Washington State Department of
Labor & Industries

State of Washington Industrial Insurance Fund Statutory Financial Information Report

For the Fiscal Years Ended June 30, 2014 and 2013



State of Washington Industrial Insurance Fund
Statutory Financial Information Report
For the Fiscal Years Ended June 30, 2014 and 2013

Prepared by:

Department of Labor and Industries
Joel Sacks, Director
Ernie LaPalm, Deputy Director
Randi Warick, Deputy Director for Financial Management

Actuarial Services
Bill Vasek, FCAS, Senior Actuary
Mark Mercier, ACAS, MAAA
Russell Frank, FCAS, MAAA
Joshua Ligosky, FCAS, MAAA

Administrative Services
Chris Freed, Assistant Director

Financial Services
Sharon Elias, Chief Accounting Officer
Rob Cotton, MBA, CPA, CMA, CGAP, Workers' Compensation Accounting Manager
Margo Driver, CPA, Revenue Accounting Manager
Linda Tilson, Accounting Services Manager
Cara Hsieh, CPA, Workers' Compensation Accountant
Cathy Mowlds, Workers' Compensation Accountant
Anna Quichocho, CPA, Workers' Compensation Accountant
Mariya Rohde, Workers' Compensation Accountant
Leslie Yonkers, Workers' Compensation Accountant
Financial Services Program Personnel

Insurance Services Division Personnel

Additional assistance provided by:
Washington State Office of Financial Management
Washington State Investment Board

Washington State Department of
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Keep Washington Safe and Working

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Introductory Section

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STATE OF WASHINGTON
DEPARTMENT OF LABOR AND INDUSTRIES
P.O. Box 44000 • Olympia Washington 98504-4000

December 3, 2014

The Honorable Jay Inslee, Governor
Honorable Members of the Legislature
Director of Office of Financial Management
Washington State Citizens
Olympia, Washington 98504

RE: Statutory Financial Information Report

The Revised Code of Washington 51.44.115 requires the Department of Labor and Industries (L&I) to publish a Statutory Financial Information Report for the Industrial Insurance Fund (State Fund) in conformity with statutory accounting practices and principles promulgated by the National Association of Insurance Commissioners within six months of the close of each fiscal year. This report is published to fulfill that requirement for the fiscal year ended June 30, 2014.

L&I is fully responsible for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal controls established for this purpose. Because the cost of internal controls should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The independent certified public accounting firm, Eide Bailly, LLP, has issued an unmodified ("clean") opinion on the Statutory Financial Information Report for the fiscal years ended June 30, 2014 and 2013. The independent auditor's report is located at the front of the financial section of this report.

Management's Discussion and Analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the Consolidated Statutory Financial Statements. The MD&A complements the information provided in this letter of transmittal and should be read together with it.

Following the MD&A are the consolidated financial statements and notes to the financial statements. The required schedules and an independent actuarial opinion complete the Statutory Financial Information Report.

PROFILE OF THE STATE FUND

The workers' compensation system has existed in Washington State for 103 years. Washington was one of the first states to enact workers' compensation laws. Our state's Workmen's Compensation Act, established on July 28, 1911, was designed to protect workers and employers from injustice and financial hardship arising from work-related injuries in extremely hazardous work. In 1923, Washington became one of only two states where workers pay a portion of the insurance premiums.

The Industrial Insurance Fund covers 169,000 employers and approximately 2.58 million workers statewide. Total premiums assessed in the State Fund in fiscal year 2014, including both the employer and worker portions, were $1.86 billion. Over 86,000 claims were accepted in fiscal year 2014; about 80 percent of the accepted claims were for medical treatment only and received no compensation for time off work or disability-related benefits. Approximately 40,000 claims of which about 18,000 are receiving time-loss benefits are active in any given month, and many involve long-term disability and complex medical issues. In the same year, retraining plans were completed by 501 injured workers who were not able to return to their occupations after injury.

The Industrial Insurance Fund is part of the Workers' Compensation Program and is made up of the Accident, Medical Aid, and Pension Reserve Accounts. The activities within the Industrial Insurance Fund are financed and operated in a manner similar to private business entities. Premiums collected from employers and workers and investment earnings finance the cost of providing medical coverage, time-loss payments, disability benefits, Stay at Work reimbursements, and structured settlements. L&I prepares a Statutory Financial Information Report for the Washington State Industrial Insurance Fund of the Workers' Compensation Program annually, based on a fiscal year beginning July 1 and ended June 30.

Governor Jay Inslee directed state agencies to measure performance, improvements, innovation, engagement, transparency and accountability in state government. In response, L&I established five goals: making workplaces safe, helping injured workers return to work, making it easier to do business with L&I, helping honest workers and businesses by cracking down on dishonest ones, and making L&I an employer of choice in Washington State.

L&I made significant progress on these goals during fiscal year 2014 by implementing a logging safety initiative, piloting new approaches to maintain injured workers' connection to the workforce and their motivation to return to work, establishing claim processors to allow adjudicators time to focus on complex claims, adding two more Centers of Occupational Health and Education, and launching the Stay at Work Awareness Campaign. By May 2014, L&I's

medical provider network included over 20,000 providers focused on ensuring that workers receive the best possible care designed to help them heal and return to work. New computer applications have made it easier to do business with L&I, such as filing wage complaints electronically and paying workers' compensation quarterly premiums and license purchases using credit cards. L&I has also created a Construction Underground Economy Advisory Committee to develop strategies to ensure all entities are operating on a fair and level playing field and has embraced a Lean culture of continuous improvement.

ACKNOWLEDGEMENTS

As in the work and service we provide every day, this Statutory Financial Information Report represents our commitment to maintain excellence in financial reporting, and the financial statements are in conformance with the highest standards of financial accountability.

The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of L&I, the Washington State Office of Financial Management, and the Washington State Investment Board.

Sincerely,

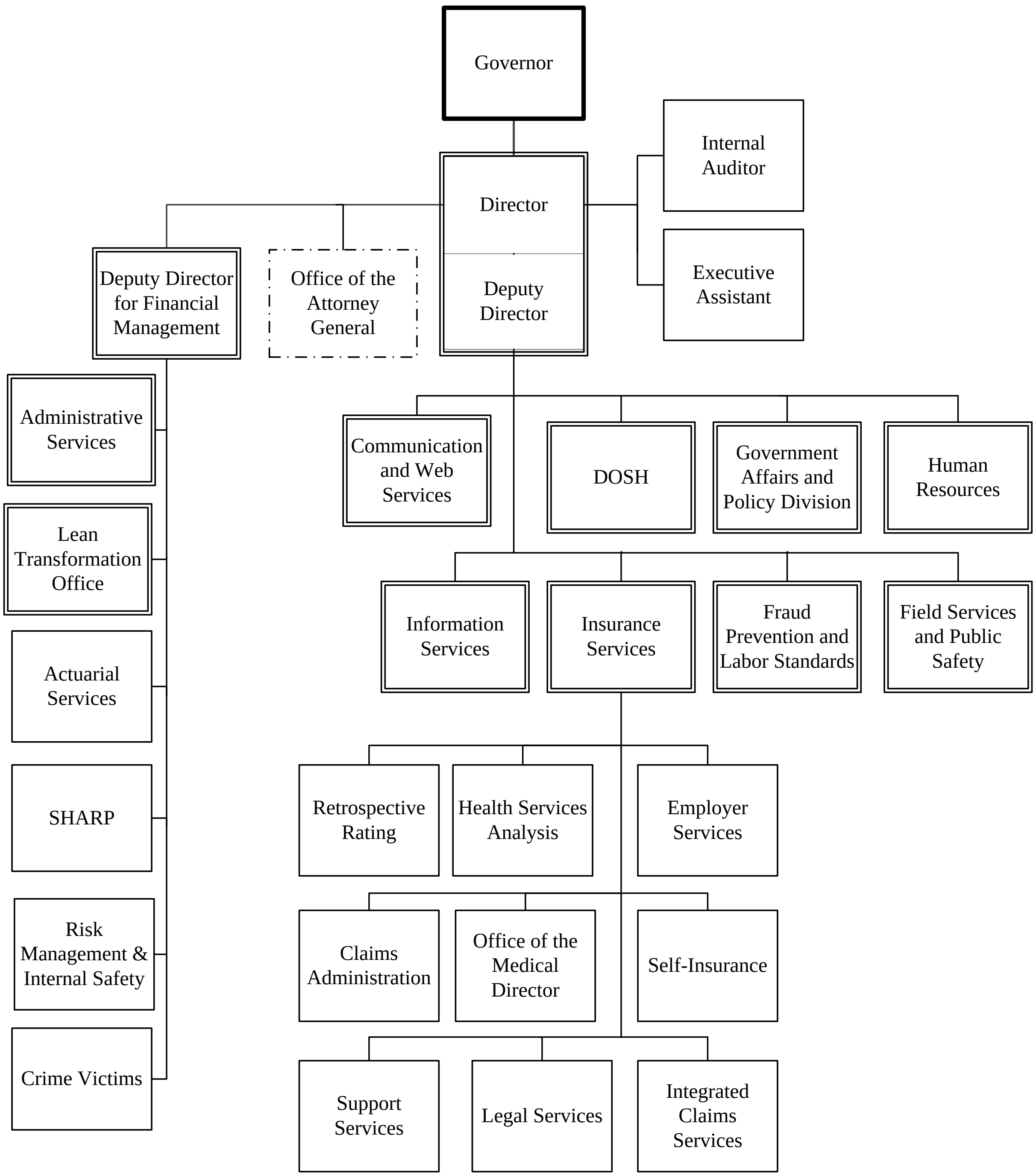
Joel Sacks
Director

Randi Warick
Deputy Director for
Financial Management

Vickie Kennedy
Assistant Director for
Insurance Services

Washington State Department of
Labor & Industries

Organization Chart
June 30, 2014



Financial Section

Washington State Department of
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EideBailly
CPAs & BUSINESS ADVISORS

Independent Auditor's Report

Mr. Joel Sacks Director
Washington State Department of Labor and Industries
Industrial Insurance Fund
Olympia, Washington

Report on the Financial Statements

We have audited the accompanying consolidated statutory financial statements (referred to as the financial statements) of Washington State Department of Labor and Industries Industrial Insurance Fund (Fund), which comprise the consolidated statutory statement of admitted assets, liabilities, and contingency reserve as of June 30, 2014 and 2013, and the related consolidated statutory statements of operations and changes in contingency reserve, and consolidated statutory cash flows for the years then ended, and the related notes to the consolidated statutory financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting practices prescribed or permitted by the Insurance Department of the State of Washington. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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.

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

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4310 17th Ave. S. | P.O. Box 2545 | Fargo, ND 58108-2545 | T 701.239.8500 | F 701.239.8600 | EOE

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

As described in Note 1 to the financial statements, the financial statements are prepared using accounting practices prescribed or permitted by the Insurance Department of the State of Washington, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Fund as of June 30, 2014 and 2013, or the results of its operations or its cash flows for the year then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and contingency reserve of the Fund as of June 30, 2014 and 2013, and the results of its operations and its cash flows for the year then ended, on the basis of accounting described in Note 1.

Other Matters

Required Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplementary information included in the *Supplemental Schedule of Investment Risk Interrogatories* and the *Summary Investment Schedule* on pages 75 through 79 are required to be presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and are not a required part of the basic statutory-basis consolidated financial statements. Such information included in the schedules referred to above is the responsibility of management, is presented for purposes of additional analysis and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements. The *Introductory Section, Management Discussion and Analysis, the Statement of Actuarial Opinion Section, and Schedule of Claims Development Information - Basic Plan* are presented for purposes of additional analysis and are not a required part of the financial statements.

The *Schedule of Claims Development Information – Basic Plan* is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

The information contained in the *Introductory Section, Management Discussion and Analysis and the Statement of Actuarial Opinion sections* have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Eide Bailly LLP

Fargo, North Dakota
December 2, 2014

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Management's Discussion and Analysis

Our management's discussion and analysis of the state of Washington Industrial Insurance Fund's (State Fund) Statutory Financial Information Report provides an overview of the State Fund's financial performance for the fiscal years ended June 30, 2014 and 2013. The information included here should be considered along with the transmittal letter, which can be found on pages 3 to 5 of this report, and the accompanying Consolidated Statutory Financial Statements and notes to the Consolidated Statutory Financial Statements, which follow this narrative.

History and Information that Makes the State of Washington's Industrial Insurance Fund Unique

The state of Washington's Workmen's Compensation Act established the industrial insurance system in 1911, covering only extremely hazardous work. Washington's workers' compensation insurance was provided solely through the State Fund until 1971, when the system underwent a major overhaul. It was then that the legislature expanded the scope of coverage to virtually all workers and created an option for qualified employers to self-insure, thus paying the cost of claims for their injured workers from their own funds and also assuming responsibility for their own claims administration.

Washington State, through Title 51 of the Revised Code of Washington (RCW), requires all employers, unless exempted, to secure coverage for job-related injuries and illnesses, either by paying insurance premiums to the State Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Under statute RCW 51.16.035, the state of Washington's Department of Labor and Industries (L&I) is required to have the lowest possible rates while maintaining solvency of the system. L&I is also required to limit rate fluctuations, follow recognized insurance principles, and stimulate and encourage accident prevention.

In Washington, premiums are based on the workers' exposure to risk (hours on the job), to which employers and workers agreed in the 1930s. Also, Washington requires both the employers and workers to contribute to the cost of premiums.

Size and Scope of Washington's Industrial Insurance Fund

The information on the following page provides some context on the size and scope of the State Fund and how it changed between fiscal year 2013 and 2014.

Statistics at a Glance				
		Fiscal Year 2014		Fiscal Year 2013
Employers insured*		169,000		168,000
Workers covered*		2,580,000		2,487,000
Hours reported**		3,388,000,000		3,270,000,000
Premiums assessed (employers' portion)**	$	1,514,000,000	$	1,429,000,000
Premiums assessed (workers' portion)**	$	343,000,000	$	313,000,000
Benefits incurred expense*	$	2,131,342,000	$	2,162,748,000
Number of claims filed		106,903		103,328
Total days paid for lost work		7,054,849		7,521,311

Note: The data above is a snapshot as of September following the fiscal year-end.
* Rounded to the nearest thousand, ** Rounded to the nearest million

In fiscal year 2014, Washington's workers' compensation system provided insurance for about 2.58 million employees working for 169,000 employers. There were 106,903 claims filed and 86,968 claims accepted. Among the accepted claims, 69,752 of them were medical-only claims. Fifty-one fatal pensions were awarded in fiscal year 2014. Total premiums assessed from both employers and workers during the current year were approximately $1,857 million. The business or industry group that filed the greatest number of claims is restaurant and taverns. The most common injuries were traumatic injuries to muscles, tendons, ligaments, and back joints, including spine and spinal cord.

Using the Statutory Financial Statements

The accompanying Consolidated Statutory Financial Statements include the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve; Consolidated Statutory Statement of Operations and Changes in Contingency Reserve; and Consolidated Statutory Statement of Cash Flows. These financial statements have been prepared in conformity with the Statutory Accounting Principles (SAP), as promulgated by the National Association of Insurance Commissioners, whereby the main purpose of SAP-based information is to determine solvency. Solvency is defined as "*the availability of the Industrial Insurance Fund's admitted assets to satisfy its obligations to injured workers and beneficiaries*". The notes to the Consolidated Statutory Financial Statements provide additional information that is essential to a full understanding of the data provided in the Consolidated Statutory Financial Statements.

The accompanying Consolidated Statutory Financial Statements report the financial position and results of operations for three of the seven Workers' Compensation Program accounts: the Accident, Medical Aid, and Pension Reserve Accounts. These three accounts represent the Workers' Compensation Program Basic Plan, also known as the Industrial Insurance Fund. The State Fund is accounted for as an enterprise fund of the state of Washington and reports business activities under the accrual basis of accounting, much like a private business enterprise.

Overview of the Financial Statements

This discussion and analysis serves as an introduction to the State Fund's financial statements, which consist of the following components:

The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve provides information about the Fund's admitted assets and liabilities and reflects the contingency reserve as of June 30, 2014 and 2013. The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve can be found on page 27 of this report.

The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve reflects revenues and expenses for fiscal years 2014 and 2013. The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve can be found on page 28 of this report.

The Consolidated Statutory Statement of Cash Flows reflects cash collections and cash payments to arrive at the net increase or decrease in cash during fiscal years 2014 and 2013. The Consolidated Statutory Statement of Cash Flows can be found on page 29 of this report.

The Notes to the Consolidated Statutory Financial Statements are an integral part of the financial statements and are essential to a full understanding of the Industrial Insurance Fund's financial position and results of operations presented in the financial statements. The Notes to the Consolidated Statutory Financial Statements can be found on pages 31 to 71 of this report.

Elimination for Consolidated Financial Statements

It is important to the readers of the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve that we include details of each account, report the true contingency reserve balance, and show compliance with the statutory Pension Reserve Account transfer requirement. Each year, the Pension Reserve Account's assets and liabilities are evaluated, and a transfer is made between the Accident, Pension Reserve, and Second Injury Accounts, as required by law. In order to arrive at an accurate consolidated Industrial Insurance Fund balance, the receivable and the accrued liability of $6,917,000 resulting from the transfer between the Pension Reserve Account and the Accident Account was eliminated in fiscal year 2014.

Financial Highlights

Condensed Financial Snapshot
(dollars in millions)

	As of and For the Fiscal Year Ended June 30, 2014	As of and For the Fiscal Year Ended June 30, 2013	$ Change	% Change
Total admitted assets	$ 14,233	$ 13,183	$ 1,050	7.96%
Total liabilities	13,283	12,564	719	5.72%
Total revenues earned	2,587	2,255	332	14.72%
Total expenses incurred	2,451	2,466	(15)	(0.61%)
Total contingency reserve	950	620	330	53.23%

Financial Position

The State Fund's financial position at June 30, 2014 and 2013 was as follows:

Summary of Financial Position
As of June 30, 2014 and 2013
(dollars in thousands)

	June 30, 2014	June 30, 2013	$ Change	% Change
Admitted Assets				
Fixed income investments	$ 11,377,374	$ 9,020,076	$ 2,357,298	26.1%
Treasury Inflation-Protected Securities	-	1,589,964	(1,589,964)	(100.0%)
Equities investments	1,886,836	1,730,470	156,366	9.0%
Short-term investments	264,598	208,683	55,915	26.8%
Unsettled trade receivables	41,222	1,694	39,528	2333.4%
Total Investments	13,570,030	12,550,887	1,019,143	8.1%
Securities lending collateral	4,354	27,469	(23,115)	(84.1%)
Interest receivable	106,653	107,081	(428)	(0.4%)
Cash and cash equivalents	10,300	7,670	2,630	34.3%
Premiums receivable, net	493,440	445,540	47,900	10.8%
Other assets	48,345	44,588	3,757	8.4%
Total Admitted Assets	$ 14,233,122	$ 13,183,235	$ 1,049,887	8.0%
Liabilities and Contingency Reserve				
Benefit liabilities	$ 12,372,673	$ 11,806,072	$ 566,601	4.8%
Claims administration liabilities	539,864	529,165	10,699	2.0%
Retrospective rating adjustments	141,598	125,616	15,982	12.7%
OPEB liabilities	32,299	25,763	6,536	25.4%
Other liabilities	192,813	49,588	143,225	288.8%
Collateral from securities lending activities	4,354	27,469	(23,115)	(84.1%)
Total Liabilities	13,283,601	12,563,673	719,928	5.7%
Contingency Reserve	949,521	619,562	329,959	53.3%
Total Liabilities and Contingency Reserve	$ 14,233,122	$ 13,183,235	$ 1,049,887	8.0%

Total admitted assets of $14,233 million increased by $1,050 million, or 8.0 percent, as compared to the end of fiscal year 2013, primarily due to increases in total investments of $1,019 million and premiums receivable of $48 million, offset by a decrease in securities lending collateral of $23 million. Total investments grew mostly as a result of net income reinvested and a strong stock market.

The most significant changes in the investment balances are from increases in fixed income, equities, and short-term investments of $2,357, $156, and $56 million respectively. This increase was offset by a $1,590 million decrease in Treasury Inflation-Protected Securities (TIPS).

- Fixed income investments increased, because $220 million in equities were sold and proceeds were invested in fixed income and TIPS. In addition, $1,590 million in TIPS held at the end of fiscal year 2013 were sold in the last two quarters of fiscal year 2014, and the proceeds were invested in fixed income investments. Equities were sold in order to rebalance the portfolio. TIPS were sold due to changes in the asset allocation policy. In January 2014, the Washington State Investment Board voted to eliminate the strategic asset allocation to TIPS and increase the allocation to fixed income investments. TIPS can still be purchased as part of the government allocation.

- The equity increase is due to a strong performance in the stock market. Short-term investments increased due to the timing of purchase and sale of investments.

Both assets and liabilities from securities lending activities decreased by $23 million due to low demand for borrowing securities. The June 30, 2014, balance of cash collateral held related to securities lending transactions was $4 million. Additional information on securities lending collateral is included in Note 8, Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities, of this report.

Most of the premium receivables represent the estimated premiums due for the quarter ended June 30, 2014. The estimated receivables have increased by $48 million as compared to June 30, 2013, mostly as a result of an increase in the number of hours reported by employers, more hours reported by businesses in higher rate classes, and a premium rate increase in the Medical Aid Account.

Total benefit liabilities increased $566 million, or 4.8 percent, to $12,373 million during fiscal year 2014, as shown by the following table:

Benefit Liabilities
(in thousands)

	Fiscal Year 2014	Fiscal Year 2013
Benefit liabilities, beginning	$ 11,806,072	$ 11,202,955
New liabilities incurred, current year	1,548,682	1,490,113
Development on prior years		
Change in reserve discount	333,167	352,898
Other development on prior liabilities *	249,493	254,184
Change in discount rate *	-	65,553
Claim payments	(1,564,741)	(1,559,631)
Change in benefit liabilities	566,601	603,117
Benefit liabilities, ending	$ 12,372,673	$ 11,806,072

* Unexpected changes.

It is expected that benefit liabilities will change every year due to normal activities, such as adding the current accident year liabilities, discounting existing liabilities, and paying claims. In addition, benefit liabilities also changed due to management’s decision to refine our actuarial estimates. This fiscal year, benefit liabilities increased as a result of the following managerial decisions that have no direct relationship to the claim operations:

- In the past, the Total Permanent Disabilities (TPD) liabilities were discounted using the same discount rate as the pension discount rate of 6.5 percent. L&I has a plan to reduce the pension discount rate from 6.5 percent to 4.5 percent by 2023. The future TPD benefit liabilities increased $154 million as a result of early adoption of the planned gradual reduction in the pension discount rate over the next nine years.

- It was previously assumed that when a claim was still active at or after 13 years of age, these claims were included in the calculation of pension liabilities, which are discounted using a 6.5 percent discount rate. A decision was made to assume that these claims will receive time-loss until they close. This model change for 13-year-plus claims resulted in increased liabilities of $102 million.

- When the legislature passed the Workers' Compensation reforms in 2011, L&I estimated the potential savings from the reforms and recognized the savings by reducing liabilities. Now that the reforms are operational and the savings are reflected in claims data, a decision was made to increase benefit liabilities to avoid double counting the 2011 reform savings.

Detailed changes in the benefit liabilities are explained in Note 9, Changes in Benefit and Claims Administration Liabilities, of this report.

The Retrospective Rating Program is a voluntary financial incentives program offered by L&I to reduce workplace injuries and costs associated with workers' compensation claims. The program provides an economic incentive to employers by refunding a portion of their workers' compensation premiums if injury claims are below estimates during three annual evaluations. If employer claims are above estimates, an additional premium is assessed to the employer's account. The Retrospective Rating Adjustments liability includes the estimated return of earned premiums through the final adjustment for all current participants. This liability increased $16 million as compared to June 30, 2013, due to the following:

- Improved retrospective rating participant performance relative to the State Fund, which increased average refund percentages and projected refunds by $8 million.

- Increase of 6 percent in standard premium enrollments for retrospective rating participants, which increased projected refunds by $8 million.

Other liabilities increased $143 million, mainly due to an increase of $147 million in unsettled trade payables, offset by a $4 million decrease in other accrued liabilities. Unsettled trade payables of $147 million are owed for the purchase of investment securities at June 30, 2014, which was not paid until July. There were no unsettled trade payables at the end of the last fiscal year.

The contingency reserve increased by $330 million, mainly as a result of a strong stock market, investment income, operational efficiencies, and premiums collected greater than new liabilities.

Results of Operations

Industrial Insurance Fund operating results and certain key financial ratios are presented in the following table:

Summary of Operations and Changes in Contingency Reserve For the Fiscal Years Ended June 30, 2014 and 2013 (dollars in thousands)	Fiscal Year 2014	Fiscal Year 2013	$ Change	% Change
Net premiums earned	$ 1,673,242	$ 1,584,213	$ 89,029	5.6%
Net investment income earned	479,774	465,868	13,906	3.0%
Net investment realized gains	303,184	87,405	215,779	246.9%
Self-insured reimbursements	75,562	68,795	6,767	9.8%
Other income	54,814	48,898	5,916	12.1%
Total Revenue Earned	2,586,576	2,255,179	331,397	14.7%
Net benefits (losses) incurred	2,131,342	2,162,748	(31,406)	(1.5%)
Claims administration expenses (LAE) incurred	166,031	149,818	16,213	10.8%
Premium administration expenses incurred	36,487	36,234	253	0.7%
Other administration expenses incurred	42,067	40,352	1,715	4.3%
Self-insured administration expenses incurred	25,982	25,319	663	2.6%
Non-insurance administration expenses incurred	49,078	51,822	(2,744)	(5.3%)
Total Administration Expenses Incurred	319,645	303,545	16,100	5.3%
Total Expenses Incurred	2,450,987	2,466,293	(15,306)	(0.6%)
Net Transfers In (Out)	-	-	-	-
Net Income (Loss)	135,589	(211,114)	346,703	(164.2%)
Other changes in contingency reserve	194,370	240,537	(46,167)	(19.2%)
Changes in contingency reserve, net	329,959	29,423	300,536	1021.4%
Beginning contingency reserve, July 1	619,562	590,139		
Ending Contingency Reserve, June 30	$ 949,521	$ 619,562		
Loss ratio	127.4%	136.5%		
Loss adjustment expense (LAE) ratio	9.9%	9.5%		
Loss and LAE Ratio	137.3%	146.0%		
Underwriting and other expense ratio	4.7%	4.8%		
Combined Ratio	142.0%	150.8%		
Less: Net investment income ratio	28.7%	29.4%		
Operating Ratio	113.3%	121.4%		

Net premiums earned for the current period is made up of net premiums collected and the change in premiums receivable and Retrospective Rating Program liabilities as compared to June 30, 2013. Net premiums earned increased $89 million, mainly due to an increase in the number of hours reported by employers, more hours reported by businesses in higher rate classes, and a premium rate increase in the Medical Aid Account effective January 1, 2014. In fiscal year 2013, employers reported 3,270 million hours worked; this figure increased to 3,388 million hours for fiscal year 2014. There has been a steady growth of quarterly standard premiums for 14 quarters since December 31, 2010. The increase during the 14 quarters was approximately 13 percent.

Net investment income earned increased $14 million during fiscal year 2014 when compared to fiscal year 2013, mainly due to a $9 million settlement recovery of Lehman bonds previously sold at a loss in fiscal year 2009. The $9 million settlement recovery resulted from a lawsuit that alleged Lehman failed to disclose material facts in connection with the various securities it sold to Washington State, including the true value and risky nature of its mortgage-related assets. In

September of 2008, the State Fund investments in the Lehman Brothers Holdings, Inc. were sold, resulting in a loss of $37 million. The remaining $5 million increase resulted from the purchase of additional credit bonds that earned more interest income.

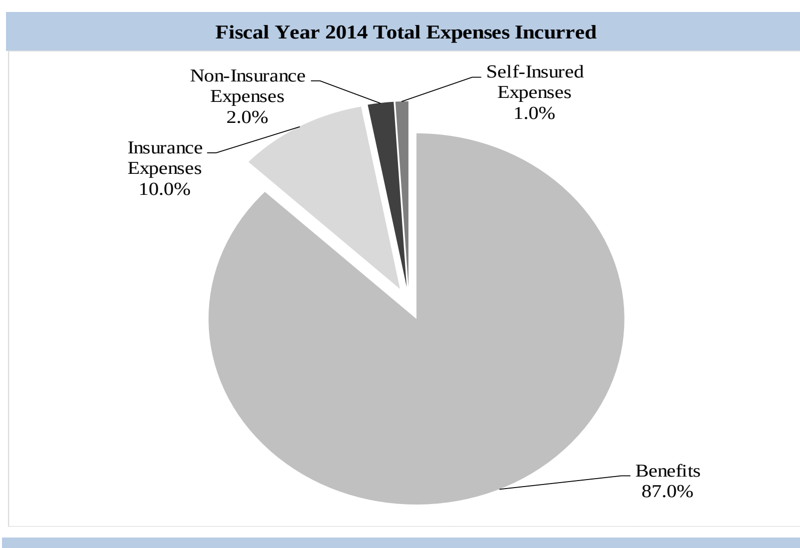
Realized gains in fiscal year 2014 were $303 million, mostly due to capital gains from the sale of TIPS and equities. TIPS were sold due to an asset allocation policy change and equities were sold to rebalance the investment portfolio.

Equities, TIPS, and bonds unrealized gains were $200 million during fiscal year 2014. Unrealized gains on equities were $334 million, which was offset by a $136 million reduction to unrealized gains resulting from the TIPS sale. When the TIPS were sold, a reversal of previously recorded unrealized gains was made to avoid duplicate reporting. Equities increased due to the improving economy and positive investment returns in the public equity markets.

Benefits incurred are made up of benefits paid plus the change in benefit liabilities during the reporting period. Benefits incurred at June 30, 2014, were $2,131 million, compared to $2,163 million at June 30, 2013. The net benefits incurred decrease of $31 million mainly resulted from the decrease in the change in benefit liabilities between fiscal year 2014 and fiscal year 2013.

Claims administration expenses incurred are made up of claims administration expenses paid plus the change in claims administration liabilities during the reporting period. The change in claims administration expenses between June 30, 2014, and June 30, 2013, of $16 million resulted primarily from the change in claims administration liabilities estimated by the actuaries and the claim portion of the Other Postemployment Benefit (OPEB) liabilities. Estimated claims administration liabilities increased mainly as a result of benefit liabilities increasing, as discussed above.

The following chart shows the ratio of benefit expense, insurance, non-insurance, and self-insured administration expenses incurred for fiscal year 2014:



The following ratios, expressed as a percentage of total net premiums earned, are recognized industry measures used to compare one insurance company to another:

- The benefit (loss) and Loss Adjustment Expense (LAE) ratio represents the total costs for processing claims and benefits as a percentage of total net premiums earned. There are many factors that impact loss and LAE ratios, including legislative decisions, claim frequency, severity, and exposure.

- The combined ratio expresses total insurance costs, including incurred expenses for benefits and administration as a percentage of total net premiums earned. When the total insurance costs exceed net premium revenues, the combined ratio exceeds 100 percent. This is expected, because income earned on investments supplements premium revenues to cover costs, so premium rates are set accordingly to arrive at the anticipated breakeven.

- The operating ratio reflects the combined ratio less the net investment income ratio and is another industry measure of overall financial performance. Ratios above 100 percent indicate that expenses are greater than premiums and net investment income earned. Insurance companies are motivated to make profits and, therefore, work toward an operating ratio below 100 percent. However, the Industrial Insurance Fund is operated as a part of state government, and its goal is to break even. An operating ratio greater than 100 percent decreases the contingency reserve balance. The operating ratio does not include realized or unrealized investment gains.

The combined ratio decreased from 150.8 percent in fiscal year 2013 to 142.0 percent in fiscal year 2014. The combined ratio decreased due to an increase in premiums earned and a decrease in benefits incurred. If we had not made the decision to refine our actuarial estimate, which resulted in increasing benefit liabilities by $386 million, our loss and combined ratios would have been 104.3 and 90.2 percent, respectively.

The operating ratio decreased from 121.4 percent in fiscal year 2013 to 113.3 percent in fiscal year 2014 as a result of the decrease in the combined ratio for the reasons stated above. If we had included the realized and unrealized investment gains in the investment ratio, our operating ratio for fiscal year 2014 would have been 83.2 percent.

The LAE ratio and the underwriting and other expense ratios remain consistently lower when compared to the workers' compensation insurance industry.

Cash Flows and Liquidity

Cash Flows - The primary sources of cash were from premiums collected and investment income. The primary uses of cash were for benefit payments, administration expenses, and purchases of investments.

Cash flows of the Industrial Insurance Fund are summarized as follows:

Cash Flow Summary
For the Fiscal Years Ended June 30, 2014 and 2013
(dollars in thousands)

	Fiscal Year 2014	Fiscal Year 2013	$ Change	% Change
Operations				
Net premiums collected	$ 1,641,324	$ 1,575,083	$ 66,241	4.2%
Other reimbursements and income	116,908	108,092	8,816	8.2%
Net benefits paid	(1,564,741)	(1,559,631)	(5,110)	0.3%
Insurance administration expenses paid	(229,603)	(227,785)	(1,818)	0.8%
Self-insured administration expenses paid	(25,608)	(24,582)	(1,026)	4.2%
Non-insurance administration expenses paid	(47,209)	(49,556)	2,347	(4.7%)
Cash used in operations	(108,929)	(178,379)	69,450	(38.9%)
Investment Activities				
Investment income	480,418	466,403	14,015	3.0%
Net realized gains	303,184	87,405	215,779	246.9%
Purchases, net	(667,810)	(370,871)	(296,939)	80.1%
Investment management expenses	(4,233)	(3,858)	(375)	9.7%
Cash provided by investment activities	111,559	179,079	(67,520)	(37.7%)
Change in Cash				
Net increase (decrease) in cash	$ 2,630	$ 700	$ 1,930	275.7%

Net premiums collected increased $21 million in the Accident Account and $45 million in the Medical Aid Account over the prior year for a total increase of $66 million. This increase was mainly due to higher number of hours reported by employers, more hours reported by businesses in higher rate classes, and a premium rate increase in the Medical Aid Account.

Benefits paid increased $5 million when compared to the prior year. Benefits paid in the Pension Reserve Accounts increased by $26 million, but were partially offset by decreases in the Accident and Medical Aid Accounts of $13 million and $8 million, respectively. The net increase of $5 million is explained by the following:

- The pension benefits paid increase is mainly because of higher numbers of pensioners receiving benefits, together with higher average monthly benefits.

- The Accident Account's benefits paid decrease resulted mostly from lower time-loss payments because of fewer active time-loss claims being paid.

- The Medical Aid Account's benefits paid decrease is mostly due to low medical growth and a small increase in average medical payments per claim. It was also a result of fewer active time-loss claims this year as compared to last year. However, the Stay at Work claim payments to employers increased due to more claimants receiving benefits.

Other reimbursements and income collected increased $9 million, mainly from an increase in cash from fines, penalties, interest, and self-insured employer surety receipts, including about $5 million remitted to L&I as a result of the Hostess bankruptcy. A self-insured employer is required to provide a surety bond as insurance in case it ever defaults on its obligation to its injured workers. In case of default, the surety proceeds are paid from either a bond company or a bank and are used to provide future benefits to the injured workers of that employer.

The increase in net investment income collected of $14 million is mainly due to the $9 million settlement recovery of Lehman bonds. The increase in net realized gains is comprised of an increase in fixed income and equity realized gains of $188 million and $28 million, respectively. The fixed income realized gains resulted from the sales of TIPS due to the asset allocation policy change, and equity realized gains resulted from rebalancing the portfolio.

There was a decrease of $297 million in the net purchase and sale of investments as compared to the prior year due to investment activities and market conditions. During fiscal year 2014, investment purchases exceeded sales by $668 million, mainly because we had net cash flow from investment income and realized gains collected to reinvest.

Liquidity - The Industrial Insurance Fund's operations require sufficient liquidity to meet both short-term and long-term requirements. Resources to ensure short-term liquidity come from two basic factors:

- L&I may increase rates in order to increase its contingency reserve, resulting in positive cash flow.

- Premiums are paid to L&I every three months.

The Industrial Insurance Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. The Industrial Insurance Fund is able to match projected cash inflows from premiums and investment income from its portfolio with projected cash outflows for payment of benefits.

Future Plan

L&I has a 9-year plan to steadily rebuild the Industrial Insurance Fund contingency reserve to a range between 13 and 15 percent of liabilities (less securities lending obligations). In order to maintain the actuarial solvency of the funds while keeping reasonable limits on rate fluctuations, L&I's goal for fiscal year 2015 is to increase the contingency reserve balance from $950 million in the Industrial Insurance Fund to $1,032 million by increasing rates and reducing costs $35 million to $70 million.

Currently, L&I discounts pension liabilities using a 6.5 percent discount rate. L&I plans to gradually decrease the pension liability discount rate from 6.5 to 4.5 percent over a nine-year period, as previously discussed. By the end of calendar year 2015, L&I plans to reduce the discount rate to a range between 6.2 and 6.3 percent.

The mortality assumptions underlying the calculation of pension liabilities, developed by the Office of Insurance Commissioner and used since 1987, do not consider the gender of the recipient. L&I has developed updated mortality tables, including separate tables by gender, and intends to implement them during fiscal year 2015.

Requests for Information

This report is designed to provide a general overview of the Industrial Insurance Fund and to illustrate the Fund's financial position and results of operations to interested parties. If you have any questions about this report or need additional financial information, please contact the Chief Accounting Officer at the Department of Labor & Industries, P.O. Box 44833, Olympia, Washington 98504-4833.

In accordance with the Revised Code of Washington (RCW) 51.44.115, L&I also publishes a Comprehensive Annual Financial Report (CAFR) for the Workers' Compensation Program. This report is prepared in compliance with Generally Accepted Accounting Principles (GAAP).

The Industrial Insurance Fund Statutory Financial Information Report and the Workers' Compensation Program CAFR are available at L&I's website at:
http://www.lni.wa.gov/ClaimsIns/Insurance/Learn/StateFund/Reports.

Consolidated Statutory Financial Statements

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve

As of June 30, 2014 and 2013
(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Elimination for Consolidated Statements	Total June 30, 2014	Total June 30, 2013
Admitted Assets						
Cash and Investments						
Investments, net						
Fixed income	$ 4,216,721,000	$ 3,775,677,000	$ 3,384,976,000	$ -	$ 11,377,374,000	$ 9,020,076,000
Treasury Inflation-Protected Securities	-	-	-	-	-	1,589,964,000
Equities	575,632,000	832,811,000	478,393,000	-	1,886,836,000	1,730,470,000
Short-term	58,981,000	162,615,000	43,002,000	-	264,598,000	208,683,000
Unsettled trade receivables	13,093,000	28,128,000	1,000	-	41,222,000	1,694,000
Total Investments	4,864,427,000	4,799,231,000	3,906,372,000	-	13,570,030,000	12,550,887,000
Securities lending collateral	4,116,000	238,000	-	-	4,354,000	27,469,000
Interest receivable	42,507,000	31,019,000	33,127,000	-	106,653,000	107,081,000
Cash and cash equivalents	6,821,000	2,259,000	1,220,000	-	10,300,000	7,670,000
Total Cash and Investments	4,917,871,000	4,832,747,000	3,940,719,000	-	13,691,337,000	12,693,107,000
Other Assets						
Premiums receivable, net, incl. earned-but-unbilled	305,701,000	187,739,000	-	-	493,440,000	445,540,000
Real estate and improvements						
(less $7,870,000 encumbrances)	16,028,000	16,027,000	-	-	32,055,000	29,824,000
Self-insurance receivables, net	3,203,000	3,156,000	3,688,000	-	10,047,000	10,757,000
Miscellaneous receivables, net	9,065,000	537,000	3,558,000	(6,917,000)	6,243,000	4,007,000
Total Other Assets	333,997,000	207,459,000	7,246,000	(6,917,000)	541,785,000	490,128,000
Total Admitted Assets	$ 5,251,868,000	$ 5,040,206,000	$ 3,947,965,000	$ (6,917,000)	$ 14,233,122,000	$ 13,183,235,000
Liabilities and Contingency Reserve						
Liabilities						
Benefits	$ 4,565,089,000	$ 3,882,285,000	$ 3,925,299,000	$ -	$ 12,372,673,000	$ 11,806,072,000
Other Liabilities						
Claims administration	192,032,000	347,832,000	-	-	539,864,000	529,165,000
Retrospective rating adjustments	141,598,000	-	-	-	141,598,000	125,616,000
Accrued liabilities						
OPEB claim administration	7,893,000	10,041,000	-	-	17,934,000	14,571,000
OPEB other administration	8,657,000	5,708,000	-	-	14,365,000	11,192,000
Other accrued liabilities	23,818,000	16,094,000	12,612,000	(6,917,000)	45,607,000	49,430,000
Deferred revenue	87,000	47,000	-	-	134,000	158,000
Unsettled trade payables	25,099,000	111,919,000	10,054,000	-	147,072,000	-
Collateral from securities lending activities	4,116,000	238,000	-	-	4,354,000	27,469,000
Total Other Liabilities	403,300,000	491,879,000	22,666,000	(6,917,000)	910,928,000	757,601,000
Total Liabilities	4,968,389,000	4,374,164,000	3,947,965,000	(6,917,000)	13,283,601,000	12,563,673,000
Contingency Reserve	283,479,000	666,042,000	-	-	949,521,000	619,562,000
Total Liabilities and Contingency Reserve	$ 5,251,868,000	$ 5,040,206,000	$ 3,947,965,000	$ (6,917,000)	$ 14,233,122,000	$ 13,183,235,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System with adjustments for statutory basis of accounting.

Consolidated Statutory Statement of Operations and Changes in Contingency Reserve

For the Fiscal Years Ended June 30, 2014 and 2013

(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total Fiscal Year 2014	Total Fiscal Year 2013
Revenues					
Net standard premiums earned	$ 1,158,298,000	$ 690,920,000	$ -	$ 1,849,218,000	$ 1,720,942,000
Less net retrospective rating adjustments	(175,976,000)	-	-	(175,976,000)	(136,729,000)
Net premiums earned	982,322,000	690,920,000	-	1,673,242,000	1,584,213,000
Net investment income earned	188,414,000	146,023,000	145,337,000	479,774,000	465,868,000
Net fixed income investment realized gains	77,122,000	141,100,000	43,749,000	261,971,000	74,060,000
Net equity investment realized gains	13,271,000	19,834,000	8,108,000	41,213,000	13,345,000
Self-insured administrative expense assessments	12,221,000	11,742,000	-	23,963,000	26,879,000
Self-insured second injury pension reserve assessments	-	-	36,096,000	36,096,000	26,086,000
Self-insured cash funded & bonded pension reimbursements	-	-	15,503,000	15,503,000	15,830,000
Fines, penalties, and interest	42,570,000	2,869,000	65,000	45,504,000	39,332,000
Other income	7,253,000	2,057,000	-	9,310,000	9,566,000
Total Revenues Earned	1,323,173,000	1,014,545,000	248,858,000	2,586,576,000	2,255,179,000
Expenses					
Benefits incurred	866,681,000	678,064,000	586,597,000	2,131,342,000	2,162,748,000
Administration expenses incurred					
Insurance expenses incurred					
Claims administration expenses incurred	60,222,000	105,809,000	-	166,031,000	149,818,000
Premium administration expenses incurred	18,121,000	18,366,000	-	36,487,000	36,234,000
General insurance administration expenses incurred	14,639,000	7,575,000	-	22,214,000	20,148,000
Other agencies insurance expenses incurred	10,082,000	9,771,000	-	19,853,000	20,204,000
Total insurance expenses incurred	103,064,000	141,521,000	-	244,585,000	226,404,000
Self-insured administration expenses incurred	13,880,000	12,102,000	-	25,982,000	25,319,000
Non-insurance administration expenses incurred	35,462,000	13,916,000	-	49,378,000	51,822,000
Total administration expenses incurred	152,406,000	167,539,000	-	319,945,000	303,545,000
Total Expenses Incurred	1,019,087,000	845,603,000	586,597,000	2,451,287,000	2,466,293,000
Net Income (Loss) Before Transfers	304,086,000	168,942,000	(337,739,000)	135,289,000	(211,114,000)
Transfers In (Out)					
Pension funding transfers	(274,175,000)	-	274,175,000	-	-
Net Transfers In (Out)	(274,175,000)	-	274,175,000	-	-
Net Income (Loss)	29,911,000	169,242,000	(63,564,000)	135,289,000	(211,114,000)
Other Changes in Contingency Reserve					
Equities unrealized gains (losses)	101,345,000	145,833,000	86,424,000	333,602,000	272,445,000
Treasury Inflation-Protected Securities unrealized gains (losses)	(40,882,000)	(72,705,000)	(22,704,000)	(136,291,000)	(6,316,000)
Bonds unrealized gains (losses)	1,719,000	1,303,000	-	3,022,000	(88,000)
Change in nonadmitted assets	(11,455,000)	5,948,000	(156,000)	(5,663,000)	(25,504,000)
Changes in Contingency Reserve, Net	80,638,000	249,321,000	-	329,959,000	29,423,000
Beginning contingency reserve, July 1	202,841,000	416,721,000	-	619,562,000	590,139,000
Ending Contingency Reserve, June 30	$ 283,479,000	$ 666,042,000	$ -	$ 949,521,000	$ 619,562,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System with adjustments for statutory basis of accounting.

Consolidated Statutory Statement of Cash Flows

For the Fiscal Years Ended June 30, 2014 and 2013

(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total Fiscal Year 2014	Total Fiscal Year 2013
Standard premiums collected	$ 1,137,786,000	$ 663,532,000	$ -	$ 1,801,318,000	$ 1,707,886,000
Less retrospective rating adjustments	(159,994,000)	-	-	(159,994,000)	(132,803,000)
Net premiums collected	977,792,000	663,532,000	-	1,641,324,000	1,575,083,000
Self-insured administration expense reimbursements	12,533,000	12,041,000	-	24,574,000	26,429,000
Self-insured second injury pension reserve reimbursements	-	-	34,357,000	34,357,000	35,593,000
Self-insured cash funded and bonded pension reimbursements	-	-	18,449,000	18,449,000	17,490,000
Fines, penalties, and interest	24,349,000	2,056,000	-	26,405,000	23,419,000
Other income (expenses)	10,404,000	2,417,000	302,000	13,123,000	5,161,000
Fund transfers in (out)	(273,028,000)	-	273,028,000	-	-
Operating Cash Flow In	752,050,000	680,046,000	326,136,000	1,758,232,000	1,683,175,000
Benefits paid	592,923,000	571,434,000	400,384,000	1,564,741,000	1,559,631,000
Administration expenses					
Insurance expenses					
Claims administration expenses	58,738,000	93,231,000	-	151,969,000	153,242,000
Premium administration expenses	17,825,000	18,159,000	-	35,984,000	35,201,000
General insurance administration expenses	14,193,000	7,470,000	-	21,663,000	19,692,000
Other agencies insurance expenses	10,129,000	9,858,000	-	19,987,000	19,650,000
Total insurance expenses	100,885,000	128,718,000	-	229,603,000	227,785,000
Self-insured administration expenses	13,667,000	11,941,000	-	25,608,000	24,582,000
Non-insurance administration expenses	34,018,000	13,191,000	-	47,209,000	49,556,000
Total Administration Expenses Paid	148,570,000	153,850,000	-	302,420,000	301,923,000
Operating Cash Flow Out	741,493,000	725,284,000	400,384,000	1,867,161,000	1,861,554,000
Net Operating Cash Flow In (Out)	10,557,000	(45,238,000)	(74,248,000)	(108,929,000)	(178,379,000)
Investment income - bonds	187,454,000	147,358,000	144,324,000	479,136,000	465,477,000
Investment income - equities	383,000	595,000	304,000	1,282,000	926,000
Net realized gains on investments	90,393,000	160,934,000	51,857,000	303,184,000	87,405,000
Net (purchases) sales of investments	(284,679,000)	(262,263,000)	(120,868,000)	(667,810,000)	(370,871,000)
Investment expenses	(1,594,000)	(1,464,000)	(1,175,000)	(4,233,000)	(3,858,000)
Total Investment Cash Flow In (Out)	(8,043,000)	45,160,000	74,442,000	111,559,000	179,079,000
Net Cash Flow In (Out)	2,514,000	(78,000)	194,000	2,630,000	700,000
Beginning Cash, July 1	4,307,000	2,337,000	1,026,000	7,670,000	6,970,000
Ending Cash, June 30	$ 6,821,000	$ 2,259,000	$ 1,220,000	$ 10,300,000	$ 7,670,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is Washington State's Agency Financial Reporting System (AFRS) with adjustments for statutory basis of accounting.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Notes to the Consolidated Statutory Financial Statements

For the Fiscal Years Ended June 30, 2014 and 2013

Index

Note 1 - Summary of Significant Accounting Policies

1.A. Nature of Operations

The state of Washington's Department of Labor & Industries (L&I) administers the state's Workers' Compensation Program. Through Title 51 of the Revised Code of Washington (RCW), Washington State requires all employers, unless excluded or exempt, to secure coverage for job-related injuries and illnesses, either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. The agency is the exclusive writer of workers' compensation insurance in the state of Washington for all businesses except the self-insured. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Chapter 51.44 RCW provides six benefit accounts: the Accident Account, Medical Aid Account, Pension Reserve Account, Supplemental Pension Account, Second Injury Account, and the Self-Insured Employer Overpayment Reimbursement Account, primarily to make compensation payments to injured workers or to medical providers for rehabilitation services to injured workers. A seventh account, called the Industrial Insurance Rainy Day Fund Account, was created to receive transfers of funds from the Accident and Medical Aid Accounts when assets for those accounts combined are between 10 and 30 percent in excess of their funded liabilities. The funds are then set aside to reduce a rate increase or aid businesses during or recovering from economic recessions. The Industrial Insurance Rainy Day Fund Account did not have any activity during fiscal year 2014 or balance on June 30, 2014. These seven accounts are known collectively as the Workers' Compensation Program.

The Accident, Medical Aid, and Pension Reserve Accounts are referred to as "the Industrial Insurance Fund" and are the focus of this report. The Supplemental Pension, Second Injury, Self-Insured Employer Overpayment Reimbursement, and Industrial Insurance Rainy Day Fund Accounts are not part of the Industrial Insurance Fund and are not included in this report.

The Industrial Insurance Fund is self-sustaining through the ability to assess the appropriate rates of insurance premiums and prudent investment management. The three accounts are maintained on an actuarially solvent basis, except that a cash-flow basis is used for the components of the Pension Reserve Account when self-insured employers guarantee related benefits with a surety bond. The accompanying consolidated statutory statements report on the financial position and results of operations of the Industrial Insurance Fund.

1.A.1. Description of the Industrial Insurance Fund

There are three accounts making up the Industrial Insurance Fund: the Accident, Medical Aid, and Pension Reserve Accounts.

The Accident Account pays compensation directly to injured workers for lost wages during temporary disability and permanent partial disability awards. It also pays costs for vocational retraining and for structured settlements. Pursuant to RCW 51.44.070, funds from the Accident Account are to be transferred to the Pension Reserve Account for the present value of pensions awarded to survivors of fatally injured workers and to workers who have a permanent total disability.

Revenues for this account come from employer-paid premiums based on individual employers' reported payroll hours and are reported net of refunds. Employers may elect to have their premiums retrospectively rated with an annual adjustment for actual benefits incurred. The retrospective adjustment calculation considers both the Accident and Medical Aid Accounts' experience and premiums together and may result in either a rebate of premiums paid or an assessment of additional premiums due. All retrospective premium adjustments are financed entirely through the Accident Account.

On behalf of injured workers, the Medical Aid Account pays for the cost of medical, vocational rehabilitation services, and Stay at Work reimbursements.

Equal contributions from employers and employees fund this account. It is the employer's responsibility to collect the employee portion of the medical aid premium and submit the employee and employer contributions to L&I quarterly.

The Pension Reserve Account pays benefits to all permanently disabled pensioners (including disabled employees of self-insured employers), their dependents, and surviving dependents of fatalities.

Funding for pension payments is generated by transfers from the Accident and Second Injury Accounts and cash funded or bonded pension payments from self-insured employers. Funding required to cover the estimated present cash value of monthly pension payments is calculated upon the basis of an annuity; such annuity values are based upon L&I's experience as to rates of mortality, disability, remarriage, and interest, according to RCW 51.44.070.

1.B. Accounting Practices and Basis of Presentation

The Industrial Insurance Fund follows the Statutory Accounting Principles (SAP), which includes the Statements of Statutory Accounting Principles (SSAP), as promulgated by the National Association of Insurance Commissioners (NAIC), as directed by RCW 51.44.115. The SAP are very conservative in nature and are designed to protect injured workers to ensure that, in the event of liquidation, sufficient amounts have been set aside to provide for outstanding claims. This accounting basis is used to present solvency and the adequacy of premium rates.

The SAP are required to be used by property and casualty insurance enterprises in the United States (U.S.) when reporting their financial position to state insurance regulators, subject to any differences prescribed or permitted by each state's law. The NAIC defines prescribed accounting practices as "… those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. The NAIC Accounting Practices and Procedures Manual (AP&P) is not intended to preempt states' legislative and regulatory authority."[1] Washington's (WA) prescribed differences from the NAIC are addressed in RCW 48.13.071, which provides limits on

[1] NAIC AP&P Manual as of March 2014, Section: Preamble Questions and Answers, Question 2, page P-13.

investments. The NAIC defines permitted practices as "…practices specifically requested by an insurer that depart from NAIC SAP and state prescribed accounting practices, and have received approval from the insurer's domiciliary state regulatory authority."[2]

In accordance with Title 51 RCW and Title 296 of the Washington Administrative Code (WAC), the Industrial Insurance Fund is administered by L&I. Pursuant to Title 48 RCW and Title 284 WAC, L&I is not required to file annual statements with the Washington State Office of the Insurance Commissioner (WSOIC). The Industrial Insurance Fund is not required to report to the WSOIC or complete an annual statement in accordance with the NAIC annual statement filing instructions. Since the Industrial Insurance Fund is not subject to oversight by the WSOIC, there is no requirement that the Industrial Insurance Fund request approval from WSOIC for departures from SAP. Thus, we have no such permitted practices.

While there are no prescribed or permitted practices followed by the Industrial Insurance Fund that differ from SAP, a long-established practice of discounting on a non-tabular basis exists that departs from SSAP No. 65, which allows discounting fixed and reasonably determinable payments on a tabular-only basis. Non-tabular discounting is only permitted in certain instances in which states have prescribed or permitted practices to allow it. (See Note 1.C.3 and Note 11.B for additional information on discounting methodology and non-tabular discounting.)

In addition, the Industrial Insurance Fund recognizes a liability for the net Other Postemployment Benefit (OPEB) obligation based on Governmental Accounting Standards Board (GASB) Statement No. 45 – Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. The net OPEB obligation includes the unfunded actuarial accrued liability amortized over thirty years. This practice departs from SSAP No. 92. The Industrial Insurance Fund participates in a multiemployer OPEB plan. SSAP No. 92 states that employers with multiemployer plans are not required to recognize the unfunded status of the OPEB plan, but are only required to recognize the required contribution to the plan for the period reported.

The following table shows the Industrial Insurance Fund's net income and contingency reserve as reported on the accompanying financial statements and what they would have been if there were no departures from NAIC SAP requirements:

Effect of Practices that Depart from SAP

	As of and For the Fiscal Year Ended June 30, 2014	As of and For the Fiscal Year Ended June 30, 2013
Net Income, WA basis	**$ 135,289,000**	**$ (211,114,000)**
Effect of practices that depart from SAP		
Non-tabular discounting	(212,890,000)	394,392,000
OPEB administration liability	6,536,000	6,526,000
Net Income, NAIC SAP basis	**$ (71,065,000)**	**$ 189,804,000**
Contingency Reserve, WA Basis	**$ 949,521,000**	**$ 619,562,000**
Effect of practices that depart from SAP		
Non-tabular discounting	(1,732,001,000)	(1,519,111,000)
OPEB administration liability	32,299,000	25,763,000
Contingency Reserve, NAIC SAP basis	**$ (750,181,000)**	**$ (873,786,000)**

[2] NAIC AP&P Manual as of March 2014, Section: Preamble Questions and Answers, Question 2, page P-13.

The financial statement layout and terminology were selected based on the terminology and formatting customary to governmental insurance funds. The Industrial Insurance Fund refers to losses as "benefits" and loss adjustment expenses as "claims administration expenses." Any surplus remaining in the Fund is referred to as "contingency reserve."

1.B.1. Use of Estimates

The preparation of financial information in conformity with SAP requires management to make estimates and assumptions that affect the reported amounts of admitted assets, liabilities, and contingency reserve at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Material estimates that are susceptible to significant changes include benefit and claims administration liabilities, premium receivables, self-insurance receivables, retrospective rating adjustment liabilities, and accrued liabilities for other postemployment benefits. Actual results could differ materially from those estimates.

Management's estimates are based on its knowledge of and experience with past and current events and circumstances and its assumptions about conditions it expects will exist in the future. The most significant estimates made in these statutory financial statements are the benefit and claims administration liabilities at the date of the financial information. Factors relevant to the estimation of these liabilities include the estimation of the ultimate frequency and severity of losses, the level of inflation of future medical costs over long periods of time, the future legal environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed after the fiscal year-end by a nationally recognized, qualified consulting actuarial firm. The independent actuarial firm's opinion is included at the end of this report.

1.B.2. Differences between SAP and GAAP

The SAP followed by the Industrial Insurance Fund vary in some respects from Generally Accepted Accounting Principles (GAAP) as promulgated by GASB. Some of the most significant differences between SAP and GAAP are as follows:

- Investments in bonds are reported for SAP at amortized cost or market value based on their NAIC designation; for GAAP, investments in bonds are reported at fair value.

- For SAP, all loan-backed securities are adjusted for the effects of changes in prepayment assumptions using the prospective method, which equates the carrying amount of the investment to the present value of the anticipated future cash flows using a recalculated effective yield. The recalculated yield is then used to amortize the investment balance for subsequent accounting periods. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the undiscounted estimated future cash flows. Under GAAP, all loan-backed securities are reported at fair value.

- SAP assets designated as *nonadmitted assets* are defined as "assets having economic value other than those which can be used to fulfill policyholder obligations and assets unavailable due to encumbrances or third party interests" and are excluded from total admitted assets. These assets consist primarily of premium receivables in collection that have been outstanding for over ninety days, office furniture, equipment, and prepaid expenses. Nonadmitted assets are charged against the contingency reserve unless otherwise specifically addressed within the NAIC's AP&P Manual. Under GAAP, premium receivables are presented net of allowance for doubtful accounts, furniture and equipment are presented net of accumulated depreciation, and prepaid expenses are presented at full cost.

- SAP limits the aggregate amount of admitted electronic data processing equipment and operating system software, net of accumulated depreciation, to 3 percent of the reporting entity's capital and surplus. Under GAAP, computer equipment and software purchases meeting the state's capitalization criteria are recorded as assets, net of accumulated depreciation, with no limitations.

- The focus of SAP accounting is solvency; therefore, it is concerned with assets that can be used immediately to cover benefit liabilities. GAAP accounting is focused on "going concern," which assumes that an entity has the ability to survive, and therefore, assets and liabilities are presented in the order of liquidity and classified as current and non-current.

- The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve presents premiums earned and investment income as the primary revenue sources, and expenses are presented as activities. GAAP presentations separate operating income from investment income, since investment activity is not normally a primary revenue source. GAAP also presents expenses by character rather than by the purpose of the item purchased or service obtained and the net effect of revenues and expenses as a change in net position.

- Both SAP and GAAP require the statement of cash flows to be prepared using the direct method. However, the statutory statement of cash flows differs in certain aspects from the presentation required by GAAP. On the SAP Consolidated Statement of Cash Flows, "Cash Flows In" includes operating transfers and other income. "Cash Flows Out" is categorized by benefits paid and administration expenses. The GAAP statement of cash flows includes a reconciliation between operating income from the statement of operations and cash flows from operating activities.

1.C. Significant Accounting Policies

1.C.1. Recognition of Premiums

Workers' compensation insurance premiums are determined by individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Industrial Insurance Fund offers a Retrospective Premium Rating Plan, under which an employer's premiums are adjusted annually for up to three years following the plan year, based on the employer's actual loss experience.

Premiums are due within 30 days following each calendar quarter in which payroll hours are reported. Net premiums receivable reported in the financial statement is an actuarial estimate of the two most recent quarters' uncollected premium balances, based on past collection statistics, growth projection, observed development of premiums reported, statistical analysis, and other factors, including actuarial judgment. This amount represents the estimated premiums that will ultimately be collected. All premium receivables exceeding 90 days in age are adjusted as nonadmitted assets in the current period and are not included in the net premiums receivable amount. For premium receivables over 90 days in age, collection efforts are continued until the premiums are collected or all legal means are exhausted.

According to SSAP No. 53, a premium deficiency reserve is recognized "…when the anticipated losses, loss adjustment expenses, and maintenance costs exceed the recorded unearned premium reserve and any future installment premiums on existing policies." Because the Industrial Insurance Fund has sufficient anticipated investment income and no unearned premium reserves or installment premium contracts, no premium deficiency reserve is recorded.

1.C.2. Benefit and Claims Administration Liabilities

The Industrial Insurance Fund establishes benefit and claims administration liabilities arising from its workers' compensation coverage based on estimates of the ultimate cost of benefits that have been reported but not resolved and claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the type of benefit involved. Since actual claim costs depend on complex factors such as inflation, changes in doctrines of legal liabilities, claim adjudication, and judgments, the actual ultimate claim costs may differ from the estimates.

Benefit and claims administration liabilities are recomputed quarterly using a variety of actuarial and statistical techniques. These techniques are used to produce current estimates that reflect recent settlements, claim frequency, expected inflation, and other economic, legal, and social factors. A provision for inflation in the calculation of estimated future benefits is implicit in the calculation, because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Future premium income is not offset against benefit liabilities, because benefit liabilities come from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay benefit and claims administration liabilities is not contingent upon any future premiums for future coverage periods.

Adjustments to benefit and claims administration liabilities are charged or credited to benefit and claims administration expense in the periods in which they are made. Unpaid benefits and claims administration expenses include amounts based on past experience for claims development on reported claims and benefits incurred but not reported. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in the period affected.

1.C.3. Discounting Methodology

The Industrial Insurance Fund discounts benefit and claims administration expense reserves to reflect the time value of money. The Industrial Insurance Fund uses both tabular and non-tabular discounting. Non-tabular discounting is an accounting practice that departs from SSAP No. 65 as disclosed in 1.B. of this note. The bullets below discuss the discount method and rate applied to each discounted liability category.

- The benefit liabilities in the Pension Reserve Account are discounted on a tabular basis at 6.5 percent.

- Liabilities in the Accident Account for pensions incurred but not-yet-awarded are discounted on both a tabular and non-tabular basis. For each future pension award, the estimated future pension payments are discounted from the anticipated payment dates back to the anticipated date of the pension award on a tabular basis from 4.5 to 6.5 percent. The payments are then discounted from the anticipated date of the pension award back to the evaluation date on a non-tabular basis at 1.5 percent.

- All other Accident and Medical Aid Account benefit and claims administration liabilities are discounted on a non-tabular basis at 1.5 percent.

The discount rate is typically carried at long-term yield rates for risk-free assets, and the investment term is set equal to the average duration of the benefit and claims administration expense payments. Per L&I policy, the Industrial Insurance Fund's non-tabular discount rate is set 2 percentage points less than the 5-year average of the 20-year U.S. Treasury yield, rounded to the nearest one-half percent.

1.C.4. Cash and Cash Equivalents

Cash includes cash in banks, cash on deposit with the Office of the State Treasurer (OST), and cash on hand. It also consists of cash equivalents invested by OST which are short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value due to interest rate fluctuations. Under RCW 43.08.015, OST has the statutory responsibility to ensure the effective cash management of state public funds. RCW 43.84.080 authorizes the Treasurer to invest available cash and includes a list of eligible investments.

The beginning and ending cash and cash equivalent amounts on the Consolidated Statutory Statement of Cash Flows do not include short-term investments. It is not practical to include short-term investments because of the volume of transactions and complexity involved in reporting, as they are managed by the Washington State Investment Board (WSIB), a separate Washington State agency.

1.C.5. Investments

The Industrial Insurance Fund uses the following accounting policies to value investments:

- Investment grade bonds are stated at amortized cost using the scientific interest method. Non-investment grade bonds with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC.

- Short-term investments are stated at amortized cost using the scientific interest method. Per SSAP No. 2, accounting for short-term investments should follow guidance for similar long-term investments (see discussion above on investment grade bonds). Therefore, any short-term bond premiums and discounts are amortized using the scientific interest method.

- Common stocks are stated at fair value.

- Investment grade loan-backed securities are stated at amortized cost. Non-investment grade loan-backed securities with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC. In compliance with SSAP No. 43R, changes in currently estimated cash flows are reviewed quarterly using the State Street Corporation's investment valuation model for prepayment assumptions in valuing mortgage backed securities. These securities are revalued using the prospective adjustment method. See Note 2.H. for other-than-temporary impairment analysis of mortgage-backed securities.

- Securities Lending Collateral - Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Industrial Insurance Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. Securities lending transactions collateralized by securities that the Industrial Insurance Fund does not have the ability to pledge or sell unless the borrower defaults are not reported as assets or liabilities.

1.C.6. Unusual Items and Restricted Assets

The U.S. Department of Energy has contracted with L&I to pay benefits to the Industrial Insurance Fund for workers injured on the job at the Hanford nuclear production complex. The Industrial Insurance Fund has received amounts, including trust cash and trust investments, in advance from the U.S. Department of Energy to cover the pension liability for these injured workers. These amounts are not reported in the financial statements.

As of June 30, 2014, trust cash amounted to $194,012 and is available to reimburse the Industrial Insurance Fund for monthly pension payments. In addition, trust investments totaling $2,477,155 were invested in U.S. Treasury Notes and are also available to reimburse the Industrial Insurance

Fund for future expenses. At June 30, 2013, trust cash and trust investment balances were $510,031 and $3,007,396, respectively.

The following tables summarize restricted assets at June 30, 2014 and 2013:

Restricted Assets
June 30, 2014
(in thousands)

Restricted Asset Category	Total General Account Restricted Assets	Restricted G/A Assets Supporting S/A Activity	Total Separate Account (S/A) Restricted Assets	Restricted S/A Assets Supporting G/A Activity	Total Restricted	Total Assets	% Restricted to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Collateral held under security lending agreements	4,354	0	0	0	4,354	4,354	100.00%	14,233,122	0.03%

Restricted Assets
June 30, 2013
(in thousands)

Restricted Asset Category	Total General Account (G/A) Restricted Assets	Restricted G/A Assets Supporting S/A Activity	Total Separate Account (S/A) Restricted Assets	Restricted S/A Assets Supporting G/A Activity	Total Restricted	Total Assets	% Restricted to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Collateral held under security lending agreements	27,469	0	0	0	27,469	27,469	100.00%	13,183,235	0.21%

1.C.7. Capital Assets

Capital assets are tangible or intangible assets held and used in the Industrial Insurance Fund operations that have a service life of more than one year and meet the state's capitalization policy. In accordance with the Washington State Office of Financial Management's (OFM) policy, it is the Industrial Insurance Fund's policy to capitalize:

- All land
- Buildings, building improvements, improvements other than buildings, and leasehold improvements with a cost of $100,000 or greater
- All capital assets with a unit cost (including ancillary costs) of $5,000 or greater, unless otherwise noted
- Infrastructure with a cost of $100,000 or greater
- Intangible assets either purchased or internally developed, with a cost of $1,000,000 or greater, that are "identifiable" by meeting either of the following conditions:
  - The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged; or

    - The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable

- All capital assets acquired with a Certificate of Participation

Capital assets are recorded at cost. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use. Normal maintenance and repair costs that do not materially add to the value or extend the life of capital assets are not capitalized. The cost and related accumulated depreciation of disposed of capital assets are removed from the accounting records.

The value of assets constructed for use in the Industrial Insurance Fund includes all direct construction costs and indirect costs that are related to the construction. Net interest costs incurred during the period of construction, if material, are capitalized.

Depreciation and amortization expenses are calculated using the straight-line method over the estimated useful lives of the assets. Total depreciation and amortization expense for capital assets was $7.2 million for the fiscal year ended June 30, 2014, and $8.4 million for the fiscal year ended June 30, 2013.

Generally, estimated useful lives are as follows:

- Buildings and building components 5 to 50 years
- Furnishings, equipment, and collections 3 to 50 years
- Other improvements 3 to 50 years
- Infrastructure 20 to 50 years
- Intangible assets with definite useful lives 3 to 50 years

In accordance with SAP, not all capitalized assets are admitted for reporting purposes. Common examples of nonadmitted capital assets are equipment, furniture, and supplies. These nonadmitted assets are adjusted from the respective account's contingency reserve, and current purchases are immediately expensed. SSAP No. 16 allows electronic data processing (EDP) equipment and operating system software to be admitted, up to 3 percent of the contingency reserve. However, the Industrial Insurance Fund takes a more conservative approach and does not admit any EDP equipment or operating system software.

1.C.8. Risk Management

The state of Washington operates a self-insurance liability program pursuant to RCW 4.92.130. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state's management believes it is more economical to manage its risks internally and set aside assets for claims settlement in the Risk Management Fund, an internal service fund. A limited amount of commercial insurance is purchased for certain liabilities and to limit the exposure to catastrophic losses. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past ten fiscal years. Otherwise, the self-insurance liability program services all claims against the state for injuries and property damage to third parties.

The Industrial Insurance Fund participates in the state's self-insurance liability program, in proportion to its anticipated exposure to liability losses, to manage its various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters.

Note 2 - Investments

2.A. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship over the Industrial Insurance Fund's investments is vested in the voting members of the WSIB. The legislature established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, chapter 42.52 RCW, as it makes investment decisions and seeks to meet its investment objectives.

In accordance with RCW 43.33A.110, Industrial Insurance Fund investments are to be managed to limit fluctuations in the industrial insurance premiums and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the strategic objectives are to:

- Maintain the solvency of the accounts
- Maintain premium rate stability
- Ensure sufficient assets are available to fund the expected liability payments
- Subject to the objectives above, achieve a maximum return at a prudent level of risk

Performance objectives are intended to provide the WSIB and the Industrial Insurance Fund with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost, the performance of the investment portfolios shall be judged relative to the strategic objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each account. The CMIs are developed and calculated with the goal to construct a hypothetical passive portfolio with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each Industrial Insurance Fund account. The return for each account's portfolio should not be significantly different from that of its CMI over the long-term.

Eligible Investments - Eligible investments are securities and deposits that are in accordance with the Industrial Insurance Fund's investment policy and chapter 43.33A RCW. Eligible investments include:

- U.S. equities
- International equities
- U.S. Treasuries and government agencies
- Credit bonds
- Mortgage-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Asset-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Commercial mortgage-backed securities rated investment grade, as defined by Barclays Capital Global Family of Fixed Income Indices
- Investment grade non-U.S. dollar bonds

Investment Restrictions - To meet stated objectives, investments of the Industrial Insurance Fund are subject to the following constraints:

- All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140.
- Asset allocations will be reviewed every three to four years or sooner if there are significant changes in funding levels or the liability durations.
- Assets will be rebalanced across asset classes when the fair value of the assets falls outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.
- Sector allocation for U.S. equities should be within a range of 55 to 65 percent. Allocation for international equities should be within a range of 35 to 45 percent.
- No corporate fixed income issue cost shall exceed 3 percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed 6 percent of the Fund's fair value at any time. This rule applies to any specific corporate bond relative to all of the Fund's assets in aggregate, across all accounts and all their asset class holdings.

- The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the Morgan Stanley Capital International (MSCI) U.S. Investable Market Index. The benchmark and structure for international equities will be the MSCI All Country World Ex U.S. Investable Market Index. Both portfolios will be 100 percent passively managed in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.

- The fixed income portfolios' structures vary depending upon the required duration target. The duration targets will be reviewed every three years or sooner if there are significant changes in the funding levels or the liability durations.

- Sector allocation of fixed income investments must be managed within the following prescribed ranges:

  - U.S. Treasuries and government agencies — 5 to 25 percent
  - Credit bonds — 20 to 80 percent
  - Asset-backed securities — 0 to 10 percent
  - Commercial mortgage-backed securities — 0 to 10 percent
  - Mortgage-backed securities — 0 to 25 percent

  These targets are long-term in nature. Deviations may occur in the short term as a result of interim market conditions; however, if a range is exceeded, the portfolios must be rebalanced to the target allocations as soon as it is practical.

- Total market value of below investment grade credit bonds, as defined by Barclays Capital Global Family of Fixed Income Indices, shall not exceed 5 percent of the total market value of the funds. Although below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held. Total market value of below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities shall not exceed 5 percent of total market value of the funds.

2.B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. The risk is managed within the portfolios using effective duration, which is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Increases in prevailing interest rates generally translate into decreases in fair values of those investments. The Industrial Insurance Fund does not have a formal policy specifically for interest rate risk.

As of June 30, 2014, the Industrial Insurance Fund's portfolio was within the duration targets below:

- Accident Account – within plus or minus 20 percent of an effective duration target of seven years
- Medical Aid Account – within plus or minus 20 percent of an effective duration target of six years
- Pension Reserve Account – within plus or minus 20 percent of an effective duration target of seven years

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time, those differences should not be material.

2.C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Industrial Insurance Fund's investment policies limit the fixed income securities to investment grade or higher at the time of purchase. Investment grade securities are those fixed income securities with a Moody's rating of Aaa to Baa or a Standard and Poor's rating of AAA to BBB. The rated debt investments of the Industrial Insurance Fund as of June 30, 2014, were rated by Moody's and/or an equivalent national rating organization.

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Industrial Insurance Fund's policy states that corporate fixed income issues cost shall not exceed 3 percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed 6 percent of the Fund's fair value at any time. There was no concentration of credit risk as of June 30, 2014.

Custodial Credit Risk - Custodial credit risk is the risk that in the event a depository institution or counterparty fails, the Industrial Insurance Fund would not be able to recover the value of its deposits, investments, or collateral securities. As of June 30, 2014, investment securities (excluding cash, cash equivalents and repurchase agreements held as securities lending collateral) are registered and held in the name of the WSIB for the benefit of the Industrial Insurance Fund, and are not exposed to custodial credit risk. There are no general policies relating to custodial credit risk.

2.D. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Industrial Insurance Fund does not have a formal policy to limit foreign currency risk. The Industrial Insurance Fund had $682.4 million and $668.2 million invested in an international commingled equity index fund at June 30, 2014 and 2013, respectively. As such, no currency denomination risk is present at June 30, 2014.

2.E. Derivatives

To manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns, the Industrial Insurance Fund is authorized to utilize various derivative financial instruments, including collateralized mortgage obligations, financial futures, forward contracts, interest rate and equity swaps, and options.

Derivative transactions involve, to varying degrees, market and credit risk. The Industrial Insurance Fund mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding and, thereby, prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. The only derivative securities held directly by the Industrial Insurance Fund were collateralized mortgage obligations (CMOs) of $1.47 billion and $1.57 billion at June 30, 2014 and 2013, respectively.

2.F. Reverse Repurchase Agreements

State law permits the Industrial Insurance Fund to enter into reverse repurchase agreements, i.e., a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the state or provide securities or cash of equal value, the Industrial Insurance Fund would suffer an economic loss equal to the difference between the fair value, plus accrued interest, of the underlying securities and the agreement obligation, including accrued interest.

There were no reverse repurchase agreements during fiscal years 2014 or 2013, and there were no liabilities outstanding as of June 30, 2014 or 2013.

2.G. Wash Sales Transactions

Wash sales are any transfers when an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security. These transactions involve unrated securities or those with NAIC designations of 3 or below. There were no wash sale transactions in the Industrial Insurance Fund during fiscal year 2014 or 2013.

2.H. Bonds

At June 30, 2014 and 2013, bonds were comprised of U.S. government, other governments, corporate, mortgage-backed, and other loan-backed securities, with an aggregate book adjusted carrying value (BACV) of $11,377,374,000 and $10,610,040,000 and fair value of $12,232,300,000 and $11,329,577,000, respectively, as shown in the following tables:

Book Adjusted Carrying Values and Fair Values
June 30, 2014
(in thousands)

	Book Adjusted Carrying Value	Fair Value Excess over BACV	BACV Excess over Fair Value	Fair Value
U.S. government obligations - excluding mortgage-backed securities	$ 1,055,063	$ 2,993	$ (12,734)	$ 1,045,322
All other government obligations	1,346,981	81,828	(8,521)	1,420,288
Mortgage-backed and other loan-backed securities	1,916,467	154,793	(4,372)	2,066,888
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	6,943,856	648,336	(10,774)	7,581,418
Hybrid securities	115,007	3,457	(80)	118,384
Total	$ 11,377,374	$ 891,407	$ (36,481)	$ 12,232,300

Book Adjusted Carrying Values and Fair Values
June 30, 2013
(in thousands)

	Book Adjusted Carrying Value	Fair Value Excess over BACV	BACV Excess over Fair Value	Fair Value
U.S. government obligations - excluding mortgage-backed securities	$ 2,683,872	$ 146,619	$ (52,751)	$ 2,777,740
All other government obligations	1,145,913	69,507	(17,737)	1,197,683
Mortgage-backed securities	1,770,201	194,039	(4,303)	1,959,937
Industrial and miscellaneous - excluding mortgage-backed securities	5,010,054	443,872	(59,709)	5,394,217
Total	$ 10,610,040	$ 854,037	$ (134,500)	$ 11,329,577

The following tables present the Industrial Insurance Fund's bond investments by type and by stated contractual maturity in years, and provide the BACV and fair value of bonds as of June 30, 2014 and 2013. Expected maturities may differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Schedule of Maturities
June 30, 2014
(in thousands)

			Maturity			
Investment Type	**Fair Value**	**Book Adjusted Carrying Value**	**1 year or less**	**Over 1 year through 5 years**	**Over 5 years through 10 years**	**Over 10 years**
U.S. government obligations - excluding mortgage-backed securities	$ 1,045,322	$ 1,055,063	$ 49,965	$ 701,984	$ 303,114	$ -
All other government obligations	1,420,288	1,346,981	101,980	605,281	380,619	259,101
Mortgage-backed and other loan-backed securities	2,066,888	1,916,467	-	186,258	132,085	1,598,124
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	7,581,418	6,943,856	206,943	2,384,979	1,740,925	2,611,009
Hybrid securities	118,384	115,007	-	-	115,007	-
Total	$ 12,232,300	$ 11,377,374	$ 358,888	$ 3,878,502	$ 2,671,750	$ 4,468,234

Schedule of Maturities
June 30, 2013
(in thousands)

			Maturity			
Investment Type	**Fair Value**	**Book Adjusted Carrying Value**	**1 year or less**	**Over 1 year through 5 years**	**Over 5 years through 10 years**	**Over 10 years**
U.S. government obligations - excluding mortgage-backed securities	$ 2,777,740	$ 2,683,872	$ 189,909	$ 1,168,036	$ 687,472	$ 638,455
All other government obligations	1,197,683	1,145,913	-	554,336	327,551	264,026
Mortgage-backed securities	1,959,937	1,770,201	-	54,195	57,420	1,658,586
Industrial and miscellaneous - excluding mortgage-backed securities	5,394,217	5,010,054	100,984	1,149,250	1,804,885	1,954,935
Total	$ 11,329,577	$ 10,610,040	$ 290,893	$ 2,925,817	$ 2,877,328	$ 4,516,002

The following additional tables are included to summarize the different classes of investments held by the Industrial Insurance Fund as they are rated by the National Association of Insurance Commissioners (NAIC). There were not any securities with an NAIC designation higher than 5 at the fiscal years ended June 30, 2014 and 2013.

Fair Value of Securities by NAIC Designation
June 30, 2014
(in thousands)

	NAIC Designation					
	1	**2**	**3**	**4**	**5**	**Total**
U.S. government obligations - excluding mortgage-backed securities	$ 1,045,322	$ -	$ -	$ -	$ -	$ 1,045,322
All other government obligations	1,078,670	268,776	72,842	-	-	1,420,288
Mortgage-backed and other loan-backed securities	2,066,331	-	-	-	557	2,066,888
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	4,085,593	3,297,875	197,950	-	-	7,581,418
Hybrid securities	30,201	83,046	5,137	-	-	118,384
Total	$ 8,306,117	$ 3,649,697	$ 275,929	$ -	$ 557	$ 12,232,300

Fair Value of Securities by NAIC Designation
June 30, 2013
(in thousands)

	NAIC Designation					
	1	**2**	**3**	**4**	**5**	**Total**
U.S. government obligations-excluding mortgage-backed securities	$ 2,777,740	$ -	$ -	$ -	$ -	$ 2,777,740
All other government obligations	804,911	316,447	76,325	-	-	1,197,683
Commercial mortgage-backed securities	388,249	-	-	-	-	388,249
Residential mortgage-backed securities	1,571,688	-	-	-	-	1,571,688
Industrial and miscellaneous - excluding mortgage-backed securities	2,222,226	2,972,255	184,899	14,837	-	5,394,217
Total	$ 7,764,814	$ 3,288,702	$ 261,224	$ 14,837	$ -	$ 11,329,577

Gross unrealized losses on bonds, the fair value of the related bonds aggregated by investment category, and length of time that individual bonds have been in a continuous unrealized loss position at June 30, 2014 and 2013, were as follows:

Bonds with Unrealized Losses
June 30, 2014
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government obligations - excluding mortgage-backed securities	$ 150,344	$ (67)	$ 650,563	$ (12,667)	$ 800,907	$ (12,734)
All other government obligations	33,966	(220)	144,648	(9,268)	178,614	(9,488)
Mortgage-backed and other loan-backed securities	94,762	(311)	114,492	(4,076)	209,254	(4,387)
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	337,239	(1,461)	412,437	(10,675)	749,676	(12,136)
Hybrid securities	19,920	(80)	-	-	19,920	(80)
Total	$ 636,231	$ (2,139)	$ 1,322,140	$ (36,686)	$ 1,958,371	$ (38,825)

Bonds with Unrealized Losses
June 30, 2013
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government obligations - excluding mortgage-backed securities	$ 825,870	$ (51,437)	$ -	$ -	$ 825,870	$ (51,437)
All other government obligations	334,410	(18,511)	-	-	334,410	(18,511)
Mortgage-backed securities	148,715	(4,303)	-	-	148,715	(4,303)
Industrial and miscellaneous - excluding mortgage-backed securities	1,099,241	(63,079)	10,120	(574)	1,109,361	(63,653)
Total	$ 2,408,236	$ (137,330)	$ 10,120	$ (574)	$ 2,418,356	$ (137,904)

In compliance with SSAP No. 26, management has looked at all bonds in an unrealized loss position and used several categories of information to determine whether any impairment is other-than-temporary. The information considered included general market conditions, industry or company financial prospects, an issuer's fundamental credit difficulties, and the length of time and the extent to which the fair value had been below cost. Management has no intention to sell these securities and does not believe these impairments are other-than-temporary.

Similarly, in compliance with SSAP No. 43R, management has looked at mortgage-backed and other loan-backed securities with unrealized losses and has used several categories of information to determine whether any impairment is other-than-temporary. State Street Corporation's investment valuation model for prepayment assumptions and determining currently estimated cash flows in valuing mortgage-backed and other loan-backed securities was used. The factors that are considered include discounted cash flow on an investment, the length of time and amount of impairment, forecasts, market data, and financial condition of the issuer(s). As of June 30, 2014, no mortgage-backed or other loan-backed securities have been determined to be other-than-temporarily impaired.

The following tables summarize realized gains or losses of bonds that were redeemed or sold during fiscal years 2014 and 2013:

Bonds Redeemed or Sold
June 30, 2014
(in thousands)

	Sales Proceeds	Realized Gains	Realized Losses	Net Realized Gains (Losses)
U.S. government obligations - excluding mortgage-backed securities	$ 2,144,351	$ 279,503	$ (34,345)	$ 245,158
All other government obligations	42,535	859	-	859
Mortgage-backed securities	179,324	-	-	-
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	527,401	19,165	(3,211)	15,954
Hybrid securities	-	-	-	-
Total	$ 2,893,611	$ 299,527	$ (37,556)	$ 261,971

Bonds Redeemed or Sold
June 30, 2013
(in thousands)

	Sales Proceeds	Realized Gains	Realized Losses	Net Realized Gains (Losses)
U.S. government obligations - excluding mortgage-backed securities	$ 577,665	$ 48,344	$ -	$ 48,344
All other government obligations	90,210	-	-	-
Mortgage-backed securities	172,839	-	-	-
Industrial and miscellaneous - excluding mortgage-backed securities	737,021	26,522	(806)	25,716
Total	$ 1,577,735	$ 74,866	$ (806)	$ 74,060

In compliance with SSAP No. 26, paragraph 20.l, the following table shows the details of the structured notes held by the Industrial Insurance Fund at June 30, 2014. No structured notes were held by the Fund at June 30, 2013.

Structured Notes
June 30, 2014
(in thousands)

CUSIP Identification	Actual Cost	Fair Value	Book/Adjusted Carry Value	Mortgage-Referenced Security (Y/N)
064159CR5	$ 20,000	$ 20,110	$ 20,000	N
136069FV8	25,000	25,148	25,000	N
172967GV7	20,000	20,218	20,000	N
63254AAH1	10,000	10,062	10,000	N
045167CL5	25,000	24,991	25,000	N
Total	$ 100,000	$ 100,529	$ 100,000	

2.I. Common Stocks

The gross unrealized losses on common stocks, fair value of the common stocks, and length of time that individual common stocks have been in a continuous unrealized loss position, at June 30, 2014 and 2013, were as follows:

Common Stocks with Unrealized Losses
June 30, 2014
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commingled index funds	-	-	41,339	(3,659)	41,339	(3,659)
	$ -	$ -	$ 41,339	$ (3,659)	$ 41,339	$ (3,659)

Common Stocks with Unrealized Losses
June 30, 2013
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commingled index funds	225,537	(9,777)	246,876	(38,320)	472,413	(48,097)
	$ 225,537	$ (9,777)	$ 246,876	$ (38,320)	$ 472,413	$ (48,097)

In compliance with SSAP No. 30, management has looked at all commingled index funds in an unrealized loss position and used several categories of information to determine whether any impairment is other-than-temporary. The information considered for broad equity funds included general market conditions and prospects for the economy as a whole in the short term. Management has no intention to sell these commingled index funds and does not believe these impairments are other-than-temporary.

2.J. Fair Value Measurements

The Industrial Insurance Fund has categorized its investments that are reported on the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve at fair value into a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three-level hierarchy is based on the degree of subjectivity inherent in the valuation method by which fair value was determined. The three levels are defined as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities

- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.
The following is a description of the valuation methodologies used for assets measured at fair value:

- Industrial & miscellaneous bonds - value is based on market values approved by the NAIC

- Equities – value is based on the underlying equity

- Other invested assets – value is based on the underlying equity

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of the future fair values. The Industrial Insurance Fund has determined that its valuation methods are appropriate and consistent with other market participants; however, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables present the financial instruments related to the Fund's assets carried at fair value as of June 30, 2014 and 2013, by the SSAP No. 100 valuation hierarchy:

Investment Assets Carried at Fair Value
June 30, 2014
(in thousands)

	Level 1	Level 2	Level 3	Total
Fixed income	$ -	$ 47,876	$ -	$ 47,876
Equities	-	1,886,836	-	1,886,836
Total	$ -	$ 1,934,712	$ -	$ 1,934,712

Investment Assets Carried at Fair Value
June 30, 2013
(in thousands)

	Level 1	Level 2	Level 3	Total
Fixed income	$ -	$ 61,398	$ -	$ 61,398
Equities	-	1,730,470	-	1,730,470
Total	$ -	$ 1,791,868	$ -	$ 1,791,868

Only bonds with an NAIC designation of 3-6 and a fair value lower than the book adjusted value are carried at fair value on the financial statements. On June 30, 2014, there were four bonds in this category, with fair values totaling $47,875,840. On June 30, 2013, there were seven bonds in this category, with fair values totaling $61,398,000.

At the end of each reporting period, the Industrial Insurance Fund evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. This policy also applies to transfers into or out of Level 3. During the current year, no transfers into or out of Levels 1, 2 or 3 were required.

The fair values of bonds categorized as Level 2 were valued using a market approach. These valuations were determined to be Level 2 valuations, as quoted markets prices for similar instruments in an active market were utilized. This was accomplished by the use of matrix pricing. Matrix pricing takes quoted prices of bonds with similar features and applies analytic methods to determine the fair value of bonds held.

The following tables reflect the fair values and admitted values of all admitted assets and liabilities. The fair values are also categorized into the three-level fair value hierarchy as described above.

Investment Assets at Fair Value
June 30, 2014
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total
Fixed income	$ 12,232,300	$ 11,377,374	$ -	$ 12,232,300	$ -	$ 12,232,300
Equities	1,886,836	1,886,836	-	1,886,836	-	1,886,836
Short-term investments	264,598	264,598	-	264,598	-	264,598
Total	$ 14,383,734	$ 13,528,808	$ -	$ 14,383,734	$ -	$ 14,383,734

Investment Assets at Fair Value
June 30, 2013
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total
Fixed income	$ 11,329,577	$ 10,610,040	$ -	$ 11,329,577	$ -	$ 11,329,577
Equities	1,730,470	1,730,470	-	1,730,470	-	1,730,470
Short-term investments	208,773	208,683	-	208,773	-	208,773
Total	$ 13,268,820	$ 12,549,193	$ -	$ 13,268,820	$ -	$ 13,268,820

Note 3 - Real Estate and Improvements

At June 30, 2014 and 2013, the Accident and Medical Aid Accounts admitted only land, buildings, and improvements, net of accumulated depreciation and encumbrances.

SSAP No. 40 requires that buildings more than 50 percent occupied by the reporting entity be categorized as a real estate investment and that depreciation and interest expenses be classified as investment expenses. The building occupied by the Industrial Insurance Fund's employees is financed through general obligation bonds of the state of Washington. The remaining balance due on the bonds as of June 30, 2014, was $7.9 million. Due to indirect ownership by the state of Washington, the land, building, and improvements are not shown as a real estate investment of the Industrial Insurance Fund. The related depreciation and interest expenses are allocated between administrative and non-insurance expenses based on percentage of use by employees.

Real Estate and Improvements
(in thousands)

	June 30, 2014	June 30, 2013
Land	$ 3,204	$ 3,204
Building occupied by Industrial Insurance Fund	65,134	65,134
Improvements, other than buildings	1,020	1,020
Encumbrances	(7,870)	(11,475)
Accumulated depreciation - building	(28,995)	(27,641)
Accumulated depreciation - improvements	(438)	(418)
Total	$ 32,055	$ 29,824

Note 4 - Investment Income

The Industrial Insurance Fund does not admit investment income due and accrued if amounts are over 90 days past due. As of June 30, 2014 and 2013, all investment income due and accrued was admitted, with balances accrued by security type, as summarized in the following table:

Interest Income Admitted Due and Accrued
(in thousands)

	June 30, 2014	June 30, 2013
U.S. Government obligations - excluding mortgage-backed securities	$ 1,894	$ 13,067
All other government obligations	14,653	14,139
Mortgage-backed and other loan-backed securities	7,904	7,851
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	80,467	71,950
Hybrid securities	1,733	-
Other interest	2	74
Total	$ 106,653	$ 107,081

The following table provides details for net investment income by security type for the fiscal years ended June 30, 2014 and 2013:

Net Investment Income Earned (in thousands)	Fiscal Year 2014	Fiscal Year 2013
U.S. Government obligations - excluding mortgage-backed securities	$ 27,304	$ 32,124
All other government obligations	47,767	41,697
Mortgage-backed and other loan-backed securities	90,326	98,465
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	296,113	290,847
Hybrid securities	5,515	-
Total Bond Interest	467,025	463,133
Equities dividends	1,283	926
Net securities lending income	355	910
Other interest and litigation income	9,486	577
Amortization	5,876	4,145
Gross investment income	484,025	469,691
Investment expenses	(4,251)	(3,823)
Total Net Investment Income Earned	$ 479,774	$ 465,868

Note 5 - Retirement Plans, Compensated Absences, Deferred Compensation Plan, and Other Postemployment Benefits

5.A. Retirement Plans

Industrial Insurance Fund employees participate in the Washington State Public Employees' Retirement System (PERS), administered by the Department of Retirement Systems. The PERS is a multiemployer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans, and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by February 28, 2002, are Plan 2 members, unless they exercised an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, have the irrevocable option of choosing membership in either Plan 2 or Plan 3.

All employers are required to contribute at the level established by the legislature. Each biennium, the State Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan

3 are developed by the Washington State Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. Under Plan 3, employer contributions finance the defined benefit portion of the plan, and employee contributions finance the defined contribution portion. Plan 3 members can choose from six employee contribution rate options ranging from 5 to 15 percent. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

Under the PERS, the employee and employer contribute a percentage of the employee's compensation. The employer contribution rates for the Industrial Insurance Fund for fiscal years ended June 30, 2014 and 2013, for each of Plans 1, 2, and 3 were 9.21 and 7.21 percent of the employee's annual covered salary, respectively. The Industrial Insurance Fund contributed $13,528,925 and $10,147,452 to the PERS during the fiscal years ended June 30, 2014 and 2013, respectively. The Industrial Insurance Fund's contribution was 1.5 percent of total employer contributions to the plans in fiscal years ended June 30, 2014 and 2013. The employer contribution rate from July 1, 2014, to June 30, 2015, has already been established by the legislature to be 9.21 percent for each of Plans 1, 2, and 3.

An actuarial valuation of the PERS plan for the Industrial Insurance Fund as a stand-alone entity is not available. Pension note disclosures for the PERS are included in the Comprehensive Annual Financial Report for the state of Washington. A copy of this report may be obtained by contacting the Accounting Division of the Office of Financial Management at P.O. Box 43113, Olympia, Washington 98504-3113 or online at http://www.ofm.wa.gov/cafr.

5.B. Compensated Absences

Industrial Insurance Fund employees accrue vested annual leave at a variable rate based on years of service. In general, accrued annual leave cannot exceed 240 hours at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested; i.e., the Industrial Insurance Fund does not pay employees for unused sick leave upon termination except upon employee death or retirement, when the Industrial Insurance Fund is liable for 25 percent of the employee's accumulated sick leave. In addition, the Industrial Insurance Fund has a "sick leave buyout option" in which, each January, employees who have accumulated sick leave in excess of 480 hours may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the Industrial Insurance Fund's policy to liquidate unpaid compensated absence balances outstanding at June 30 with future resources, rather than advance funding it with currently available expendable financial resources.

The Industrial Insurance Fund recognizes the expense and accrues a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits as applicable, as the leave is earned. The annual leave and sick leave accrued liability was $13,945,050 and $14,661,965 at June 30, 2014 and 2013, respectively.

5.C. Deferred Compensation Plan

Industrial Insurance Fund employees have the option to participate in the state of Washington's Deferred Compensation Plan (DCP). There are no contributions made on behalf of employees to the DCP by the Industrial Insurance Fund. The Department of Retirement Systems administers the DCP and contracts with a third party (currently Great-West Financial Retirement Services) for recordkeeping and other administrative services. The WSIB selects and monitors DCP's investment options based on advice and recommendations provided by the Employee Retirement Benefits Board.

5.D. Other Postemployment Benefits

The Industrial Insurance Fund is administered by L&I, an agency of the state of Washington and part of the primary government. Employees of the Industrial Insurance Fund are eligible to participate in the state of Washington's defined benefit Other Postemployment Benefit (OPEB) plan, a multiemployer plan, as administered by the state through the Washington State Health Care Authority (HCA).

Plan Description and Funding Policy

Per RCW 41.05.065, the Public Employees Benefits Board (PEBB) created within the HCA is authorized to design benefits and determine the terms and conditions of employee and retired employee participation and coverage, including establishment of eligibility criteria for both active and retired employees. PEBB programs include medical, dental, life, and long-term disability insurance.

The relationship between the PEBB OPEB plan and its member employers and their employees and retirees is not formalized in a contract or plan document. Rather, the benefits are provided in accordance with a substantive plan. A substantive plan is one in which the plan terms are understood by the employers and plan members. This understanding is based on communications between the HCA, employers and plan members, and the historical pattern of practice with regard to the sharing of benefit costs.

The PEBB retiree OPEB plan is available to employees who elect to continue coverage and pay the administratively-established premiums at the time they retire under the provisions of the retirement system to which they belong. Retirees' access to PEBB plans depends on the retirement eligibility of their respective retirement systems. PEBB members are covered in the following retirement systems: Public Employees' Retirement System, Public Safety Employees' Retirement System, Teachers' Retirement System, School Employees' Retirement System, Washington State Patrol Retirement System, and Higher Education.

Per RCW 41.05.022, retirees who are not yet eligible for Medicare benefits may continue participation in the state's non-Medicare community-rated health insurance risk pool on a self-pay basis. Retirees in the non-Medicare risk pool receive an implicit subsidy. The implicit subsidy exists because retired members pay a premium based on a claims experience for active employees and other non-Medicare retirees. The subsidy is valued using the difference between the age-based claim costs and the premium. In calendar year 2013, the average weighted implicit subsidy was valued at $294 per month per member, and in calendar year 2014, the average weighted implicit subsidy is projected to be $291 per month per member.

Retirees who are enrolled in both Parts A and B of Medicare may participate in the state's Medicare community-rated health insurance risk pool. Medicare retirees receive an explicit subsidy in the form of reduced premiums. Annually, the HCA administrator recommends an amount for the next calendar year's explicit subsidy for inclusion in the Governor's budget. In calendar year 2013, the explicit subsidy was up to $150 per month per member, and it remained at up to $150 per month per member in calendar year 2014.

Administrative costs, as well as implicit and explicit subsidies, are funded by required contributions from participating employers. The subsidies provide monetary assistance for medical benefits.

Contributions are set by the legislature each biennium as part of the budget process. In fiscal year 2014, the cost of the subsidies was approximately 5.9 percent of the cost of benefits for active employees. The benefits are funded on a pay-as-you-go basis.

The plan has no investments or other assets. Accordingly, the PEBB OPEB plan is not reported in the financial statements of the state, nor is a separate financial report publicly available.

For information on the results of the most recent actuarial valuation for the OPEB, refer to:
http://osa.leg.wa.gov/Actuarial_Services/OPEB/OPEB.htm

Annual OPEB Cost and Net OPEB Obligation

The state's (general government agencies and higher education institutions) annual OPEB cost (expense) is calculated based on the annual required contribution (ARC) of the state as the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The annual OPEB cost recorded for the Industrial Insurance Fund represents an allocation of the total ARC of the state of Washington, adjusted for interest and amortization. The Industrial Insurance Fund's annual OPEB cost is calculated by the Washington State Office of the State Actuary (OSA) and is recorded by OFM. The allocation is primarily based on L&I's number of active and retired employees in relation to the total number of active and retired employees of the state.

The following table shows components of the Industrial Insurance Fund's allocated annual OPEB costs and changes in the Industrial Insurance Fund's Net OPEB Obligation (NOO) for fiscal years 2014 and 2013. All contributions required by the funding method were paid.

Components of Allocated Annual OPEB Cost

	Fiscal Year 2014	Fiscal Year 2013
Annual required contribution	$ 8,625,000	$ 8,359,000
Allocated interest on Net OPEB Obligation	1,031,000	769,000
Allocated amortization of Net OPEB Obligation	(924,000)	(677,000)
Allocated annual OPEB cost	8,732,000	8,451,000
Allocated contributions made	(2,196,000)	(1,925,000)
Increase in Net OPEB Obligation	6,536,000	6,526,000
Net OPEB Obligation, beginning of year	25,763,000	19,237,000
Net OPEB Obligation, end of year	$ 32,299,000	$ 25,763,000

The Industrial Insurance Fund's NOO represents 1.7 percent and 1.6 percent of the state of Washington's NOO as of June 30, 2014 and 2013, respectively. The Industrial Insurance Fund's contribution was 1.4 percent of total employer contributions to the plan in fiscal years ended June 30, 2014 and 2013.

The Industrial Insurance Fund's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the NOO for fiscal years 2014, 2013, and 2012 were as follows:

Net OPEB Obligation
by Fiscal Year

	2014	2013	2012
Allocated annual OPEB cost	$ 8,732,000	$ 8,451,000	$ 7,796,000
Percentage of annual OPEB cost contributed	25.1%	22.8%	27.2%
Net OPEB Obligation	$ 32,299,000	$ 25,763,000	$ 19,237,000

A complete description of the funded status and actuarial assumptions of the state of Washington's OPEB plan is included in the Comprehensive Annual Financial Report for the state of Washington. A copy of this report may be obtained by contacting the Accounting Division of the Office of Financial Management at P.O. Box 43113, Olympia, Washington 98504-3113, or online at http://www.ofm.wa.gov/cafr.

Note 6 - Commitments and Contingencies

6.A. Commitments

Effective July 1, 1992, the Washington State Legislature required the Industrial Insurance Fund, under RCW 48.22.070, to participate in an assigned risk pool providing workers' compensation coverage under the United States Longshoreman and Harbor Workers' Act. The Industrial Insurance Fund is obligated to participate 50 percent in the underwriting losses or surpluses of the assigned risk pool. This participation is scheduled to continue indefinitely due to amending legislation passed in 1997. However, the Industrial Insurance Fund has not made any payments to this risk pool since enactment of this indefinite commitment.

6.B. Contingencies

The Industrial Insurance Fund is party to numerous routine legal proceedings that normally occur in operations. At any given point, there may be numerous lawsuits that could financially impact the Fund. Although the outcome of these lawsuits is not currently determinable, the resolution of these matters is not likely to have a material impact on the Industrial Insurance Fund's financial position, revenues, or expenses.

6.C. Exposure

The lack of diversity of exposure by line of business and by state could be a risk factor for benefit liability and claims administration expense (CAE) reserves. By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Fund's benefit liability and CAE reserves. Such trends would include legislative benefit level changes that may have an effect on all open workers' compensation claims.

Note 7 - Leases

The Industrial Insurance Fund leases land, office facilities, office and computer equipment, and other assets under a variety of operating lease agreements. Although lease terms vary, most leases are subject to appropriation from the state legislature to continue the obligation. Since the possibility of not receiving funding from the legislature is remote, leases are considered non-cancelable for financial reporting purposes. Certain operating leases are renewable for specified periods. Management expects the leases to be renewed or replaced by other leases.

The total operating lease rental expenses for fiscal years 2014 and 2013 were $10,368,992 and $10,467,386, respectively. There are no contingent rental payments or unusual renewal options, escalation clauses or restrictions, and there have been no early terminations of existing leases. Certain rental commitments have renewal options extending through the year 2018. Some of these renewals are subject to adjustments in future periods.

The following table presents future minimum payments for operating leases as of June 30, 2014:

Future Minimum Payments June 30, 2014			
Operating Leases (by Fiscal Year)	**Accident Account**	**Medical Aid Account**	**Total**
2015	$ 3,877,200	$ 3,668,657	$ 7,545,857
2016	3,366,593	3,153,278	6,519,871
2017	2,670,945	2,465,394	5,136,339
2018	975,124	800,564	1,775,688
2019	396,567	236,794	633,361
Total Future Minimum Lease Payments	$ 11,286,429	$ 10,324,687	$ 21,611,116

Note 8 - Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities

Securities Lending

The Industrial Insurance Fund participates in securities lending programs with the WSIB and the OST to increase investment income. At June 30, 2014, the Industrial Insurance Fund had $4,115,764 of cash collateral received through the WSIB in the Accident Account. There was $237,929 of cash collateral received in the Medical Aid Account invested through the OST.

Securities Lending - WSIB

Washington State law and WSIB policy permit the Industrial Insurance Fund to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation to act as agent for the WSIB in securities lending transactions. As State Street Corporation is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

Debt securities were loaned and collateralized by the Industrial Insurance Fund’s agent with cash, U.S. government or U.S. agency securities, including U.S. agency mortgage-backed securities (exclusive of letters of credit). When the loaned securities had collateral denominated in the same currency, the collateral requirement was 102 percent of the fair value, including accrued interest of the securities loaned. All other securities were required to be collateralized at 105 percent of the fair value, including accrued interest of the loaned securities.

During fiscal years 2014 and 2013, securities lending transactions could be terminated on demand by either the Industrial Insurance Fund or the borrower. At June 30, 2014 and 2013, the cash collateral held had an average duration of 22.5 days and 22.4 days, and an average weighted final maturity of 82.2 days and 57.4 days, respectively. Because securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. To provide liquidity to manage those mismatches, State Street

Corporation is required to re-invest no less than the targeted 20 percent of the cash collateral received in the overnight maturities to ensure sufficient liquidity available for the return of collateral to borrowers within the ordinary course of business. In the event that loans are returned beyond what is expected in the ordinary course of business, State Street Corporation would be allowed to sell investments at its discretion and in accordance with the investment guidelines of the cash collateral account.

No more than 20 percent of the total on loan value can be held by a specific borrower. Collateral investment guidelines specifically prohibit European domiciled holdings. There are no restrictions on the amount of securities that can be lent. Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. State Street Corporation indemnified the Industrial Insurance Fund by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. State Street Corporation’s responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During fiscal years 2014 and 2013, there were no significant violations of legal or contractual provisions, no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Industrial Insurance Fund incurred no losses during fiscal years 2014 or 2013 resulting from a default by either the borrowers or the securities lending agents.

At June 30, 2014 and 2013, total collateral held was $70,982,464 and $26,381,220 and fair value of securities on loan were $69,443,310 and $26,200,506, respectively.

The market value of cash collateral assets at June 30, 2014 and 2013, was $4,115,764 and $26,381,220, respectively. The following tables provide information regarding cash collateral assets:

Cash Collateral Held Under Securities Lending
June 30, 2014
(in thousands)

	NAIC Designation	Book Adjusted Carrying Value	Level 2 Fair Value	Maturity Date: Under 30 days	30 - 59 days	60 - 89 days	90 - 119 days	120 - 179 days	180 days - less than 1 year	1 - 2 years
Commercial paper	1	$ 484	$ 484	$ -	$ 68	$ 137	$ 48	$ 127	$ 104	$ -
Yankee CD's	1	758	758	99	172	154	34	158	141	-
Certificate & time deposits	1	485	485	152	34	69	-	69	161	-
Cash	1	515	515	515	-	-	-	-	-	-
Cash	2	429	429	429	-	-	-	-	-	-
Cash	Not Rated	1,149	1,149	1,149	-	-	-	-	-	-
Corporate	1	226	227	-	-	-	-	-	69	158
Bank note	1	69	69	-	-	-	-	-	-	69
Total Cash Collateral Held		$ 4,115	$ 4,116	$ 2,344	$ 274	$ 360	$ 82	$ 354	$ 475	$ 227

Cash Collateral Held Under Securities Lending
June 30, 2013
(in thousands)

	NAIC Designation	Book Adjusted Carrying Value	Level 2 Fair Value	Maturity Date: Under 30 days	30 - 59 days	60 - 89 days	90 - 119 days	120 - 179 days	180 days - less than 1 year	1 - 2 years
Cash and cash equivalents	1	$ 6,062	$ 6,063	$ 1,274	$ 880	$1,529	$ 304	$ 729	$ 1,145	$ 202
Commercial paper	1	4,791	4,792	304	1,214	1,300	607	810	557	-
Repurchase agreements	2	2,206	2,206	2,206	-	-	-	-	-	-
Repurchase agreements	Not rated	12,570	12,570	12,570	-	-	-	-	-	-
Bank and promissory notes	1	749	750	-	-	345	-	-	-	405
Total Cash Collateral Held		$ 26,378	$26,381	$16,354	$2,094	$3,174	$ 911	$ 1,539	$ 1,702	$ 607

Non-cash collateral cannot be pledged or sold absent borrower default. Accordingly, non-cash collateral held under securities lending contracts with a value of $66,866,700 at June 30, 2014, has not been included in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. At June 30, 2013, there was no non-cash collateral held. Net earnings received through the securities lending program were $354,723 for fiscal year 2014 and $910,453 for fiscal year 2013.

Securities Lending – OST

State statutes permit the OST to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The OST, which has contracted with Citibank as a lending agent to lend securities, receives earnings for this activity.

The OST lending agent lends U.S. government and U.S. agency securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent.

The cash is invested by the lending agent in accordance with investment guidelines approved by the OST. The securities held as collateral and the securities underlying the cash collateral are held by the custodian. One option available to the lending agent is to invest cash collateral into an OST account in the Local Government Investment Pool (LGIP). The LGIP portfolio is invested in a manner generally consistent with a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17CFR.270.2a-7). Rule 2a-7 funds are limited to high-quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. At June 30, 2014 and 2013, the Industrial Insurance Fund’s cash collateral totaled $237,929 and $1,088,426, respectively, all of which was invested in the LGIP.

The contract with the lending agent requires them to indemnify the OST if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or if the borrower fails to pay the OST for income distribution by the securities' issuers while the securities are on loan. The OST cannot pledge or sell collateral securities received unless the borrower defaults. At June 30, 2014, the fair value of securities on loan for the Industrial Insurance Fund totaled $232,283. At June 30, 2013, the fair value of securities on loan was $1,065,797.

The OST's investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the OST. During fiscal years 2014 and 2013, the OST had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the OST.

There were no violations of legal or contractual provisions or any losses resulting from a default of a borrower or lending agent during the fiscal year.

Note 9 - Changes in Benefit and Claims Administration Liabilities

An increase of $650.1 million in the provision for insured events of prior years in benefit and claims administration liabilities in fiscal year 2014 is comprised of a $350.1 million change in the reserve discount and $300.0 million of adverse development on prior years. The reason for the adverse development in prior years is mainly due to early adoption of the planned gradual reduction in the pension discount rate from 6.5 to 4.5 percent by 2023, a model change for claims active for 13 or more years treated as time-loss claims, and a liability increase to avoid double-counting the 2011 reform savings.

The following schedule presents the changes in benefit and claims administration liabilities for the fiscal years ended June 30, 2014 and 2013, for the Industrial Insurance Fund:

Changes in Benefit and Claims Administration Liabilities
(in thousands)

	Fiscal Year 2014	Fiscal Year 2013
Unpaid benefit and claims administration liabilities, July 1	$ 12,335,237	$ 11,738,930
Incurred benefit and claims administration liabilities		
Provision for insured events of the current year	1,643,940	1,631,274
Increase in provision for insured events of prior years	650,069	677,906
Total incurred benefit and claims administration liabilities	2,294,009	2,309,180
Less Payments		
Benefit and claims administration liabilities attributable to		
Insured events of the current year	(296,885)	(296,347)
Insured events of prior years	(1,419,824)	(1,416,526)
Total payments	(1,716,709)	(1,712,873)
Total unpaid benefit and claims administration liabilities, June 30	$ 12,912,537	$ 12,335,237
Current portion	$ 1,458,437	$ 1,411,259
Long-term portion	$ 11,454,100	$ 10,923,978

At June 30, 2014 and 2013, $20.4 billion and $20.0 billion of unpaid benefit and claims administration liabilities are shown at their net present and settlement value of $12,912 million and $12,335 million, respectively. In the Accident Account, liabilities for pensions incurred but not-yet-awarded are discounted on both a tabular and non-tabular basis. For each future pension award, the estimated future pension payments are discounted from the anticipated payment dates back to the anticipated date of the pension award on a tabular basis from 4.5 to 6.5 percent. The payments are then discounted from the anticipated date of the pension award back to the evaluation date, on a non-tabular basis, at 1.5 percent. For more information on discounting, see Note 1.C.3.

All other Accident and Medical Aid Account benefits and claims administration liabilities are discounted at 1.5 percent. The benefit liabilities in the Pension Reserve Account are discounted at 6.5 percent.

2014 Benefit Liability Development by Program
(dollars in thousands)

Program/ Category	Undiscounted Liabilities	Discount Rate	Benefit Liabilities
Accident	$ 6,950,589	1.5%, 4.5%-6.5%	$ 4,565,089
Medical Aid	5,183,269	1.5%	3,882,285
Pensions	7,636,040	6.5%	3,925,299
Total Benefit Liability	19,769,898		12,372,673
Claim Administration Expense (CAE)	596,557	1.5%	539,864
Total Benefit and CAE Liabilities	$ 20,366,455		$ 12,912,537

2013 Benefit Liability Development by Program
(dollars in thousands)

Program/ Category	Undiscounted Liabilities	Discount Rate	Benefit Liabilities
Accident	$ 7,133,436	1.5% & 6.5%	$ 4,291,331
Medical Aid	4,990,475	1.5%	3,775,655
Pensions	7,318,128	6.5%	3,739,086
Total Benefit Liability	19,442,039		11,806,072
Claim Administration Expense (CAE)	581,726	1.5%	529,165
Total Benefit and CAE Liabilities	$ 20,023,765		$ 12,335,237

Note 10 - Retrospectively-Rated Contracts and Contracts Subject to Redetermination

10.A. Method Used to Estimate

The Industrial Insurance Fund estimates accrued retrospective premium annual adjustments for unadjusted enrollment periods by reviewing historical participation and return patterns. The historical averages are used to arrive at an estimate of net retrospective return premiums for unadjusted periods. Cumulative return premiums for periods from the first annual adjustment through the third annual adjustment are system-generated, and the accruals are the difference between the cumulative returns and the amount already returned. The third annual retrospective adjustment is final.

10.B. Method Used to Record

Retrospective return premiums due to employers are netted with additional premiums due from employers and recorded as a liability.

10.C. Amount and Percent of Net Retrospective Premiums

Net premiums for the fiscal years ended June 30, 2014 and 2013, on retrospectively-rated workers' compensation policies were $750.3 million (41 percent), and $713.9 million (42 percent), of total workers' compensation net premiums, respectively.

10.D. Calculation of Nonadmitted Retrospective Premiums

Retrospective additional premiums 90 days past due after the third annual retrospective adjustment are nonadmitted.

Note 11 - Discounting of Liabilities for Unpaid Benefits or Unpaid Claims Administration Expenses

The case reserves shown in this exhibit are the reserves for pensions awarded through June 30, 2014, only. The State Fund estimates case reserves on certain other individual claims solely for the purpose of classification rating, retrospective rating, and experience rating. Such case reserves are not maintained on claims that do not enter the rating calculations, so they are not meaningful for claims less than approximately 18 months old or more than approximately seven years old.

11.A. Tabular Discounts

The mortality table was developed in 1987 by the Office of the Insurance Commissioner based on 1980 census data. The liabilities are discounted at 6.5 percent per annum. The June 30, 2014, liabilities include $6,471,644,000 of such reserves, net of tabular discounts. The amount of the tabular discount for case reserves is $3,710,741,000 and $2,011,176,000 for Incurred But Not Reported (IBNR) reserves at June 30, 2014.

At June 30, 2013, the liabilities, net of tabular discounts, amounted to $6,270,858,000. The amount of the tabular discount for case reserves was $3,579,042,000 and $2,590,374,000 for IBNR reserves.

Liabilities Discounted on a Tabular Basis
June 30, 2014
(in thousands)

Fiscal Accident Year	Benefit Liabilities Gross of Tabular Discount	Tabular Discounts		Benefit Liabilities Net of Tabular Discount
		Case	IBNR	
2004 & Prior	$ 5,901,066	$ 2,504,590	$ 256,761	$ 3,139,715
2005	588,586	211,109	79,286	298,191
2006	649,948	213,478	105,424	331,046
2007	746,516	219,237	145,983	381,296
2008	794,157	195,649	188,313	410,195
2009	725,296	146,516	198,405	380,375
2010	621,829	97,648	195,611	328,570
2011	562,482	68,295	192,803	301,384
2012	522,764	32,617	202,452	287,695
2013	532,227	13,634	218,602	299,991
2014	548,690	7,968	227,536	313,186
Total	$ 12,193,561	$ 3,710,741	$ 2,011,176	$ 6,471,644

11.B. Non-Tabular Discounts

The non-tabular discount rate is based upon the 5-year average of the 20-year treasury yield rounded to the nearest one-half percent, less 2 percentage points. As of June 30, 2014, the rounded 5-year average was 3.5 percent, and the indicated non-tabular discount rate was 1.5 percent. The non-tabular discount is calculated using the selected non-tabular discount rate and the anticipated payout of the liabilities.

Excluding liabilities related to fiscal accident year 2014, the June 30, 2014, liabilities included $7,646,193,000 of discounted loss and loss adjustment expense liabilities discounted on a non-tabular basis at 1.5 percent.

The June 30, 2014, liabilities included $8,447,374,000 of reserves for benefits and $539,864,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $1,675,308,000; the reserve for defense and cost-containment expense was $37,267,000; and the reserve for adjusting and other expense was $19,426,000.

At June 30, 2013, liabilities included $8,066,986,000 of reserves for benefits and $529,165,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $1,466,550,000; the reserve for defense and cost-containment expense was $35,193,000; and the reserve for adjusting and other expense was $17,368,000.

Liabilities Discounted on a Non-Tabular Basis
June 30, 2014
(in thousands)

Fiscal Accident Year	Benefit & CAE Liabilities Net of Tabular and Gross of Non-Tabular Discount	Non-Tabular Discounts: Case	Non-Tabular Discounts: IBNR	Non-Tabular Discounts: DCC	Non-Tabular Discounts: AO	Benefit & CAE Liabilities Net of Tabular and Non-Tabular Discount
2004 & Prior	$ 2,559,487	$ -	$ 525,587	$ 11,034	$ 2,079	$ 2,020,787
2005	371,156	-	65,999	1,357	610	303,190
2006	450,810	-	75,538	1,569	823	372,880
2007	568,684	-	88,887	1,858	1,152	476,787
2008	719,733	-	109,431	2,303	1,518	606,481
2009	767,953	-	115,259	2,431	1,646	648,617
2010	788,243	-	116,046	2,492	1,714	667,991
2011	836,532	-	120,196	2,651	1,840	711,845
2012	970,874	-	135,583	3,104	2,140	830,047
2013	1,163,602	-	149,723	3,666	2,645	1,007,568
2014	1,522,165	-	173,059	4,802	3,259	1,341,045
Total	$ 10,719,239	$ -	$1,675,308	$ 37,267	$ 19,426	$ 8,987,238

Note 12 - Related Party Transactions

L&I administers the state's Workers' Compensation Program, including the Industrial Insurance Fund. It is an agency of the state of Washington; therefore, other Washington State agencies are related parties. Certain goods and services, such as attorney general legal services, information technology services, facilities management, building security, and cash and investment management services, are provided to L&I by other state agencies.

Total expenses incurred for goods and services provided by other Washington State agencies were $47,362,442 in fiscal year 2014 and $45,897,398 in fiscal year 2013. During fiscal year 2014 and 2013, 88.8 percent and 91.0 percent, respectively, of the total related party expenses were to the Attorney General's Office, the Department of Enterprise Services, and Consolidated Technology Services. Total amounts due to other state agencies were $6,218,924 and $6,415,981 at June 30, 2014 and 2013, respectively.

The Washington State Legislature and the Governor provide appropriation authority from the Industrial Insurance Fund for use by the following Washington State agencies:

- **Board of Industrial Insurance Appeals** - hears appeals of decisions made by L&I

- **University of Washington** - promotes health and minimizes occupational disease or injury through teaching, research, and service

- **Department of Health** - completes surveys and on-site investigations of farm worker housing

- **Health Care Authority** - assists with reviews to develop preferred prescription drug lists

- **Joint Legislative Audit and Review Committee** - performs a performance audit of the workers' compensation claims management system

Total operating expenses incurred by these agencies in the Industrial Insurance Fund were $25,740,586 in fiscal year 2014 and $26,048,136 in fiscal year 2013.

The Industrial Insurance Fund also transfers expenses and cash within the Accident, Medical Aid, and Pension Reserve Accounts, as well as the Supplemental Pension and Second Injury Accounts from the Workers' Compensation Program.

Note 13 - Income Taxes

The Industrial Insurance Fund is exempt from federal income tax under the Internal Revenue Service Code sections 115 and 501(c) (27).

Note 14 - Capital and Contingency Reserve

14.A. Capital

The Industrial Insurance Fund has no shares of stock authorized or outstanding.

14.B. Contingency Reserve

The contingency reserve represents net admitted assets available for financing ongoing operations and uncertainties not otherwise reserved. Changes in the contingency reserve are made up of investment and insurance operating results.

For fiscal years 2014 and 2013, changes in the contingency reserve resulted from the following:

Explanation of State Fund Operating and Investment Results
(in thousands)

	Fiscal Year 2014	Fiscal Year 2013
Contingency Reserve, July 1	$ 619,562	$ 590,139
Unexpected Investment Results		
Actual unrealized and realized gains (losses)		
Equities: unrealized gains	333,602	272,445
TIPS: unrealized gains (losses)	(136,291)	(6,316)
Bonds: unrealized gains (losses)	3,022	(88)
Equities: realized gains	41,213	13,345
Fixed income: realized gains	261,971	74,060
Total actual unrealized and realized gains	503,517	353,446
Less expected gains	(95,800)	(110,100)
Total Unexpected Investment Results	407,717	243,346
Insurance Operation Results		
Prior year loss favorable (unfavorable)	(249,493)	(254,184)
Reduction of non-pension discount rate	-	(65,553)
Premium adequacy	171,735	105,814
Total Insurance Operating Results	(77,758)	(213,923)
Change in contingency reserve	329,959	29,423
Contingency Reserve, June 30	$ 949,521	$ 619,562

The contingency reserve balances by account for fiscal years 2014 and 2013 were:

Contingency Reserve Balances by Account
(in thousands)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total
Contingency Reserve, June 30, 2014	$ 283,479	$ 666,042	$ -	$ 949,521
Contingency Reserve, June 30, 2013	$ 202,841	$ 416,721	$ -	$ 619,562

Note 15 - Asbestos and Environmental Reserves

Claims related to asbestos and hazardous chemicals or waste arise mainly as a result of the claimants' exposure at work and are covered by the Industrial Insurance Fund. There is not a large exposure, and it is not fundamentally different from any other injury due to exposure to hazardous materials in normal industrial activity. Case and IBNR reserves related to asbestos or environmental exposure claims are not specially reserved. IBNR and CAE reserves related to asbestos claims are included as part of benefit and CAE liabilities.

The table below shows a gross basis for the case reserves related to asbestos. L&I does not currently hold any reinsurance agreements.

Workers' Compensation
Asbestos Claims

	Fiscal Year 2014	Fiscal Year 2013
Beginning case reserve related to asbestos	$ 50,746,260	$ 49,298,040
Benefits incurred	6,831,078	8,452,858
Payments made	(7,037,359)	(7,004,638)
Ending case reserve related to asbestos	$ 50,539,979	$ 50,746,260

Note: Amounts are case reserves and do not include IBNR or CAE reserves.

Note 16 - Subsequent Events

For the annual Statutory Financial Information Report as of June 30, 2014, an analysis of subsequent events has been evaluated through the report issuance date of December 31, 2014. The event described below existed after June 30, 2014.

16.A. Proposed Rate Announcement

Each year, the Director of L&I adopts new workers' compensation insurance premium rates for the next calendar year. On September 16, 2014, the Director announced a proposed 1.8 percent increase in the average premium rate for 2015. The following four principles were used to guide the rate-setting process:

1. Set steady and predictable rate increases to help businesses plan ahead.
2. Benchmark rates against wage inflation (this happens automatically in other states).
3. Slowly rebuild the reserves to protect against unexpected changes.
4. Lower costs while focusing on better outcomes for injured workers.

The final rates will be adopted in early December 2014 and go into effect on January 1, 2015.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Supplementary Information

State of Washington Workers' Compensation Program - Basic Plan
Schedule of Claims Development Information
Fiscal Years 2005 through 2014
(in millions)

The table below illustrates how the Workers' Compensation Program Basic Plan's earned revenues (net of reinsurance) and investment revenues compare to the related costs of losses (net of loss assumed by reinsurers) and other expenses assumed by the program as of the end of each of the last ten fiscal years. The Workers' Compensation Program has not purchased reinsurance since September 30, 2002, and has never had a qualifying event that generated a recovery.

The rows of the table are defined as follows:

1. This line shows each fiscal year's earned contribution revenues and investment revenues.
2. This line shows the Basic Plan's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called fiscal accident year).
3. This section shows the cumulative amounts paid as of the end of successive years for each "fiscal accident year".
4. This section shows how each fiscal accident year's incurred claims increased or decreased as of the end of successive years. Annual re-estimation results from new information received on known claims, re-evaluation of existing information on known claims, and emergence of new claims not previously known.
5. This line compares the latest re-estimated incurred claims amount to the amount originally established (line 2) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and re-estimates is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature fiscal accident years.

The columns of the table show data for successive fiscal years.

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
1. Net earned required contribution and investment revenues	$ 2,452	$ 1,392	$ 2,406	$ 1,697	$ 1,692	$ 2,797	$ 2,525	$ 2,581	$ 1,928	$ 2,888
2. Estimated incurred claims and expenses, end of fiscal accident year	2,308	2,141	2,196	2,256	2,363	2,312	2,254	2,086	2,105	2,061
3. Paid (cumulative) as of:										
End of fiscal accident year	260	278	295	310	322	298	289	284	296	297
One year later	556	589	625	679	667	604	584	580	593	
Two years later	715	754	817	890	863	773	747	734		
Three years later	821	873	953	1,042	1,000	890	857			
Four years later	906	964	1,059	1,162	1,107	981				
Five years later	977	1,038	1,144	1,258	1,192					
Six years later	1,039	1,103	1,216	1,337						
Seven years later	1,094	1,159	1,281							
Eight years later	1,142	1,210								
Nine years later	1,186									
4. Re-estimated incurred claims and expenses:										
End of fiscal accident year	2,308	2,141	2,196	2,256	2,363	2,312	2,254	2,086	2,105	2,061
One year later	1,989	2,053	2,234	2,559	2,535	2,271	2,139	2,026	2,001	
Two years later	1,939	2,055	2,390	2,647	2,538	2,261	2,066	1,967		
Three years later	1,954	2,151	2,441	2,724	2,485	2,137	2,012			
Four years later	2,025	2,196	2,526	2,662	2,411	2,147				
Five years later	2,067	2,244	2,445	2,576	2,439					
Six years later	2,111	2,198	2,388	2,621						
Seven years later	2,056	2,186	2,419							
Eight years later	2,058	2,183								
Nine years later	2,050									
5. Increase (decrease) in estimated incurred claims and expenses from end of policy year	(258)	42	223	365	76	(165)	(242)	(119)	(104)	

Source: Washington State Department of Labor & Industries Actuarial Services

Supplemental Investment Risk Interrogatories
June 30, 2014

1. The Industrial Insurance Fund's total admitted assets as reported on page 27 of this annual Statutory Financial Information Report were $14,233,122,000 at June 30, 2014.

2. The following are the Industrial Insurance Fund's ten largest exposures to a single issuer/borrower/investment by investment category, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed as exempt in the Appendix to the SVO's *Practices and Procedures Manual* (ii) property occupied by the Industrial Insurance Fund, and (iii) policy loans:

	Amount	Percentage of Total Admitted Assets
Bonds - Freddie Mac	$ 848,839,000	5.96%
Bonds - Fannie Mae	420,039,000	2.95%
Bonds - Citibank Credit Card Issuance	152,930,000	1.07%
Bonds - JPMorgan Chase & Co	114,967,000	0.81%
Bonds - Citigroup Inc.	113,917,000	0.80%
Bonds - Trans-Canada Pipelines	106,660,000	0.75%
Bonds - Norfolk Southern Corp	105,394,000	0.74%
Bonds - Providence of British Columbia	99,988,000	0.70%
Bonds - Bank of Novia Scotia	99,958,000	0.70%
Bonds - Pepsico Inc.	94,813,000	0.67%

3. The Industrial Insurance Fund's total admitted assets held in bonds and preferred stocks, by NAIC designation, including bonds classified as short-term investments at June 30, 2014, were:

	Amount	Percentage of Total Admitted Assets
Bonds with an NAIC designation of 1	$ 8,044,475,000	56.52%
Bonds with an NAIC designation of 2	3,338,813,000	23.46%
Bonds with an NAIC designation of 3	258,362,000	1.82%
Bonds with an NAIC designation of 5	322,000	0.00%

4. Assets held in foreign investments:

   Assets held in foreign investments exceeded 2.5% of the Industrial Insurance Fund's total admitted assets.

Supplemental Investment Risk Interrogatories
June 30, 2014

Total admitted assets held in foreign investments at June 30, 2014:

Asset Type		Amount	Percentage of Total Admitted Assets
Bonds	$	3,257,269,000	22.89%
Equities		682,400,000	4.79%

Total admitted assets held in foreign investments in bonds by NAIC rating at June 30, 2014:

NAIC Designation		Amount	Percentage of Total Admitted Assets
Countries designated NAIC – 1	$	2,055,636,000	14.44%
Countries designated NAIC – 2		883,462,000	6.21%
Countries designated NAIC – 3		318,171,000	2.24%

Two countries with the largest foreign investment exposure in each NAIC designation at June 30, 2014:

Issuer	NAIC Designation		Amount	Percentage of Total Admitted Assets
Australia	1	$	417,728,000	2.93%
Cayman Islands	1		348,349,000	2.45%
Brazil	2		306,314,000	2.15%
Indonesia	2		134,151,000	0.94%
SupraNational	3 or below		309,291,000	2.17%
Costa Rica	3 or below		8,880,000	0.06%

Supplemental Investment Risk Interrogatories
June 30, 2014

Ten largest non-sovereign (i.e., non-governmental) investments held in foreign issues at June 30, 2014:

Issuer	NAIC Designation	Amount	Percentage of Total Admitted Assets
Vale Overseas Limited	2	$ 88,778,000	0.62%
National Australia Bank	1	64,991,000	0.46%
Siemens Financieringsmat	1	59,926,000	0.42%
Southern Copper Corp	2	57,295,000	0.40%
National Australia Bank Ltd	1	54,952,000	0.39%
State Grid Overseas Inv	1	54,306,000	0.38%
Aust & NZ Banking Group	1	53,976,000	0.38%
DBS Bank Ltd/Singapore	1	49,996,000	0.35%
Nomura Holding Inc	2	49,717,000	0.35%
Oderbrecht Finance Ltd	2	46,481,000	0.33%

	Amount	Percentage of Total Admitted Assets
5. Total admitted assets held in Canadian investments	$1,331,750,000	9.36%

6. The Industrial Insurance Fund had no investments with *contractual sales restrictions*, which are defined as “investments having restrictions that prevent investments from being sold within 90 days.”

7. The Industrial Insurance Fund’s admitted assets held in equity interests, including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests) and excluding money market and bond mutual funds listed in the Appendix to the SVO’s *Practices and Procedures Manual*, as exempt, or Class 1, were:

Fund	Amount	Percentage of Total Admitted Assets
Blackrock MSCI U.S. IMI Index	$ 1,138,631,000	8.00%
MSCI EAFE Index SL CTF	468,340,000	3.29%
MSCI Emerging Markets Free IND	136,287,000	0.96%
MSCI Small Cap Index (Provisio)	65,750,000	0.46%
Canada MSCI CTF	49,820,000	0.35%
MSCI Equity Index Fund	19,595,000	0.14%
MSCI Canada Small Cap	8,412,000	0.06%

Assets held in equity interest exceeded 2.5% of the Industrial Insurance Fund’s total admitted assets.

Supplemental Investment Risk Interrogatories
June 30, 2014

8. The Industrial Insurance Fund did not hold any non-affiliated, privately-placed equities under Securities Exchange Commission (SEC) Rule 144a or SEC Rule 144 without volume restrictions.

9. The Industrial Insurance Fund did not hold general partnership interests.

10. The Industrial Insurance Fund did not own any mortgage loans.

11. The Industrial Insurance Fund did not have any individual parcels or groups of contiguous parcels of real estate.

12. The Industrial Insurance Fund held no investments in mezzanine real estate loans.

13. The Industrial Insurance Fund did not have admitted assets subject to repurchase agreements, reverse repurchase agreements, dollar repurchase agreements or dollar reverse repurchase agreements at June 30, 2014.

14. The Industrial Insurance Fund did not own any warrants not attached to other financial instruments, options, caps, or floors at June 30, 2014.

15. The Industrial Insurance Fund did not have any exposure for collars, swaps, or forwards during fiscal year 2014.

16. The Industrial Insurance Fund did not have any potential exposure for futures contracts during fiscal year 2014.

Summary Investment Schedule
June 30, 2014

The Industrial Insurance Fund held cash and invested assets as of June 30, 2014, consisting of the following:

	Gross investment holding		Admitted assets as reported in the annual statement			
	Amount	Percentage	Amount	Securities Lending Reinvested Collateral Amount	Total Amount	Percentage
Bonds						
U.S. Treasury securities	$ 1,055,063,000	7.71%	$ 1,055,063,000	$ -	$ 1,055,063,000	7.71%
Foreign government (including Canada, excluding mortgage-backed securities)	1,346,981,000	9.84%	1,346,981,000	-	1,346,981,000	9.84%
Mortgage-backed securities (includes residential and commercial mortgage-backed securities)						
Issued or guaranteed by GNMA	74,993,000	0.55%	74,993,000	-	74,993,000	0.55%
Issued or guaranteed by FNMA, FHLMC	1,272,725,000	9.30%	1,272,725,000	-	1,272,725,000	9.30%
Issued or guaranteed by all other	395,819,000	2.89%	395,819,000	-	395,819,000	2.89%
Other fixed income securities (excluding short-term)						
Unaffiliated domestic securities	4,047,897,000	29.57%	4,047,897,000	-	4,047,897,000	29.57%
Unaffiliated foreign securities	3,183,896,000	23.25%	3,183,896,000	-	3,183,896,000	23.25%
Equity interests						
Commingled index funds - domestic	1,138,631,000	8.32%	1,138,631,000	-	1,138,631,000	8.32%
Commingled index funds - foreign	748,205,000	5.46%	748,205,000	-	748,205,000	5.46%
Receivables for securities and interest	147,875,000	1.08%	147,875,000	-	147,875,000	1.08%
Cash and cash equivalents	10,300,000	0.08%	10,300,000	3,216,000	13,516,000	0.10%
Securities lending collateral	4,354,000	0.03%	-	-	-	0.00%
Short-term investments	264,598,000	1.92%	264,598,000	1,138,000	265,736,000	1.93%
Total	$ 13,691,337,000	100.00%	$ 13,686,983,000	$ 4,354,000	$ 13,691,337,000	100.00%

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Independent Actuarial Opinion

Deloitte.

Deloitte Consulting LLP
350 South Grand Avenue
Suite 200
Los Angeles, California 90071-3462
USA

Tel: + 1 213 688 0800
Fax: + 1 213 688 0100
www.deloitte.com

October 3, 2014

Statement of Actuarial Opinion

State of Washington – Industrial Insurance Fund

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am a Member of the American Academy of Actuaries and meet its qualification standards for rendering this Statement of Actuarial Opinion, and I am a Fellow of the Casualty Actuarial Society. I was appointed by the Washington State Auditors' Office to provide a Statement of Actuarial Opinion regarding the reasonableness of the State of Washington Industrial Insurance Fund's ("the Fund") carried loss and loss adjustment expense ("LAE") reserves as of June 30, 2014.

The Fund is comprised of three Workers' Compensation Program Accounts: the Accident Account, the Medical Aid Account, and the Pension Reserve Account. The Fund is currently administered by the State of Washington Department of Labor & Industries ("the Department").

Scope

I have examined the reserves listed in Exhibit A: Scope, as shown in the Fund's Statutory Financial Information Report, as of June 30, 2014. The loss and loss adjustment expense reserves specified in Exhibit A, on which I am expressing an opinion, reflect the Loss Reserve Disclosure items (8 thru 10) listed in Exhibit B.

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data provided by Mr. William Vasek, the Department's Chief Actuary, his actuarial staff, and Sharon Elias, the Department's Financial Services Program Manager. I evaluated that data for reasonableness and consistency. My examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.

My review was limited to items listed in Exhibit A, and did not include an analysis of any other balance sheet items. I have not examined the Fund's assets and I have formed no opinion as to the validity or value of these assets.

Opinion

In my opinion, the amounts carried in Exhibit A on account of the items identified:

(A) meet the requirements of the insurance laws of the State of Washington.

(B) are consistent with reserves computed in accordance with accepted loss reserving standards and principles.

(C) make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Fund under the terms of its contracts and agreements.

Relevant Comments

A. Risk of Material Adverse Deviation

I have identified the major risk factors for the Fund as the lack of diversity of exposure by line of business and by state, future medical trend, the discounting of the reserves, reserve leverage, and future cost of living adjustments. The potential impact of these risk factors is described in the following paragraphs. The absence of other risk factors from this listing does not imply that additional factors will not be identified in the future as having been a significant influence on the Fund's reserves.

By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Fund's loss and loss adjustment expense reserves. Such trends would include legislative benefit level changes and adverse decisions or interpretations of law that may have an effect on all open workers' compensation claims.

A major assumption in the analysis of the medical component of the workers' compensation reserves is the selection of a long-term medical trend factor to apply to future calendar year medical payments. Estimating medical trend has become increasingly difficult in recent years because it has been highly variable. In my opinion, there is a higher than normal degree of variability associated with the Fund's medical loss reserves due to the uncertainty surrounding future medical trends and the expected length of medical payments.

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money using an average annual interest rate of 3.61%. Changes to the interest rate used for discounting could result in material changes to the reserves.

The Fund defines its "Contingency Reserve" as the difference between its assets and liabilities. Other insurance companies typically refer to this Contingency Reserve as Statutory Surplus. Due to the size of the Fund's Contingency Reserve, $949.5 million, relative to the size of its loss and loss adjustment expense reserve, $12.9 billion, any small changes in reserves will have a material impact on the Contingency Reserve. The current reserve leverage ratio (reserve / contingency reserve) is significantly higher than the majority of workers' compensation carriers in the industry and workers' compensation funds in other states.

An implicit assumption in the Department's actuarial review is that the State of Washington cost of living adjustments will be similar to cost of living adjustments approved by the Federal Government for Social Security retirement benefits. Future State of Washington cost of living adjustments that vary significantly from those approved by the Federal Government for Social Security retirement benefits could result in a material change in future costs and the adequacy of the reserves, especially for the Pension Reserve Account.

With respect to this Statement of Actuarial Opinion, the amount of adverse deviation that I consider to be material is $189.9 million. My basis for determining this amount is 20% of the Contingency Reserve, which is an amount that would represent a reasonable upward fluctuation in loss and loss adjustment expense reserves from those carried by the Fund that would be material to the Contingency Reserve. At this time, my assessment is that the Fund does have a significant risk of a material adverse deviation.

My materiality standard was selected based on the context in which this opinion letter will be used. It is prepared solely to assess the reasonableness of the Fund's loss and loss adjustment expense reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

B. Other Disclosures in Exhibit B

Underwriting Pools or Associations

The Fund participates in the Washington United States Longshore and Harbor Workers' Compensation Act Assigned Risk Plan ("WARP") which was established to provide USL&H workers' compensation insurance coverage for employers unable to purchase it through the normal private insurance market. The Fund pays assessments to WARP and participates in any underwriting losses or surpluses incurred by WARP. Based on discussions with the Department, we understand that WARP is not currently in a deficit position. Therefore, the Fund has not booked a reserve to account for any unpaid claim liability related to WARP.

We understand that the Fund does not participate in any other voluntary or involuntary pools.

Asbestos Exposures and Environmental Exposures

I have reviewed the Fund's exposure to asbestos and environmental claims. In my opinion, the chance of material liability related to asbestos and environmental claims is remote. The Fund has not provided coverage that could reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.

Disclosure of Unearned Premium Reserves for Long Duration Contracts

The Fund does not write single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase.

Reinsurance

The Fund has no ceded or assumed reinsurance. Based on discussions with the Department's management and their description of the Fund's ceded (and/or assumed) reinsurance, I am not aware of any reinsurance contract that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.

Discounting

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money. The amount of discount is based on an actuarially derived projected payment pattern and selected annual interest rates as follows.

- For the Medical Aid Account, the Department's selected interest rate is 1.5%.
- For the Pension Reserve Account, the Department's selected interest rate is 6.5%.
- For the Accident Account, combinations of interest rates are used to discount the reserves. The future total permanent disability transfers made to the Pension Account assume interest discounts based on an annual rate of 6.5% that is gradually reduced each calendar quarter for the next eight to nine years until settling on a long term annual rate of 4.5%. The future fatal transfers made to the Pension Account assume interest discounts based on an annual rate of 6.5%. The actual transfer payments and all other payments are discounted using a Department selected rate of 1.5%.

The average combined interest rate for the Fund is approximately 3.61% with a total discount amount of $7.5 billion. The interest rates were selected by the Department, and I make no opinion regarding the appropriateness of the selected rates. The interest rate used to discount the Accident Account future total permanent disability transfers made to the Pension Account changed from 6.5% last year to the interest rates that gradually decrease to 4.5% discussed above. The interest rate used to discount the Accident Account future fatal transfers made to the Pension Account remained at 6.5% this year. The interest rate used for all other future payments remained the same this year at 1.5%. The effect of reducing the interest rate assumptions this year was an increase in the discounted unpaid claim liability of $199.8 million including the current fiscal accident year.

Major Assumption Changes

Over the past year, the Department has reduced its estimate of the number of total permanent disability claims for accident periods prior to June 30, 2013. The reduction was the result of the closing of more of the active time loss claims than was expected over the past year and using more recent averages in the selection of claim development factors to reflect more recent history. The effect of reducing this estimate was a decrease in the discounted unpaid claim liability of approximately $157.8 million.

Last year, the Department treated time loss claims open beyond 13 years as total permanent disability claims even though the transfer to the Pension Reserve Account had not actually occurred. The argument was that claims receiving time loss benefits for more than 13 years would eventually turn into pension claims. This year, the Department moved this assumption from 13 years to 30 years. The change does not theoretically change the estimate of future undiscounted payments but it does affect the interest used to discount the reserve for payments occurring between 13 years and 30 years. Last year, the Department used a 1.5% interest rate to discount the time loss payments made in the first 13 years and a 6.5% interest rate for payments made thereafter (treating them like total permanent disability transfer). This year, the Department used a 1.5% interest rate to discount the reserves for time loss payments made in the first 30 years and a 4.5% interest rate for payments made thereafter. This change in approach increased the discounted unpaid claim liability in the Accident Account by $101.6 million.

C. General Uncertainty

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss adjustment expense, it is necessary to project future loss and loss adjustment expense payments. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. No warranty is expressed or implied that such variance will not occur.

Further, my projections make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Fund's historical data base or which are not yet quantifiable.

Actuarial Report

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the Department to be retained for a period of seven years in its administrative offices and available for regulatory examination.

This Statement of Opinion is solely for the use of assessing the reasonableness of the loss and LAE reserves and is only to be relied upon by the Fund and the State.

Rod Morris

Rod Morris, FCAS, MAAA
Deloitte Consulting LLP
350 South Grand Avenue, Suite 200
Los Angeles, CA 90071
(213) 688-3374
rmorris@deloitte.com
October 3, 2014

Statement of Actuarial Opinion – Year Ended June 30, 2014

State of Washington Industrial Insurance Fund

Exhibit A: SCOPE

Loss Reserves:	**Amount**
A. Net of Reinsurance Reserve for Unpaid Losses	$12,372,673,000
B. Net of Reinsurance Reserve for Unpaid Loss Adjustment Expenses	$ 539,864,000
Total Net Loss and Loss Adjustment Expenses Reserves	$12,912,537,000
C. Reserve of Unpaid Losses – Direct and Assumed	$12,372,673,000
D. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed	$ 539,864,000
Total Gross Loss and Loss Adjustment Expense Reserves	$12,912,537,000
E. Retroactive Reinsurance Reserve Assumed	$0
F. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion	$0
Premium Reserves:	
G. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	$0
H. Reserve for Net Unearned Premiums for Long Duration Contracts	$0
I. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion	$0

Statement of Actuarial Opinion – Year Ended June 30, 2014

State of Washington Industrial Insurance Fund

Exhibit B: DISCLOSURES

Item:	**Column 1**	**Column 2**	**Column 3**	**Column 4**
1. **Name of Appointed Actuary**		**Last** Morris	**First** Rodney	**Middle** Scott
2. **The Appointed Actuary's Relationship to the Company.** Enter E or C based upon the following: E if an Employee, C if a Consultant			**C**	
3. **The Appointed Actuary is a Qualified Actuary based upon what qualification?** Enter F, A, M, or O based upon the following: **F** if a Fellow of the Casualty Actuarial Society (FCAS) **A** if an Associate of the Casualty Actuarial Society (ACAS) **M** if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries approved by the Casualty Practice Council, as documented with the attached approval letter. **O** for Other			**F**	
4. **Type of Opinion, as identified in the OPINION** paragraph. Enter R, I, E, Q, or N based upon the following: **R** if reasonable **I** if Inadequate or Deficient Provision **E** if Excessive or Redundant Provision **Q** if Qualified. Use Q when part of the OPINION is Qualified. **N** if No Opinion			**R**	
5. **Materiality Standard expressed in $US** (Used to answer Question #6.)	$189,904,200			
6. Is there a Significant Risk of Material Adverse Deviation? YES or NO				YES [X] NO [ ]
7. **Statutory Surplus (Contingency Reserve)**	$949,521,000			

State of Washington Industrial Insurance Fund

Exhibit B: DISCLOSURES

Item:	**Column 1**	**Column 2**	**Column 3**	**Column 4**
8. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P				
8.1 Non-tabular Discount	$1,732,001,000			
8.2 Tabular Discount	$5,721,918,000			
9. The net reserves for losses and expenses for the Company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.	n/a			
9. The total claims made extended loss and expense reserve (Schedule P Interrogatories)				
9.1 Amount reported as loss reserves	n/a			
9.2 Amount reported as unearned premium reserves	n/a			
10. Other items on which the Appointed Actuary is providing Relevant Comments	n/a			

State of Washington Industrial Insurance Fund
Statutory Financial Information Report

Other formats for persons with disabilities are available on request.
Call 1-800-547-8367. TDD users, call 360-902-5797.
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