SAIF Corporation

Financial Statements as of and for the Years Ended December 31, 2005 and 2004, and Independent Auditors' Report

Secretary of State Audits Division Report No. 2006-31

SAIF CORPORATION

TABLE OF CONTENTS

OVERVIEW OF SAIF CORPORATION FINANCIAL REPORTING
(Prepared by SAIF Corporation)

SAIF Corporation is a public corporation created by an act of the Oregon Legislature. It traces its origins to 1914 when its predecessor organization commenced business.

SAIF is an insurance company authorized to write workers' compensation coverage in Oregon and is a servicing carrier for accounts in the assigned risk pool. SAIF also provides coverage governed by the Longshoremen's and Harbor Workers' Compensation Act, Jones Act and Federal Employers Liability Law.

SAIF Corporation prepares financial statements in conformity with statutory accounting practices, which are prescribed for use in reporting accounting transactions for insurance companies. These practices arise from state laws and from rules adopted by the State Insurance Commissioner and, for Oregon, are the practices promulgated by the National Association of Insurance Commissioners ("NAIC"). Statutory accounting practices are conservative in nature and are designed to protect policyholders and claimants to ensure that, in the event of liquidation, sufficient amounts will have been set aside to provide for the outstanding claims of injured workers and their dependants, whereas generally accepted accounting principles ("GAAP") are based on the going-concern concept and recognizes revenue when earned and expenses when incurred.

At the request of the Oregon Secretary of State's Audits Division, SAIF has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. As a component unit of the State of Oregon, SAIF is subject to the pronouncements of the Governmental Accounting Standards Board. Under accounting principles generally accepted in the United States of America as applied to governmental entities, SAIF accounts for its activities as an enterprise fund. Accordingly, SAIF follows the accrual basis of accounting. Revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

There are significant differences between the statutory statements which SAIF prepares for regulatory and management purposes and the accompanying financial statements. They include:

- Statutory accounting requires the majority of invested assets to be recorded at amortized cost, whereas investments are stated at fair value in the accompanying statements with the corresponding change in the fair value for the year recorded as investment income

- Statutory accounting does not allow the accrual of policyholder dividends until declared by the Board of Directors. Generally accepted accounting principles require the accrual of estimated policyholder dividends

- Cash collateral and collateral due to borrowers for securities lending activity are reflected on the accompanying balance sheet. Statutory accounting does not require the reporting of such items as assets and liabilities

- Acquisition costs, such as commissions and other costs related to acquiring new business, are expensed as incurred for statutory accounting, while under GAAP, they are deferred and amortized to income as premiums are earned or in relation to estimated gross profits

- Statutory accounting requires that certain assets not readily available for the payment of claims be "non-admitted" and removed from the balance sheet. Those assets, such as property and equipment are included on the GAAP financial statements.

Deloitte.

Deloitte & Touche LLP
Suite 3900
111 SW Fifth Avenue
Portland, OR 97204-3642
USA

Tel: +1 503 222 1341
Fax: +1 503 224 2172
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
SAIF Corporation:

To the Secretary of State Audits Division of
the State of Oregon:

We have audited the accompanying balance sheets of SAIF Corporation ("SAIF"), a component of the State of Oregon, as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in fund equity and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SAIF's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of SAIF as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis that precedes the financial statements is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of SAIF's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 22, 2005, on our consideration of SAIF's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

August 22, 2006

SAIF CORPORATION
Management Discussion and Analysis
Unaudited

Management of SAIF Corporation provides Management's Discussion and Analysis for readers of the Company's financial statements and for inclusion in the State of Oregon Comprehensive Annual Financial Report. This narrative overview and analysis of the financial activities of SAIF Corporation is for the calendar years ended December 31, 2005 and 2004. Readers are encouraged to consider this information in conjunction with the Company's financial statements and footnote disclosures that follow.

Overview

SAIF Corporation is a public corporation created by an act of the Oregon Legislature. It traces its origins to 1914 when its predecessor organization commenced business.

SAIF is an insurance company authorized to write workers' compensation coverage in Oregon and is a servicing carrier for accounts in the assigned risk pool. SAIF also provides coverage governed by the Longshoremen's and Harbor Workers' Compensation Act, Jones Act and Federal Employers Liability Law.

SAIF Corporation prepares financial statements in conformity with statutory accounting practices, which are prescribed for use in reporting accounting transactions for insurance companies. At the request of the Oregon Secretary of State's Audits Division, SAIF has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. As a component unit of the State of Oregon, SAIF is subject to the pronouncements of the Governmental Accounting Standards Board. Under accounting principles generally accepted in the United States of America as applied to governmental entities, SAIF accounts for its activities as an enterprise fund.

The Corporation's Board of Directors is appointed by the Governor of the State and consists of Oregon business and community leaders, three of which represent SAIF policyholders, not otherwise in the employ of the Company. The statutory charter of SAIF Corporation is "to make insurance available to as many Oregon employers as inexpensively as may be consistent with the overall integrity of the Industrial Accident Fund... and sound principles of insurance." ORS 656.752.

SAIF fulfills its charter by continuing to make workers' compensation insurance available to a greater number of policyholders at a lower premium rate. The Company's market share, based on written premium in the State of Oregon, increased from 44.3% for 2004 to 46.1% for 2005. Rising medical cost continued to be a challenge faced during the year.

Condensed Financial Information
(In thousands)
(Unaudited)

	December 31, 2005	December 31, 2004	Increase (Decrease)
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	$ 40,376	$ 243,988	$ (203,612)
Investments	3,153,767	2,790,555	363,212
Securities lending cash collateral	684,232	800,101	(115,869)
Accounts and interest receivable, net	211,129	184,807	26,322
Receivable for securities sold	262	6,682	(6,420)
Other assets	1,704	1,381	323
Total current assets	4,091,470	4,027,514	63,956
NONCURRENT ASSETS—Land, buildings, property, and equipment	20,927	22,485	(1,558)
TOTAL ASSETS	$ 4,112,397	$ 4,049,999	$ 62,398
LIABILITIES AND FUND EQUITY			
CURRENT LIABILITIES:			
Reserve for loss and loss adjustment expenses	$ 214,223	$ 202,011	$ 12,212
Unearned premiums	67,743	60,768	6,975
Accounts and interest payable	35,443	33,550	1,893
Due to brokers for security purchases	1,921	1,163	758
Obligations under securities lending	684,232	800,101	(115,869)
Other liabilities and deposits	53,669	46,670	6,999
Total current liabilities	1,057,231	1,144,263	(87,032)
NONCURRENT LIABILITIES:			
Reserve for loss and loss adjustment expenses	2,373,782	2,344,082	29,700
Other noncurrent liabilities	1,247		1,247
Total noncurrent liabilities	2,375,029	2,344,082	30,947
Total liabilities	3,432,260	3,488,345	(56,085)
FUND EQUITY	680,137	561,654	118,483
TOTAL LIABILITIES AND FUND EQUITY	$ 4,112,397	$ 4,049,999	$ 62,398

	December 31, 2005	December 31, 2004	Increase (Decrease)
OPERATING REVENUES:			
Net premiums earned	$413,172	$373,520	$ 39,652
Net investment income	114,370	173,280	(58,910)
Other income	30,315	27,996	2,319
Total operating revenues	557,857	574,796	(16,939)
OPERATING EXPENSES:			
Loss and loss adjustment expenses incurred	342,473	477,133	(134,660)
Policyholders' dividends		5	(5)
Underwriting expenses	95,313	90,699	4,614
Other expenses	1,588	3,020	(1,432)
Total operating expenses	439,374	570,857	(131,483)
OPERATING GAIN	$118,483	$ 3,939	$ 114,544
FUND EQUITY—Beginning of year	561,654	557,715	3,939
FUND EQUITY—End of year	$680,137	$561,654	$ 118,483

The unaudited condensed financial information shown above is derived from the audited financial statements for the years ended December 31, 2005 and 2004 included herein.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Position

At the end of 2005, total assets were $62.4 million greater than the prior year. Total liabilities decreased $56.1 million for the year, while fund equity increased $118.5 million.

Significant changes include:

Cash and Cash Equivalents—The majority of the Company's cash accounts are made up of short-term investments and funds utilized by external investment managers. Cash and cash equivalents may fluctuate significantly from period to period as the investment managers trade securities or anticipate changing market conditions. At the end of 2004, short-term investments totaled $12.3 million, and a bond manager had $193.1 million invested in cash equivalents. At the end of 2005, short-term investments totaled $4.3 million, and a bond manager had $10.8 million invested in cash equivalents.

Investments—At the end of 2005, investments were $363.2 million greater than the end of 2004. The increase was primarily due to an increase of $243.7 million in bond investments and a $120.1 million increase in equity investments. The increase occurred because of a significant reduction in cash, cash equivalents, and short-term holdings and a reduction in receivable for securities with proceeds rolling into the bond and equity portfolios. Another item that influenced the increase in investments was premium growth. The bond market was not as strong in 2005 as it was in 2004. The market value adjustment made to the bond holdings was $53.8 million less than the amount recorded for 2004. The equity market continued to perform well. The market value adjustment made to the equity holdings was $26.9 million more in 2005 than in 2004. The Company's BGI Russell 3000 index holdings had a positive return of 6.8% for the year.

SAIF implemented a new asset allocation policy in 2005, eliminating the Company's position in convertible securities and increasing bond duration. At the end of 2005, SAIF's asset allocation was in compliance with the asset allocation policy adopted by the Oregon Investment Council.

Securities Lending Cash Collateral—This line item can fluctuate significantly from period to period depending on the amount of investment securities on loan. The amount of securities on loan will vary depending on market conditions and the demand for certain securities in our portfolio.

Accounts and Interest Receivable—The amount of premium due to SAIF increased in 2005 primarily because of an increase in SAIF's book of business and because of increased amounts due on retrospectively rated policies. During 2005, direct earned premium for SAIF increased 9.9%. Premiums due on retrospectively rated policies increased approximately $6.2 million because of premium growth in individual retrospectively rated plans and increased claims costs, primarily for the State of Oregon retrospectively rated plans.

Accrued investment income increased significantly due to the increase in the bond portfolio and improving bond yields. The reinsurance recoverable on paid losses balance increased during 2005 due to the $2.25 million commutation of a 1993 reinsurance treaty. Other receivables amounts increased in 2005 primarily because of a large bad debt write-off in 2004.

Receivable for Securities Sold—The amount receivable for securities sold at the end of 2005 was $6.4 million less than the prior year due to a decrease in pending security trade settlements at year-end 2005.

Other Assets—The amount reported for other assets increased 23.3% because of an increase in the amount of deferred acquisition costs. Growth in premium increased the estimate of deferred agent commissions.

Reserve for Loss and Loss Adjustment Expenses—Loss reserves increased $33.4 million or 1.5% during 2005 and loss adjustment expense reserves increased $8.5 million or 2.7%. The increase in reserves was due to continued growth in the book of business.

Several loss reserve assumptions were refined which produced both favorable and unfavorable loss reserve development. There was a significant amount of favorable loss reserve development for the prior accident years. The favorable development can be attributed to changing the future medical cost escalation rate assumption from a flat 9.2% to 10% for the first three years after the accident date, followed by 8.5% per year thereafter to reflect current estimates for the expected future medical payments. This change resulted in favorable loss reserve development of approximately $128.0 million. SAIF also lowered the permanent total disability ("PTD") frequency rate from 0.09% to 0.08% of all disabling claims, which lowered loss reserves by about $19.3 million at year-end 2005. This was offset by unfavorable development of $14.2 million due primarily to higher PPD tail factors.

Loss adjustment expense also increased due to growth in our book of business. Offsetting this growth was favorable development of approximately $14.3 million for prior accident years. The cost of managing the claims function increased less than anticipated due to improved productivity resulting from the medical billing system that was installed at the end of 2004.

Unearned Premiums—The amount of unearned premium for 2005 increased $7.0 million or 11.5% because of the increase in premium due and earned premium noted above.

Accounts and Interest Payable—The increase in this line item is due primarily to an increase in the payable due to the National Workers' Compensation Reinsurance Pool.

Due to Brokers for Security Purchases—The amount payable for pending settlement of investment purchases can fluctuate significantly from period to period depending on the amount of investment activity near the end of the period.

Obligations Under Securities Lending—This line item can fluctuate significantly from period to period depending on the amount of investment securities on loan. The amount of securities on loan will vary depending on market conditions and the demand for certain securities in our portfolio.

Other Liabilities and Deposits—The increase in this line item is due primarily to an increase in the estimated amount of return premium payable on retrospective rated policies. The increase is due primarily to favorable loss development experience for one large retrospectively rated group plan.

Operations

Significant changes in revenues and expenses includes:

Net Premiums Earned—Net premium earned for 2005 was $39.7 million or 10.6% greater than 2004. New sales were $28.3 million (standard premium) for the year compared to competitive losses of $15.8 million and non-renewals of $2.8 million (does not include mid-term cancellations). The retention rate for 2005 was 95.9%. Also, as SAIF continues to write more business with greater risk, the average weighted rate tier of the total book of business continues to increase and produce higher premium amounts.

The growth in premium for 2005 slowed somewhat compared to the growth experienced during 2004 when net earned premiums increased 19.7%. Part of the slow down in growth was due to the loss of a large account with national exposure at the start of the year, which had standard premium of approximately $8.7 million. Another contributing factor to the slower growth rate was improving results for a large retrospectively rated group plan.

Net Investment Income—Investment income for 2005 was $58.9 million less than the amount recorded for 2004 because of a reduction in the market value adjustment for invested assets. Unrealized gains recorded for 2005 were $45.4 million less than the unrealized gains recorded for 2004.

Loss and Loss Adjustment Expenses Incurred—Losses incurred for 2005 decreased over 2004 because the change in direct loss reserves was $237.5 million greater in 2004 than in 2005. Incurred loss adjustment expenses for 2005 were $40.5 million more than 2004 because of the significant reduction of loss adjustment expense reserves in 2004.

Policyholders' Dividends—No dividends were declared in 2005. In 2004, undeliverable dividends were turned over to the Oregon Department of State Lands.

Underwriting Expense—This line increased because of growth in premium assessment and commission expenses associated with the growth in premium income and general operating expense increases.

Other Expenses—The decrease in this line is due to less bad-debt expenses in 2005 than in 2004.

Other Required Supplementary Information

At less than 1% of total assets, SAIF's capital assets are minimal, consisting of office buildings primarily occupied by the Company and computer and office equipment. There were no significant changes in capital assets during the year. There are no significant commitments outstanding for capital assets.

Other than accounts payable and amounts due for investment purchases, SAIF has no debt and there are no plans to issue debt.

SAIF develops an annual operating budget for planning and control purposes. It is reviewed and approved by the Board of Directors and monitored closely by management and the Board.

SAIF CORPORATION

BALANCE SHEETS
AS OF DECEMBER 31, 2005 AND 2004
(In thousands)

	2005	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 40,376	$ 243,988
Investments	3,153,767	2,790,555
Securities lending cash collateral	684,232	800,101
Accounts and interest receivable, net	211,129	184,807
Receivable for securities sold	262	6,682
Other assets	1,704	1,381
Total current assets	4,091,470	4,027,514
NONCURRENT ASSETS:		
Land	2,922	2,922
Buildings, property, and equipment	45,687	46,422
Less accumulated depreciation and amortization	(27,682)	(26,859)
Total noncurrent assets	20,927	22,485
TOTAL	$4,112,397	$4,049,999
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES:		
Reserve for loss and loss adjustment expenses	$ 214,223	$ 202,011
Unearned premiums	67,743	60,768
Accounts and interest payable	35,443	33,550
Due to brokers for security purchases	1,921	1,163
Obligations under securities lending	684,232	800,101
Due to other governments	5,070	5,326
Other liabilities and deposits	45,800	38,658
Compensated absences payable	2,799	2,686
Total current liabilities	1,057,231	1,144,263
NONCURRENT LIABILITIES:		
Reserve for loss and loss adjustment expenses	2,373,782	2,344,082
Other noncurrent liabilities	1,247	
Total noncurrent liabilities	2,375,029	2,344,082
Total liabilities	3,432,260	3,488,345
FUND EQUITY:		
Invested in capital assets	20,927	22,485
Restricted for workers' compensation	659,210	539,169
Total fund equity	680,137	561,654
TOTAL	$4,112,397	$4,049,999

See notes to financial statements.

SAIF CORPORATION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND EQUITY FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(In thousands)

	2005	2004
OPERATING REVENUES:		
Net premiums earned	$413,172	$373,520
Net investment income	114,370	173,280
Other income	30,315	27,996
Total operating revenues	557,857	574,796
OPERATING EXPENSES:		
Loss and loss adjustment expenses incurred	342,473	477,133
Policyholders' dividends		5
Underwriting expenses	95,313	90,699
Other expenses	1,588	3,020
Total operating expenses	439,374	570,857
OPERATING GAIN	118,483	3,939
FUND EQUITY—Beginning of year	561,654	557,715
FUND EQUITY—End of year	$680,137	$561,654

See notes to financial statements.

SAIF CORPORATION

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(In thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Premiums collected net of reinsurance	$ 415,017	$ 361,078
Loss and loss adjustment expenses paid	(300,561)	(269,838)
Underwriting expenses paid	(95,313)	(90,700)
Policyholder dividends paid		(5)
Other receipts	26,287	27,871
Net cash provided by operating activities	45,430	28,406
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(5,412,374)	(3,023,742)
Proceeds from sales and maturities of investments	5,043,103	3,008,302
Interest received on investments and cash balances	119,410	115,613
Interest income received from securities lending	21,621	8,751
Interest expense paid for securities lending	(20,295)	(7,910)
Net cash provided by (used in) investing activities	(248,535)	101,014
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(553)	(1,777)
Proceeds from disposition of capital assets	46	118
Net cash used in capital and related financing activities	(507)	(1,659)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(203,612)	127,761
CASH AND CASH EQUIVALENTS—Beginning of year	243,988	116,227
CASH AND CASH EQUIVALENTS—End of year	$ 40,376	$ 243,988

(Continued)

SAIF CORPORATION

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(In thousands)

	2005	2004
RECONCILIATION OF OPERATING GAIN TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating gain	$ 118,483	$ 3,939
Adjustments to reconcile operating gain to net cash provided by operating activities:		
Depreciation and amortization	2,030	2,230
Bad debt expense	1,588	2,499
Investment income reported as operating revenue	(114,370)	(173,280)
Net changes in assets and liabilities:		
Accounts and interest receivable—net	(21,004)	(18,566)
Other assets	(323)	(394)
Reserve for loss and loss adjustment expenses	41,912	207,295
Unearned premiums	6,975	6,990
Accounts and interest payable	3,140	(2,722)
Due to other governments	(256)	537
Other liabilities and deposits	7,142	350
Compensated absences payable	113	(472)
Total adjustments	(73,053)	24,467
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 45,430	$ 28,406
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES—Investments acquired through conversions and tax free exchange transactions	$ 75,097	$ 64,324

See notes to financial statements.

(Concluded)

SAIF CORPORATION

NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

1. DESCRIPTION OF BUSINESS & REGULATORY ENVIRONMENT

SAIF Corporation ("SAIF") is a public corporation created by an act of the Oregon Legislature. It traces its origins to 1914, when its predecessor organization commenced business.

SAIF is an insurance company authorized to write workers' compensation coverage in Oregon and is a servicing carrier for accounts in the assigned risk pool. SAIF also provides coverage governed by the Longshoremen's and Harbor Workers' Compensation Act, Jones Act and Federal Employers Liability Law. SAIF's Board of Directors is appointed by the Governor of the State of Oregon (the "State") and consists of Oregon business and community leaders, not otherwise in the employ of SAIF.

SAIF writes business on a direct basis and through agents. Premiums written on a direct basis were 29.7% and 29.3% of standard premium during 2005 and 2004, respectively.

The State of Oregon, Department of Consumer and Business Services ("DCBS") enforces workers' compensation laws under Oregon Revised Statutes ("ORS"). Under the reporting requirements of the DCBS, Insurance Division, SAIF is subject to Risk Based Capital ("RBC") reporting requirements of the National Association of Insurance Commissioners' ("NAIC"), which establishes that certain amounts of capital and surplus be maintained. SAIF's RBC calculated minimum capital and surplus amount on the statutory basis of accounting is $265.9 million and $318.1 million at December 31, 2005 and 2004, respectively. At December 31, 2005 and 2004, the statutory capital and surplus of SAIF exceeded the minimum RBC requirements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—At the request of the Oregon Secretary of State's Audits Division, SAIF has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America for governmental entities. As a component unit of the State of Oregon, SAIF is subject to the pronouncements of the Governmental Accounting Standards Board ("GASB"). Under accounting principles generally accepted in the United States of America as applied to governmental entities, SAIF accounts for its activities as an enterprise fund. Accordingly, SAIF follows the accrual basis of accounting. Revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, SAIF only follows Statements of the Financial Accounting Standards Board issued prior to November 30, 1989.

Investments—SAIF reports certain investments at fair value in the balance sheet and recognizes the corresponding change in the fair value of investments in the year in which the change occurs as investment income. The fair value of debt and equity securities is determined using recognized pricing services or prices quoted by one or more independent brokers. Equity securities traded on a national exchange are valued at the last reported sales price. Debt securities are generally valued at the midpoint between the bid and asked prices.

A small percentage of debt securities cannot be priced in this manner, and for these, a similar "benchmark" security is used. The benchmark has a coupon rate and maturity date comparable to the debt security being valued, and its market risk is similar considering current market conditions. Investments in leveraged buyouts representing private securities are valued at cost, or at fair market value as estimated by a recognized pricing service if a significant event has occurred which affects the value of the investment and warrants an adjustment to cost. Investments in leveraged buyouts representing publicly traded securities are stated at the quoted market price adjusted for a reasonable illiquidity discount and are reported as Other Invested Assets in Note 3. Mortgage loans on real estate are stated at the unpaid principal balance.

Realized investment gains and losses are determined using the specific identification method and are included as a component of net income upon the maturity or disposition of the investment. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments held in more than one fiscal year and sold in the current year may have been recognized as a change in the fair value of investments reported in prior years. The net change in the fair value of investments was a $27.4 million loss and a $17.9 million gain during 2005 and 2004, respectively. This takes into account all changes in fair value (including purchases and sales) that occurred during the year. The net unrealized gain on investments was $94.8 million and $122.2 million at December 31, 2005 and 2004, respectively.

Cash and Cash Equivalents—SAIF places its temporary cash investments with the Oregon Short Term Fund. The Oregon Short Term Fund is a cash and investment pool that operates as a demand deposit account. As a result, SAIF's investment is not impacted by changes in the market value of the Oregon Short Term Fund. By statute, the Oregon Short Term Fund may hold securities with maturities no greater than three years. The average maturity of the Oregon Short Term Fund as of December 31, 2005 and 2004 was 165 days and 160 days, respectively.

Oregon's State Treasurer employs the services of three external investment managers to manage SAIF's funds, one that manages a convertible bond portfolio and two that manage fixed income portfolios. The cash balances of the convertible bond manager are invested in the SSgA Money Market Fund, and the cash balances of the fixed income managers are invested in the SSgA Prime Money Market Fund. These funds seek to maximize current income while maintaining a stable $1.00 unit value by investing in high-quality, short maturity securities. The average maturity of the SSgA Money Market Fund as of December 31, 2005 and 2004 was 25 days and 29 days, respectively. The average maturity of the SSgA Prime Money Market Fund as of December 31, 2005 and 2004 was 24 days and 30 days, respectively.

Concentrations of Credit Risk—Financial instruments, which potentially subject SAIF to concentrations of credit risk, consist principally of temporary cash investments and debt securities. SAIF places its investment securities with high-credit quality financial institutions and limits the amounts of credit exposure to any one financial institution. Concentrations of credit risk with respect to investments in debt securities are limited due to the large number of such investments and their distribution among U.S. government bonds, many different industries and geographic regions.

Property and Equipment—Property and equipment are stated at cost, less accumulated depreciation. Maintenance, repairs, and minor renovations are charged to expense as costs are incurred. Upon retirement or sale, any resulting gain or loss is included as a component of net income. Property and equipment is capitalized and depreciated using the straight-line method over the estimated useful lives of the assets as follows:

	Capitalization Threshold	Useful Life
Buildings and improvements	All	30–40 years
Furniture, equipment, and machinery	\$0–\$2,000	3–7 years
Data processing software	\$500,000	3 years

Land, property, and equipment activity for the years ended December 31, 2005 and 2004 were as follows (dollars in thousands):

	2005			
	Beginning Balance	Additions	Disposals	Ending Balance
Land	\$ 2,922	\$ -	\$ -	\$ 2,922
Buildings and improvements	25,447			25,447
Equipment	11,932	544	(1,287)	11,189
Data processing software	9,043	8		9,051
Totals at historical cost	49,344	552	(1,287)	48,609
Less accumulated depreciation for:				
Buildings and improvements	(8,973)	(722)		(9,695)
Equipment	(9,997)	(807)	1,238	(9,566)
Data processing software	(7,889)	(532)		(8,421)
Total accumulated depreciation	(26,859)	(2,061)	1,238	(27,682)
Land, property, and equipment—net	\$ 22,485	\$ (1,509)	\$ (49)	\$ 20,927

	2004			
	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ 2,922	$ -	$ -	$ 2,922
Buildings and improvements	25,447			25,447
Equipment	13,659	802	(2,529)	11,932
Data processing software	8,626	975	(558)	9,043
Totals at historical cost	50,654	1,777	(3,087)	49,344
Less accumulated depreciation for:				
Buildings and improvements	(8,251)	(722)		(8,973)
Equipment	(11,503)	(919)	2,425	(9,997)
Data processing software	(7,270)	(619)		(7,889)
Total accumulated depreciation	(27,024)	(2,260)	2,425	(26,859)
Land, property, and equipment—net	$ 23,630	$ (483)	$ (662)	$ 22,485

Depreciation and amortization expense for the years ended December 31, 2005 and 2004 were $2.1 million and $2.3 million, respectively.

Internally Developed Software—Internal and external costs incurred to develop internal-use computer software and web sites during the application development stage and infrastructure stage are capitalized; costs incurred during the preliminary project stage and post-implementation/operation stage are expensed as incurred. The threshold for capitalization of internally developed software is set at $500 thousand.

Premiums—Premiums are based on individual employers' reported payroll using predetermined insurance rates based on employee risk classifications and are recognized as income on a pro rata basis over the coverage period. Ceded premiums are recognized consistent with the underlying reinsurance agreement. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums.

Policyholders' premiums due to SAIF are recorded as premiums receivable, net of the allowance for uncollectible accounts. Premiums receivable consists of both billed and unbilled amounts. Unbilled premiums receivable primarily represent an estimate of the difference between amounts earned ratably on installment-billed policies and the amount to be billed on the policy. Unbilled premiums receivable also include estimated billings on payroll reporting policies which were earned but not billed prior to year-end. SAIF uses its historical experience to estimate earned but unbilled amounts which are recorded as premiums receivable. These unbilled amounts are estimates, and while SAIF believes such amounts are reasonable, there can be no assurance the amounts ultimately received will equal the recorded unbilled amounts. The ultimate collectibility of the unbilled premiums receivable can be affected by general changes in the economy and the regulatory environment due to the increased time required to determine the billable amount. SAIF considers these factors when estimating the premium receivable for unbilled premiums. Unbilled premiums receivable at December 31, 2005 and 2004 were $81.1 million and $71.0 million, respectively, and are included in accounts and interest receivable.

Certain policyholders are required to remit deposits which represent premium expected to be payable to SAIF at the end of the month following the reporting period (monthly and quarterly), plus one additional month. Deposits are generally in the form of cash, and are recorded in policyholders' premium deposits and included in other liabilities. However, policyholders may pledge surety bonds and securities in lieu of cash deposits.

In addition to its regular premium plans, SAIF offers employers retrospective premium rating plans under which premiums are adjusted annually for up to 4-1/2 years following the plan year based on policyholders' loss experience. Adjustments to the original premiums are paid to or collected from the policyholders six months following the expiration of the policy and annually thereafter for up to 4-1/2 years. The estimate of the net accrued premiums receivable for retrospective rating plans as of December 31, 2005 and 2004 is as follows (dollars in thousands):

	2005	2004
Accrued retrospective premiums receivable	$ 79,022	$ 72,809
Reserve for retrospective rating plans	(32,410)	(26,571)

The accrued retrospective premium receivable balance is included as accounts and interest receivable in the accompanying balance sheet. The reserve for retrospective rating plans balance is included as accounts and interest payable in the accompanying balance sheet.

Reserve for Loss and Loss Adjustment Expenses—The reserve for loss and loss adjustment expenses is generally based on past experience, except for certain awarded claims which are determined on an individual case basis. The liability includes provisions for reported claims, claims incurred but not reported, and claims that are currently closed but which experience indicates will be reopened.

Management believes that the reserve for incurred but unpaid loss and loss adjustment expenses at December 31, 2005 and 2004 are a reasonable estimate of the ultimate net costs of settling claims and claims expenses incurred. Annually, the Board of Directors reviews the actuarial assumptions utilized in determining the liability for such losses. Actual claim costs depend upon such factors as duration of worker disability, medical cost trends, occupational disease and inflation, and other societal and economic factors. As a result, the process used in computing the ultimate cost of settling claims and expense for administering claims is necessarily based on estimates. The amount ultimately paid may be more or less than such estimates. Adjustments resulting from changes in estimates of these liabilities are charged or credited to operations in the period in which they occur (see Note 4).

Currently, SAIF discounts the indemnity reserve for known unpaid fatal and permanent total disability losses. SAIF does not discount the reserve for unpaid fatal and permanent total disability loss adjustment expenses. The discount rate used by SAIF was 3.5% at December 31, 2005 and 2004. The tabular discounts reflected in the reserve for loss and loss adjustment expenses were $97.3 million and $100.4 million at December 31, 2005 and 2004, respectively.

Managed Care Organization Fees—SAIF contracts with managed care organizations ("MCOs"). MCOs manage claims by arranging to provide medical and health care services under capitation agreements. The expense is based on the number of claims accepted and closed at a specific negotiated rate while managed by an MCO. During 2005 and 2004, claims covered by contracts with MCOs were approximately 88.3% and 87.3%, respectively, of total claims.

Premium Deficiency—At December 31, 2005 and 2004, no reserve for premium deficiency was required to be recorded. Premium deficiency is based upon an estimate of the amount by which the sum of anticipated claims costs, claims adjustment expenses and maintenance expenses exceeds expected premium income and earnings on investments.

Policyholders' Dividends—Substantially all of SAIF's business is written under various participating plans wherein a dividend may be returned to the policyholder. Estimated amounts to be returned to policyholders are accrued when the related premium is earned. Dividends may be paid to the extent that a surplus is accumulated from premiums, investment gains or loss reserve reductions. No policyholder dividends were declared in 2005 and 2004.

Taxes and Assessments—The Oregon Department of Justice has determined that SAIF is exempt from federal taxes, because it is an integral part of the State of Oregon and, alternatively, exempt under either or both Sections 501(c)(27)(B) and 115(1) of the Internal Revenue Code.

SAIF is subject to levies by the Oregon Workers' Compensation Division of the Department of Consumer and Business Services. Such assessments constitute an in-lieu-of-tax relative to premiums. Premium assessments were $27.5 million and $26.3 million, including $9.9 million and $10.3 million of accrued premium assessments, for the years ended December 31, 2005 and 2004, respectively.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Current Accounting Pronouncements—In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.* This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries. SAIF implemented this statement for the fiscal year ended December 31, 2005. There was no significant impact on the financial statements.

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes uniform financial reporting standards for other postemployment benefits ("OPEB") and supersedes the interim guidance included in Statement 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*, with modifications to reflect differences between pension plans and OPEB plans. The requirements of this statement are effective for SAIF's 2006 financial statements. SAIF is in the process of determining the impact of this statement on its financial statements.

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*. This statement improves the understandability and usefulness of statistical section information. The requirements of this statement are effective for SAIF's 2006 financial statements. SAIF is in the process of determining the impact of this statement.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of OPEB expense and related liabilities (assets), note disclosure, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The requirements of this statement are effective for SAIF's 2007 financial statements. SAIF is in the process of determining the impact of this statement on its financial statements.

In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation*. This statement clarifies the definition of a legally enforceable enabling legislation restriction. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The requirements of this statement are effective for SAIF's 2006 financial statements. SAIF is in the process of determining the impact of this statement on its financial statements.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. This statement establishes accounting standards for termination benefits. The requirements of this statement are effective for SAIF's 2006 financial statements. SAIF is in the process of determining the impact of this statement on its financial statements.

3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash and Cash Equivalents—Cash on deposit in state banks is covered by federal deposit insurance or is secured by the State Treasury at a minimum of 25% as required by statutes. Amounts held in the Oregon Short Term Fund are insured or secured by securities held by the State Treasurer or by its agent in the Treasurer's name. Deposits at the custodian bank are neither collateralized nor insured, but are backed by the full faith and credit of the custodian bank.

Investments—SAIF's investment policies are governed by statute and the Oregon Investment Council ("Council"). The State Treasurer ("Treasurer") is the investment officer for the Council and is responsible for the funds on deposit in the State Treasury. In accordance with Oregon statutes, the investment funds are invested, and the investments of those funds managed, as a prudent investor would do, exercising reasonable care, skill and caution. While the Treasurer is authorized to use demand deposit accounts and fixed-income investments, equity investment transactions must be directed by external investment managers that are under contract with the Council. Further, equity investments are limited to not more that 50% of the monies contributed to the Industrial Accident Fund (SAIF Corporation); however, SAIF's adopted investment policy as approved by the Council limits equity holdings to 15% of the market value of invested assets.

Cash collateral received in respect of securities loaned is invested in the custodial agent's short-term fund, an "external investment pool" for purposes of GASB Statement No. 31. SAIF's participation in this fund is voluntary. The fair value of investments held by this fund is based upon valuations provided by a recognized pricing service. This fund is not registered with the Securities and Exchange Commission, but the custodial agent is subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of SAIF's position in this fund is not the same as the value of the fund's shares, because unrealized gains and losses on the fund's investments included in fair value are not distributed to fund participants. No income from this fund was assigned to another fund by the custodial agent during 2005 and 2004.

Bond, mortgage-backed, asset-backed and equity security transactions are recorded on a trade-date basis, generally three business days prior to the settlement date. However, the number of days between trade and settlement dates for mortgage-backed securities can be up to 30 days or longer, depending on the security. Due from brokers for security sales at December 31, 2005 and 2004 was $ 0.3 million and $6.7 million, respectively. Due to brokers for security purchases at December 31, 2005 and 2004 was $1.9 million and $1.2 million, respectively.

Custodial Credit Risk for Cash and Cash Equivalents (Deposits)—Custodial credit risk for deposits is the risk that in the event of a bank failure, SAIF will not be able to recover the value of its deposits or collateral securities that are in possession of an outside party.

SAIF's cash and cash equivalents total $40.4 million and $244.0 million as of December 31, 2005 and 2004, respectively, and are composed of the following (dollars in thousands):

	2005	2004
Repurchase agreement	$ 10,800	$ 193,100
Cash balances	25,263	38,592
SSgA money market funds	4,313	12,296
Total cash and cash equivalents	$ 40,376	$ 243,988

The cash balances are on deposit in the Oregon Short Term Fund and in SAIF's custodial bank, State Street Bank and Trust Company ("State Street"). The deposits in the Oregon Short Term Fund are secured by investments held by the Oregon State Treasury's custodian bank in the Treasury's name. The cash held by State Street and the cash in the SSgA Money Market Funds (discussed in Note 2) is exposed to custodial credit risk since it was neither collateralized nor insured, but is backed by the full faith and credit of the custodian bank. The repurchase agreement is collateralized by U.S. government securities, and the securities are held at State Street.

Custodial Credit Risk for Investments—Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, SAIF will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. All of the SAIF investments were insured or registered, or securities held by the State of Oregon or its agent in the State of Oregon's name for SAIF and therefore were not exposed to custodial credit risks.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. SAIF's policy for fixed income investments effective January 1, 2005, provides that a duration target be used to manage interest rate risk. The policy calls for the portfolio duration to be within 20% of the benchmark duration. The benchmark duration as of December 31, 2005 was 5.887 years, with an acceptable range of 4.710 to 7.065 years. As of that date, the fixed income portfolio's duration was 5.950 years. The following schedule presents the fixed income investments by maturity date. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands).

2005	**Less Than 1 Year**	**1–5 Years**	**6–10 Years**	**More Than 10 Years**	**Fair Value**
Investment type bonds:					
U.S. Treasury obligations	$ 7,948	$ 110,733	$ 1,842	$ 219,895	$ 340,418
U.S. Treasury obligations—TIPS		18,904	72,714	27,478	119,096
U.S. Treasury obligations—STRIPS	84	53		16,421	16,558
U.S. federal agency mortgage securities	135,158	274,509	116,138	169,614	695,419
U.S. federal agency debt	38,451	66,685		69,333	174,469
Corporate bonds	37,606	157,457	265,172	312,197	772,432
Municipal bonds			1,415	7,121	8,536
Collateralized mortgage obligations	20,987	80,383	69,136	12,572	183,078
Asset backed securities	21,712	42,803	13,986	3,975	82,476
International debt securities	4,863	31,120	68,786	159,831	264,600
Total bonds	$ 266,809	$ 782,647	$ 609,189	$ 998,437	$ 2,657,082
Equity securities:					
Domestic equity securities					$ 542
Russell 3000 pooled equity fund					495,679
Total equity securities					496,221
Other invested assets					349
Mortgage loans on real estate					115
Total investments					$ 3,153,767

2004	Less Than 1 Year	1–5 Years	6–10 Years	More Than 10 Years	Fair Value
Investment type bonds:					
U.S. Treasury obligations	$ 7,187	$ 357,528	$ 62,235	$ 85,252	$ 512,202
U.S. Treasury obligations—TIPS			69,057	69,619	138,676
U.S. Treasury obligations—STRIPS		134		11,276	11,410
U.S. federal agency mortgage securities		27,762	36,922	466,569	531,253
U.S. federal agency debt	19,791	66,095	13,963	23,479	123,328
Corporate bonds	17,332	164,903	226,231	265,417	673,883
Municipal bonds				8,539	8,539
Collateralized mortgage obligations			3,452	118,969	122,421
Asset backed securities		37,296	26,939	18,626	82,861
International debt securities		31,255	66,228	111,369	208,852
Total bonds	$ 44,310	$ 684,973	$ 505,027	$ 1,179,115	$ 2,413,425
Equity securities:					
Domestic equity securities					$ 65,225
Russell 3000 pooled equity fund					310,885
Total equity securities					376,110
Other invested assets					841
Mortgage loans on real estate					179
Total investments					$ 2,790,555

Credit Risk—Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. SAIF's credit risk policy is to maintain a well-diversified investment portfolio. Fixed income holdings shall be the largest component of the portfolio. SAIF maintains an overall fixed income portfolio quality of at least "AA-" or higher. Additionally, the portfolio should be adequately diversified to minimize various risks.

The majority of SAIF debt investments as of December 31, 2005 and 2004 were rated by Moody's and Standard & Poor's which are nationally recognized statistical rating organizations. The following schedules represent the ratings as of December 31, 2005 and 2004 using the Standard & Poor's rating scale (dollars in thousands).

2005

	Investment Type				
Quality Ratings	Bonds	Equity Securities	Other Invested Assets	Mortgage Loans on Real Estate	Total Investments
AAA	$ 1,573,748	$ -	$ -	$ -	$ 1,573,748
AA	55,850				55,850
A	404,456				404,456
BBB	415,453				415,453
BB	99,152				99,152
B	27,415				27,415
CCC	2,646				2,646
Unrated	78,362	496,221	349	115	575,047
Fair Value	$ 2,657,082	$ 496,221	$ 349	$ 115	$ 3,153,767

2004

Quality Ratings	Investment Type				Total Investments
	Bonds	Equity Securities	Other Invested Assets	Mortgage Loans on Real Estate	
AAA	$ 1,564,509	$ -	$ -	$ -	$ 1,564,509
AA	45,271	2,997			48,268
A	245,180	10,500			255,680
BBB	400,269	24,309			424,578
BB	69,588	5,409			74,997
B	49,578	18,074			67,652
CCC	12,744				12,744
Unrated	26,286	314,821	841	179	342,127
Fair Value	$ 2,413,425	$ 376,110	$ 841	$ 179	$ 2,790,555

Concentration of Credit Risk—Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. SAIF's investment policy places a limit on the amount that may be invested in any one issuer. The following specific limitations reflect, in part, the Oregon Investment Council's current investment philosophy regarding diversification.

- No fixed income investment in any one issue shall be in excess of 5% of the outstanding fixed income obligations of the issuer

- Not more than 3% of the total market value of the SAIF fixed income portfolio shall be invested in fixed income securities of any one issuer, except U.S. government and agency obligations (no limit) and private mortgage-backed and asset-backed securities which shall be limited to 10% per issuer

- Obligations of other national governments are limited to 10% per issuer.

The amortized cost and fair value of investments at December 31, 2005 and 2004 are as follows (dollars in thousands):

2005	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Bonds:				
U.S. Treasury obligations	$ 335,285	$ 5,791	$ (658)	$ 340,418
U.S. Treasury obligations—TIPS	120,542	422	(1,868)	119,096
U.S. Treasury obligations—STRIPS	15,874	686	(2)	16,558
U.S. federal agency mortgage securities	702,378	3,209	(10,168)	695,419
U.S. federal agency debt	174,656	1,615	(1,802)	174,469
Corporate bonds	760,824	22,166	(10,558)	772,432
Municipal bonds	8,311	235	(10)	8,536
Collateralized mortgage obligations	185,181	863	(2,965)	183,079
Asset backed securities	82,893	385	(803)	82,475
International debt securities	250,043	16,012	(1,455)	264,600
Total bonds	2,635,987	51,384	(30,289)	2,657,082
Equity securities:				
Domestic equity securities	1,310		(768)	542
Russell 3000 pooled equity fund	420,546	75,133		495,679
Total equity securities	421,856	75,133	(768)	496,221
Other invested assets	1,040		(691)	349
Mortgage loans on real estate	115			115
Total investments	$3,058,998	$ 126,517	$ (31,748)	$3,153,767

2004	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Bonds:				
U.S. Treasury obligations	$ 509,298	$ 4,622	$ (1,718)	$ 512,202
U.S. Treasury obligations—TIPS	135,516	3,248	(88)	138,676
U.S. Treasury obligations—STRIPS	10,354	1,088	(32)	11,410
U.S. federal agency mortgage securities	523,514	8,596	(857)	531,253
U.S. federal agency debt	123,499	894	(1,064)	123,329
Corporate bonds	633,629	42,954	(2,700)	673,883
Municipal bonds	8,328	224	(13)	8,539
Collateralized mortgage obligations	119,761	2,917	(258)	122,420
Asset backed securities	82,812	696	(647)	82,861
International debt securities	191,800	17,850	(798)	208,852
Total bonds	2,338,511	83,089	(8,175)	2,413,425
Equity securities:				
Domestic equity securities	60,340	6,158	(1,273)	65,225
Russell 3000 pooled equity fund	268,283	42,602		310,885
Total equity securities	328,623	48,760	(1,273)	376,110
Other invested assets	1,054		(213)	841
Mortgage loans on real estate	179			179
Total investments	$2,668,367	$131,849	$ (9,661)	$2,790,555

Net investment income is comprised of the following for the years ended December 31, 2005 and 2004 (dollars in thousands):

	2005	2004
Interest income	$ 151,438	$ 121,943
Change in fair value	(27,420)	17,937
Net realized gains	15,777	46,571
Investment income	139,795	186,451
Less investment expense	(25,425)	(13,171)
Net investment income	$ 114,370	$ 173,280

Net realized gains and losses on sales of investments, which are included in net investment income, for the years ended December 31, 2005 and 2004 consist of the following (dollars in thousands):

2005	Gains	Losses	Net
Bonds	$ 35,212	$ (24,679)	$ 10,533
Equity securities	6,492	(1,262)	5,230
Other invested assets	14		14
Total	$ 41,718	$ (25,941)	$ 15,777

2004	Gains	Losses	Net
Bonds	$ 59,140	$ (21,576)	$ 37,564
Equity securities	12,508	(6,343)	6,165
Other invested assets	6,828	(3,986)	2,842
Total	$ 78,476	$ (31,905)	$ 46,571

Proceeds from the sales of investments in debt securities for the years ended December 31, 2005 and 2004 were $4,742.9 million and $2,340.4 million, respectively.

Securities with an amortized cost of $3.7 million at December 31, 2005 and 2004 were on deposit with the Federal Reserve as required by the U.S. Department of Labor under the Longshoremen's and Harbor Workers' Compensation Act.

Securities Lending—In accordance with State investment policies, SAIF participates in securities lending transactions. The Oregon State Treasury has, through a Securities Lending Agreement, authorized State Street Bank and Trust Company ("State Street") to lend SAIF's securities to broker-dealers and banks pursuant to a form of loan agreement. Both SAIF and the borrowers maintained the right to terminate all securities lending transactions on demand. There have been no significant violations of the provisions of securities lending agreements.

During the year, State Street loaned SAIF's fixed income and equity securities and received as collateral U.S. dollar-denominated cash. Borrowers were required to deliver cash collateral for each loan equal to at least 102% of the fair value of the loaned security, or 105% in the case of international equity securities. SAIF did not impose any restrictions during the year on the amount of the loans State Street made on its behalf. SAIF was fully indemnified by State Street against losses due to borrower default, and there were no losses during the year from the failure of borrowers to return loaned securities.

State Street is authorized by the Securities Lending Agreement to invest cash collateral received for securities loans in the State Street Bank and Trust Company Oregon Short-Term Investment Fund (the "Fund"). The fair value of SAIF's position in this fund is not the same as the value of the Fund's shares, because unrealized gains and losses on the Fund's investments included in its fair value are not distributed to fund participants. At December 31, 2005 and 2004, the Fund had an average-weighted maturity of 214 days and 398 days, respectively. On December 31, 2005 and 2004, SAIF had no credit risk exposure to borrowers. The collateral held and the fair value including accrued income of the SAIF securities on loan at December 31, 2005 were $684.2 million and $670.5 million, and at December 31, 2004 they were $800.1 million and $783.9 million. For 2005 and 2004, security lending income was $21.6 million and $8.9 million and security lending expense was $20.3 million and $7.9 million, respectively.

4. RESERVE FOR LOSS AND LOSS ADJUSTMENT EXPENSES

SAIF has established a reserve for both reported and unreported insured events, which includes estimates of future payments of losses and related loss adjustment expenses. In estimating the reserve for loss and loss adjustment expenses, SAIF considers prior experience, industry information, currently recognized trends affecting data specific to SAIF and other factors relating to workers' compensation insurance underwritten by SAIF.

The following table provides a reconciliation of the beginning and ending reserve for loss and loss adjustment expenses (dollars in thousands):

	2005	2004
Gross reserve for loss and loss adjustment expenses—beginning of year	$2,625,435	$2,412,926
Less reinsurance recoverable—beginning of year	(79,342)	(74,128)
Net reserve for loss and loss adjustment expenses—beginning of year	2,546,093	2,338,798
Incurred losses:		
Provision for insured events of the current year	472,049	451,396
Provision for insured events of the prior year	(129,576)	25,737
Total incurred losses	342,473	477,133
Loss payments attributable to:		
Insured events of the current year	101,102	106,642
Insured events of the prior year	199,459	163,196
Total payments	300,561	269,838
Net reserve for loss and loss adjustment expenses—end of year	2,588,005	2,546,093
Plus reinsurance recoverable—end of year	59,992	79,342
Gross reserve for loss and loss adjustment expenses—end of year	$2,647,997	$2,625,435

The favorable prior year loss reserve development noted above for 2005 was primarily the result of changing the future medical cost escalation rate assumption from a flat 9.2% to 10% for the first three years after the accident date, followed by 8.5% per year thereafter to reflect current estimates for the expected future medical payments. The unfavorable prior year loss reserve development for 2004 was the result of medical cost escalation.

Anticipated salvage and subrogation of $22.3 and $22.6 million is included as a reduction of the reserve for losses at December 31, 2005 and 2004, respectively.

5. REINSURANCE

In the ordinary course of business, SAIF cedes premiums for purposes of risk diversification and limiting maximum loss exposure from catastrophic events through contractual agreements with reinsurers. If such assuming reinsurers are unable to meet the obligations assumed under these reinsurance agreements, SAIF would be liable to pay the obligation. To minimize its exposure to significant losses from reinsurer insolvencies, SAIF evaluates the financial condition of its reinsurers and monitors concentration of credit risk.

SAIF maintains reinsurance protection providing limits of $60 million excess of $40 million per occurrence with a $5 million maximum on any one life and a $120 million aggregate limit. This reinsurance protection excludes coverage for nuclear, biological, chemical or radiological events in some or all instances. During 2005, SAIF had reinsurance protection for 90% of losses in excess of 15% of 2004 direct-earned premiums for acts of foreign terrorism through the Federal Terrorism Reinsurance Act.

The following amounts have been deducted (added) in the accompanying financial statements as a result of reinsurance ceded for 2005 and 2004 (dollars in thousands):

	2005	2004
Reserve for loss and loss adjustment expenses	$ 59,992	$ 79,342
Premiums written and earned	2,306	2,643
Loss and loss adjustment expenses incurred	(19,018)	5,533

SAIF is authorized to write business on behalf of the Oregon Workers' Compensation Insurance Plan (the "Plan"), administered by the National Council on Compensation Insurance through the National Workers' Compensation Reinsurance Pool ("NWCRP"). The Plan provides a guaranteed source of workers' compensation insurance for employers unable to obtain coverage because of unstable financial condition, poor loss experience or the inherently dangerous nature of the work. SAIF cedes such business to the Plan. In addition, SAIF is also required to assume its share of premiums and losses from the Plan based on voluntary market share.

The following amounts are included in the accompanying financial statements as a result of participation in the Plan in 2005 and 2004 (dollars in thousands):

	2005	2004
Assumed:		
Reserve for loss and loss adjustment expenses	$ 75,180	$ 69,686
Unearned premiums	3,174	2,721
Premiums written	33,494	31,821
Premiums earned	33,040	31,642
Loss and loss adjustment expenses incurred	21,629	23,851
Ceded:		
Reserve for loss and loss adjustment expenses	$ 89,025	$ 88,279
Unearned premiums	3,817	3,457
Premiums written	29,690	29,692
Premiums earned	29,330	30,220
Loss and loss adjustment expenses incurred	14,762	24,724

6. LEASE COMMITMENTS

SAIF leases office space in several locations under noncancelable operating leases expiring during various years through 2010. Lease expense was $616 thousand and $579 thousand for the years ended December 31, 2005 and 2004, respectively.

SAIF's future minimum lease payments under operating leases at December 31, 2005 and 2004 are as follows (dollars in thousands):

	2005
2006	$ 589
2007	464
2008	479
2009	472
Thereafter	481
Total minimum payments	$2,485

Certain rental commitments have renewal options extending through the year 2018. Some of these renewals are subject to adjustments in future periods. Total minimum lease payments have not been reduced by minimum sublease rentals of approximately $0.8 million and $1.1 million on leases due in the future under noncancelable subleases as of December 31, 2005 and 2004, respectively.

7. RISK MANAGEMENT

The State of Oregon administers property and casualty insurance programs covering State government agencies through its Insurance Fund. The Insurance Fund services claims for: direct physical loss or damage to State property; tort liability claims brought against the State, its officers, employees or agents; workers' compensation; and employees, elected officials and members of commissions and boards for honesty and faithful performance. The Insurance Fund is backed by a commercial excess property policy with limits of $400 million and a blanket commercial excess bond with limits of $10 million.

As a state agency, SAIF participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each State entity based on its share of services provided in a prior period. The total statewide assessment of each coverage is based on independent biennial actuarial forecasts and administrative expenses, less carryforward or equity in the Insurance Fund. Assessments for the years ended December 31, 2005 and 2004 were $248 thousand and $242 thousand, respectively.

8. CONTINGENCIES

SAIF has entered into structured settlements wherein SAIF has purchased annuities of which the claimant is payee but for which SAIF is contingently liable. The amount of the contingent liability is the amount of the liability due to the various claimants that has been offset by the purchase of the annuity. Contingent liabilities arising from these settlements were $7.0 million and $5.2 million at December 31, 2005 and 2004, respectively.

During the ordinary course of business, SAIF becomes involved in litigation arising out of matters incident to the conduct of its insurance operations. SAIF is represented in these actions by the Attorney General of the State of Oregon. In the opinion of management, based upon information furnished by counsel, the ultimate disposition of these actions will not have a material adverse effect on SAIF's financial position or results of operations.

9. DEFERRED COMPENSATION PLAN

A deferred compensation plan was authorized under Internal Revenue Code Section 457(b) and ORS 243.400 to 243.495. The plan is a benefit available to all SAIF employees wherein they may execute an individual agreement with SAIF to defer a portion of their current income until future years so as to shelter such funds from federal and state taxation until withdrawal. Participants cannot receive the funds until certain circumstances are met. Funds withheld from employees and remitted to the plan have been invested with various financial institutions and insurance companies. Plan assets are held in a custodial account or an annuity contract by the plan provider for the exclusive benefit of the participants or beneficiary. Participants' rights under the plan are equal to the fair market value of the deferred account for each participant.

10. RETIREMENT PLAN

The majority of SAIF's employees participate in the Oregon Public Employees' Retirement System ("PERS"), a cost-sharing multiple-employer defined benefit pension plan. PERS is administered by the PERS Board of Trustees under the guidelines of ORS Chapter 238. The PERS retirement allowance, payable monthly for life, may be selected from thirteen retirement benefit options. Options include survivorship benefits and lump-sum refunds. The basic benefit formula is 1.67% of a member's final average salary multiplied by the member's number of years of service. Benefits may also be calculated under either a money match or an annuity-plus-pension computation if a greater benefit results. PERS also provides death and disability benefits. A copy of the Oregon Public Employees' Retirement System annual financial report may be obtained from PERS, Fiscal Services, 11410 SW 68th Parkway, Tigard, Oregon 97223.

Beginning January 1, 2004, all covered employees are required by state statute to contribute 6.0% of their salary to the Individual Account Program (a defined contribution plan). Current law permits employers to pay employees' contributions to PERS, which SAIF has elected to do. Additionally, SAIF is required by statute to contribute 8.69% of each covered employee's salary to fund the PERS program. Rates are subject to change as a result of subsequent actuarial valuations.

SAIF employees hired after August 29, 2003 participate in the Oregon Public Service Retirement Plan ("OPSRP") after completing six months of service. OPSRP is a hybrid pension plan administered by the PERS Board of Trustees under the guidelines of ORS Chapter 238A with two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). SAIF currently contributes 8.04% of each covered employee's salary to the Pension Program (defined benefit) and 6.0% to the Individual Account Program (defined contribution). Rates are subject to change as a result of subsequent actuarial valuations.

The retirement system does not make separate measurements of assets and pension benefit obligation for individual employers. Therefore, the present value of accrued benefits, the amount of vested benefits, and the fair value and market value of the plan assets as of the most recent actuarial valuation date is not available.

SAIF participates, along with State of Oregon agencies, in paying the debt service for the bonds issued in October 2003 used to reduce the unfunded PERS liability. The bonds are scheduled to mature 25 years after the date of issuance. Currently, the repayment rate is 6.45% of payroll each month. The payment rate is recalculated each state fiscal biennium. In 2005 and 2004, SAIF paid $3.0 million and $2.1 million, respectively.

The amounts contributed by SAIF for all plans for the years ended December 31, 2005, 2004, and 2003 were $8.8 million, $6.8 million, and $6.7 million, respectively. SAIF employer contributions for the years ended December 31, 2005, 2004, and 2003 were $6.1 million, $4.2 million, and $4.1 million, respectively, which are equal to the required contributions for the year. Employee contributions paid by SAIF for the years ended December 31, 2005, 2004, and 2003 were $2.7 million $2.6 million, and $2.6 million, respectively. In accordance with GASB Statement No. 27, no pension liability was recorded at December 31, 2005 and 2004.

* * * * * *