accruals as of December 31, 2015, the amortization period for actuarial gains and losses was updated from the average future working lifetime of participants to the average life expectancy of participants effective January 1, 2016.

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

Pension Plan Benefits:

| | 2018 | 2017 |
|---|---|---|
| Change in benefit obligation | | |
| Benefit obligation at beginning of year | $ 232,429 | $ 216,620 |
| Service cost | - | - |
| Interest cost | 7,187 | 7,079 |
| Benefits paid | (9,577) | (8,928) |
| Actuarial loss | (16,283) | 17,658 |
| Benefit obligation at end of year | 213,756 | 232,429 |
| Change in plan assets | | |
| Fair value of plan assets at beginning of year | 206,848 | 191,886 |
| Actual return on plan assets | (7,247) | 23,890 |
| Employer contribution | - | - |
| Benefits paid | (9,577) | (8,928) |
| Fair value of plan assets at end of year | 190,024 | 206,848 |
| Funded status at end of year | $ (23,732) | $ (25,581) |
| Amounts recognized in the balance sheets consist of | | |
| Noncurrent liabilities | $ (23,732) | $ (25,581) |
| Net amount recognized | $ (23,732) | $ (25,581) |
| Amounts recognized in accumulated other comprehensive loss (pretax) consist of: | | |
| Net loss | $ 69,078 | $ 65,841 |
| Accumulated other comprehensive loss | $ 69,078 | $ 65,841 |

| | 2018 | 2017 |
|---|---|---|
| Information for pension plans with an accumulated benefit obligation in excess of plan assets | | |
| Projected benefit obligation | $ 213,756 | $ 232,429 |
| Accumulated benefit obligation | $ 213,756 | $ 232,429 |
| Fair value of plan assets | $ 190,024 | $ 206,848 |

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

| | 2018 | 2017 |
|---|---|---|
| Components of net periodic benefit cost (income) and other amounts recognized in other comprehensive loss | | |
| Net periodic benefit cost | | |
| Service cost | $ - | $ - |
| Interest cost | 7,187 | 7,079 |
| Expected return on assets | (14,267) | (14,406) |
| Amortization of net actuarial loss | 1,994 | 1,310 |
| Total pension income included in Personnel expense on the Income Statements | $ (5,086) | $ (6,017) |
| Other changes in plan assets and benefit obligations recognized in other comprehensive loss (pretax) | | |
| Net loss | $ 5,231 | $ 8,174 |
| Amortization of net actuarial loss | (1,994) | (1,310) |
| Total recognized in other comprehensive loss | 3,237 | 6,864 |
| Total recognized in net periodic benefit cost (income) and other comprehensive loss | $ (1,849) | $ 847 |

| | 2018 | 2017 |
|---|---|---|
| Weighted-average assumptions used to determine benefit obligation at December 31: | | |
| Discount rate | 4.07 % | 3.44 % |
| Rate of compensation increase | N/A | N/A |
| Cost of living | N/A | N/A |
| Weighted-average assumptions used to determine net periodic benefit cost: | | |
| Discount rate - projected benefit obligation | 3.44 % | 3.90 % |
| Discount rate - interest cost | 3.14 % | 3.34 % |
| Rate of compensation increase | N/A | N/A |
| Expected return on plan assets | 7.20 % | 7.50 % |
| Cost of living | N/A | N/A |

The estimated net actuarial loss that will be amortized from accumulated other comprehensive loss into net periodic benefit cost (income) over the next fiscal year is $1,466.

CCMC selects its discount rate by using the expected cash flows of future benefit payments applied against the full yield curve provided by the Citigroup Pension Liability Index.

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

As of January 1, 2016, CCMC changed the approach to measuring service and interest costs as part of Pension Plan. CCMC elected to measure expense by applying the specific spot rates along that yield curve to the plans' liability cash flows. The new approach provides a more precise measurement of service and interest costs by aligning the timing of the plan's liability cash flows to the corresponding spot rates on the yield curve. This change does not affect the measurement of CCMC's plan obligations nor the funded status of the plan.

Pension Plan Assets: Fair value, asset allocations and target allocations at December 31 are as follows:

| | 2018 | | 2017 | | 2018 |
|---|---|---|---|---|---|
| | Fair Value | Allocation | Fair Value | Allocation | Target Allocation |
| Equity funds | | | | | |
| Domestic larg cap | $ 12,304 | 6% | $ 19,359 | 9% | 10% |
| International | 29,080 | 15% | 29,481 | 14% | 15% |
| Total equity funds | 41,384 | 21% | 48,840 | 24% | 25% |
| Fixed income | | | | | |
| US Government Agencies | 24,029 | 13% | 22,143 | 11% | 11% |
| Fixed income funds | | | | | |
| Domestic | | | | | |
| Long duration bond fund | 63,704 | 34% | 101,342 | 49% | |
| Intermediate duration bond fund | 29,278 | 15% | 2,457 | 1% | |
| High-yield | 4,434 | 2% | 5,596 | 3% | |
| International | | | | | |
| Emerging markets debt | 2,852 | 1% | 3,772 | 2% | |
| Total fixed income funds | 100,268 | 54% | 113,167 | 54% | 54% |
| Real Estate fund | 23,199 | 12% | 21,330 | 10% | 10% |
| Cash and accrued income | 1,144 | 1% | 1,368 | 1% | 0% |
| | $ 190,024 | 100% | $ 206,848 | 100% | 100% |

US Government agencies are in Level 1 of the fair value hierarchy; See Note 4 for a description of Levels in the fair value hierarchy.

Equity, Fixed Income funds, and Real Estate fund investments are measured at Net Asset Value (NAV) of the units held by the Plan at year-end. The NAV, as provided by the trustee of the fund is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Were the Plan to initiate a full redemption of the Real Estate fund, the issuer reserves the right to require sixty-five business days' notification in order to ensure that securities liquidation will be carried out in an ordinary business manner.

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

Investment Policies, Strategies and Target Asset Allocations: The CCMC Board of Directors has delegated authority for setting, monitoring, and adjusting the investment policy with respect to investment funds of the Pension Plan to the Pension Plan Committee ("Committee"). The Committee selects and retains investment managers who are responsible for managing the Pension Plan assets in accordance with the objectives and guidelines set forth in the Pension Plan's Investment Policy Statement ("IPS"). Investment managers are expected to comply with all laws, regulations, and standards of ethical conduct.

Investment guidelines and the Pension Plan's asset allocation targets are based upon long-term perspectives, so that interim fluctuations in investment markets should be viewed with appropriate perspective. Consistent with the desire for adequate asset diversification, the IPS is based upon the expectation that the volatility (the standard deviation of returns) of the total Pension Plan assets will be similar to that of the investment market.

The target asset allocation is designed to provide an optimal asset mix for the portfolio, which emphasizes diversification and maximizes return for relative risk. The IPS also sets guidelines to minimize investment risk by disallowing certain transactions or investments in certain securities. Transactions that would jeopardize the tax-exempt status of the Pension Plan are not allowed. Performance objectives are set by the IPS for each asset category listed above, and are reviewed at least annually by the Committee to determine if the established objectives are appropriate.

The expected return on Pension Plan assets is an assumption primarily determined by the investment strategy adopted to meet the objectives of the Pension Plan. This assumption is developed from investment manager capital market projections which include future returns by asset category, expected volatility of returns and correlation among asset classes. Consideration is also given to the expenses of active management. Judgment is applied to the quantitative measures derived from the capital market projections to arrive at the selected return on Pension Plan assets assumption. A change in the asset allocation could significantly impact the expected rate of return on plan assets.

Cash Flows:

*Contributions:* No contributions were made in 2018 and 2017. CCMC does not expect to contribute to the Pension Plan for 2019.

*Expected Future Benefit Payments:* The following benefit payments, which reflect expected future service, are expected to be paid:

| | Pension Benefits |
|---|---|
| 2019 | $ 10,263 |
| 2020 | 10,873 |
| 2021 | 11,316 |
| 2022 | 11,706 |
| 2023 | 12,139 |
| Years 2024–2028 | 64,559 |
| | $ 120,856 |

Supplemental Executive Retirement Plan and Excess Plan (the "SERP and Excess Plans"): The SERP and Excess Plans cover employees with earnings and/or benefits which exceed the limitations set out in the Pension Plan and/or the Code. Benefits are based on formulas similar to those of the Pension Plan.

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

The Excess Plan was frozen effective December 31, 2015. Effective January 1, 2016, CCMC adopted a new Service-Based Contribution Excess Benefit Plan (the “SBC Excess Plan”) to cover earnings and/or benefits that exceed the limits imposed by the Code for the Service-Based Contribution feature of the Savings Investment Plans (the “SIP”). Benefits for the new SBC Excess Plan are based on the formula used for the SIP. CCMC accrued $208 and $190 for the contribution to the plan in 2018 and 2017, respectively.

Given the SERP & Excess Plans’ freeze to future benefits accruals as of December 31, 2015, the amortization period for actuarial gains and losses has been updated from the average future working lifetime of participants to the average life expectancy of participants effective January 1, 2016.

SERP and Excess Benefits:

| | 2018 | 2017 |
|---|---|---|
| Change in benefit obligation | | |
| Benefit obligation at beginning of year | $ 48,650 | $ 49,953 |
| Service cost | - | - |
| Interest cost | 1,428 | 1,501 |
| Benefits paid | (3,341) | (3,374) |
| Actuarial loss | (1,346) | 570 |
| Benefit obligation at end of year | 45,391 | 48,650 |
| Change in plan assets | | |
| Employer contributions | 3,341 | 3,374 |
| Benefits paid | (3,341) | (3,374) |
| Fair value of plan assets at end of year | - | - |
| Funded status at end of year | $ (45,391) | $ (48,650) |
| Amounts recognized in the balance sheets consist of: | | |
| Current liabilities | $ (3,318) | $ (3,317) |
| Noncurrent liabilities | (42,073) | (45,333) |
| Net amount recognized | $ (45,391) | $ (48,650) |
| Amounts recognized in accumulated other comprehensive loss (pretax) consist of | | |
| Net actuarial loss | $ 15,123 | $ 17,161 |
| Accumulated other comprehensive loss | $ 15,123 | $ 17,161 |
| Information for pension plans with an accumulated benefit obligation in excess of plan assets | | |
| Projected benefit obligation | $ 45,391 | $ 48,650 |
| Accumulated benefit obligation | $ 45,391 | $ 48,650 |

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

| | 2018 | 2017 |
|---|---|---|
| Components of net periodic benefit cost (income) and other amounts recognized in other comprehensive loss | | |
| Net periodic benefit cost | | |
| Service cost | $ - | $ - |
| Interest cost | 1,428 | 1,501 |
| Amortization of net actuarial loss | 692 | 619 |
| Total pension expense included in Personnel expense on the Income Statements | $ 2,120 | $ 2,120 |
| Other changes in plan assets and benefit obligations recognized in other comprehensive loss (pretax) | | |
| Net loss | $ (1,346) | $ 570 |
| Amortization of net actuarial loss | (692) | (619) |
| Total recognized in other comprehensive loss | (2,038) | (49) |
| Total recognized in net periodic benefit cost and other comprehensive loss | $ 82 | $ 2,071 |

The estimated net actuarial loss that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year is $574.

| | 2018 | 2017 |
|---|---|---|
| Weighted-average assumptions used to determine benefit obligation at December 31: | | |
| Discount rate | 3.96 % | 3.30 % |
| Rate of compensation increase | N/A | N/A |
| Cost of living | N/A | N/A |
| Weighted-average assumptions used to determine net periodic benefit cost: | | |
| Discount rate - projected benefit obligation | 3.30 % | 3.71 % |
| Discount rate - interest cost | 2.98 % | 3.10 % |
| Rate of compensation increase | N/A | N/A |
| Cost of living | N/A | N/A |

CCMC selects its discount rate by using the expected cash flows of future benefit payments applied against the full yield curve provided by the Citigroup Pension Liability Index. CCMC measures service and interest costs as part of SERP and Excess plans expense by applying the specific spot rates along the yield curve to the plans' liability cash flows.

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

Cash Flows:

*Contributions:* Since the plan is unfunded, no contributions are made. However, benefit payments are treated as contributions.

*Expected Future Benefit Payments:* The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | SERP and Excess Benefits |
|---|---|
| 2019 | $ 3,318 |
| 2020 | 3,369 |
| 2021 | 3,345 |
| 2022 | 3,309 |
| 2023 | 3,276 |
| Years 2024 - 2028 | 15,617 |
| | $ 32,234 |

Accumulated Other Comprehensive Income ("AOCI"): The AOCI amounts related to employee retirement benefit plans recognized in the balance sheets, on an after-tax basis, were $66,525 and $65,577 at December 31, 2018 and 2017, respectively.

The following table summarizes the after-tax AOCI on employee retirement benefit plans:

| | Pension Plan[1] | SERP & Excess Plans[2] | Total |
|---|---|---|---|
| AOCI balances, at December 31, 2016 | $ 38,925 | $ 11,358 | $ 50,283 |
| 2017 activity | | | |
| Pension accounting charges | 5,593 | - | 5,593 |
| SERP & Excess Plans | - | 41 | 41 |
| Deferred tax rate change from 34% to 21% | 7,533 | 2,127 | 9,660 |
| Total 2017 activity | 13,126 | 2,168 | 15,294 |
| AOCI balances, at December 31, 2017 | 52,051 | 13,526 | 65,577 |
| 2018 activity | | | |
| Pension accounting charges | 2,557 | - | 2,557 |
| SERP & Excess Plans | - | (1,609) | (1,609) |
| Total 2018 activity | 2,557 | (1,609) | 948 |
| AOCI balances, at December 31, 2018 | $ 54,608 | $ 11,917 | $ 66,525 |

**NOTE 11 - EMPLOYEE RETIREMENT BENEFIT PLANS** (Continued)

(1) These after-tax GAAP pension plan accounting charges are utilized in the adjusted book value calculation (Note 9).

(2) These SERP and Excess Plan adjustments are excluded from the adjusted book value calculation (Note 9). They represent the cumulative difference between the accumulated benefit obligation and accrued benefit liability in the balance sheets.

**NOTE 12 - CONCENTRATION OF CREDIT RISK**

CCMC's financial instruments exposed to concentration of credit risk consist of cash equivalents. CCMC maintains its cash accounts primarily with banks. Cash balances are insured by the Federal Deposit Insurance Company ("FDIC") up to $250 per depositor. CCMC had cash on deposit with four banks at December 31, 2018 and 2017 that exceeded the balance insured by the FDIC in the amount of $6,033 and $7,179, respectively. CCMC has not experienced any losses related to these balances, and management believes its credit risk to be minimal.

**NOTE 13 - SUBSEQUENT EVENTS**

CCMC has evaluated subsequent events through April 4, 2019, which is the date that the financial statements were available to be issued.

**Carl B. (Beau) Brown, CPCU**
Director
Chairman of the Board
Chief Executive Officer

**Joseph L. Volponi, FCAS**
Director
President
Chief Operating Officer

**Kenneth G. Berry**
Director

**Michael D. Bower**
Director
Executive Vice President
Technology and Investments

**Thomas R. Brown, CLU**
Director
Chairman Emeritus

**Peter Goldberg**
Director
Vice Chairman Emeritus

**Marston Nauman**
Director
Vice Chairman-Emeritus

**Michael A. Ray, CPA**
Director
Executive Vice President
Chief Financial Officer
Treasurer

**James M. Sevey, CPCU**
Director

**Hong Chen, FCAS**
Senior Vice President
Actuary

**Douglas A. Goldberg, CIC**
Senior Vice President
National Accounts
and Partner Programs

**Barbara K. Gurnett**
Senior Vice President
Learning and Website
Development

**James Inglese, CPCU**
Senior Vice President
General Counsel
Secretary

**Fong-Yee Judy Jao,**
**FCAS, MAAA**
Senior Vice President
Actuary

**James R. Kauffman, Esq.**
Senior Vice President
Claims

**Patrick O. Lynch**
Senior Vice President
Agency Services and
Customer Service

**T. Michael McCormick, Jr.**
Senior Vice President
Chief Marketing Officer

**Joseph C. Muenzen, CPCU**
Senior Vice President
Underwriting and Product
Development

**Transfer Agent/Shareholder Services:**

EQ Shareowner Services
P.O. Box 64854
St. Paul, MN 55164-0854

**Contact EQ Shareowner Services for CCMC shareholder services, including address changes, dividend issues, and share balance information:**

Write: EQ Shareowner Services
P.O. Box 64854
St. Paul, MN 55164-0854

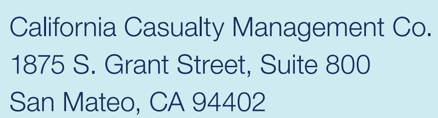
Call: 1(800) 468-9716

**Contact CCMC on other shareholder issues:**

Call: James Inglese
1(800) 288-7765 ext. 4539

**We invite you to try our new shareholder website at https://www.calcas.com/shareholder**

We look forward to seeing you there!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