

SAIF Corporation

(A Component Unit of the State of Oregon)

*Financial Statements and Supplementary
Schedule as of and for the Years
Ended December 31, 2012 and 2011, and
Report of Independent Auditors*

SAIF CORPORATION

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OVERVIEW OF SAIF CORPORATION FINANCIAL REPORTING

SAIF Corporation (SAIF) has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. As a discrete 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 a special purpose government engaged solely in business-type activities. 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.

SAIF also 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 dependents, whereas generally accepted accounting principles (GAAP) are based on the going-concern concept and recognize revenues when earned and expenses when incurred.

There are significant differences between the statutory statements that 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. GAAP requires the accrual of estimated policyholder dividends.
- 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 "nonadmitted" and removed from the statement of net position. Those assets, such as property and equipment, are included on the GAAP financial statements.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors of
SAIF Corporation

The Secretary of State Audits Division of
The State of Oregon

Report on the Financial Statements

We have audited the accompanying financial statements of SAIF Corporation ("SAIF"), a component unit of the State of Oregon, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise SAIF's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SAIF'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.

MOSS ADAMS LLP***Opinions***

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of SAIF Corporation as of December 31, 2012 and 2011, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and postemployment healthcare benefit plan schedule of funding progress on pages 4 through 12 and 35, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 30, 2013 on our consideration of SAIF Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SAIF Corporation's internal control over financial reporting and compliance.



Eugene, Oregon
July 30, 2013

SAIF CORPORATION
Management's Discussion and Analysis
December 31, 2012 and 2011

Management of SAIF Corporation (SAIF) prepares Management's Discussion and Analysis for readers of SAIF's financial statements. This narrative overview and analysis of the financial activities of SAIF is as of and for the years ended December 31, 2012 and 2011. Readers are encouraged to consider this information in conjunction with SAIF's financial statements and notes that follow.

Financial Statements

This discussion and analysis is intended to serve as an introduction to SAIF's financial statements: the Statements of Net Position; the Statements of Revenues, Expenses, and Changes in Fund Net Position; and the Statements of Cash Flows. The financial statements are designed to provide the readers with an overview of SAIF's financial position and activities.

The Statements of Net Position present information on SAIF's assets and liabilities, with the difference between the two reported as net position. Assets and liabilities are classified as either current or noncurrent.

The Statements of Revenues, Expenses, and Changes in Fund Net Position are SAIF's income statements. Revenues earned and expenses incurred during the year are classified as either operating or nonoperating.

The Statements of Cash Flows present the changes in SAIF's cash and cash equivalents during the year. These statements are prepared using the direct method of cash flows. The statements break out the sources and uses of SAIF's cash and cash equivalents into the following categories: operating activities, investing activities, and capital and related financing activities.

**Condensed Financial Information
(In thousands)**

Condensed Statements of Net Position Information

	December 31,			2011 to 2012 Increase (Decrease)	2010 to 2011 Increase (Decrease)
	2012	2011	2010		
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	\$ 88,393	\$ 43,883	\$ 41,742	\$ 44,510	\$ 2,141
Investments	4,313,235	4,083,247	4,037,034	229,988	46,213
Securities lending cash collateral	315,896	199,303	228,043	116,593	(28,740)
Accounts and interest receivable, net	362,037	350,574	334,200	11,463	16,374
Other assets	<u>9,192</u>	<u>9,238</u>	<u>7,142</u>	<u>(46)</u>	<u>2,096</u>
Total current assets	<u>5,088,753</u>	<u>4,686,245</u>	<u>4,648,161</u>	<u>402,508</u>	<u>38,084</u>
NONCURRENT ASSETS—Capital assets, net	<u>15,771</u>	<u>16,515</u>	<u>17,541</u>	<u>(744)</u>	<u>(1,026)</u>
TOTAL ASSETS	<u>\$ 5,104,524</u>	<u>\$ 4,702,760</u>	<u>\$ 4,665,702</u>	<u>\$ 401,764</u>	<u>\$ 37,058</u>
LIABILITIES AND NET POSITION					
CURRENT LIABILITIES:					
Reserve for losses and loss adjustment expenses	\$ 243,397	\$ 225,388	\$ 209,117	\$ 18,009	\$ 16,271
Unearned premiums	198,567	184,117	168,288	14,450	15,829
Policyholders' dividends payable	35	-	-	35	-
Accounts payable	58,818	57,886	51,159	932	6,727
Obligations under securities lending	315,817	199,315	228,042	116,502	(28,727)
Other liabilities and deposits	<u>63,998</u>	<u>49,770</u>	<u>45,163</u>	<u>14,228</u>	<u>4,607</u>
Total current liabilities	<u>880,632</u>	<u>716,476</u>	<u>701,769</u>	<u>164,156</u>	<u>14,707</u>
NONCURRENT LIABILITIES:					
Reserve for losses and loss adjustment expenses	2,809,214	2,794,005	2,795,522	15,209	(1,517)
Other postemployment benefits obligation	<u>2,024</u>	<u>1,640</u>	<u>1,260</u>	<u>384</u>	<u>380</u>
Total noncurrent liabilities	<u>2,811,238</u>	<u>2,795,645</u>	<u>2,796,782</u>	<u>15,593</u>	<u>(1,137)</u>
Total liabilities	<u>3,691,870</u>	<u>3,512,121</u>	<u>3,498,551</u>	<u>179,749</u>	<u>13,570</u>
NET POSITION:					
Net investment in capital assets	15,771	16,515	17,541	(744)	(1,026)
Unrestricted	<u>1,396,883</u>	<u>1,174,124</u>	<u>1,149,610</u>	<u>222,759</u>	<u>24,514</u>
Total net position	<u>1,412,654</u>	<u>1,190,639</u>	<u>1,167,151</u>	<u>222,015</u>	<u>23,488</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 5,104,524</u>	<u>\$ 4,702,760</u>	<u>\$ 4,665,702</u>	<u>\$ 401,764</u>	<u>\$ 37,058</u>

**Condensed Revenues, Expenses,
and Changes in Fund Net Position Information**

	Years Ended December 31,			2011 to 2012 Increase (Decrease)	2010 to 2011 Increase (Decrease)
	2012	2011	2010		
OPERATING REVENUES:					
Net premiums earned	\$ 401,350	\$ 357,475	\$ 333,323	\$ 43,875	\$ 24,152
Other income	<u>25,242</u>	<u>23,574</u>	<u>16,859</u>	<u>1,668</u>	<u>6,715</u>
Total operating revenues	<u>426,592</u>	<u>381,049</u>	<u>350,182</u>	<u>45,543</u>	<u>30,867</u>
OPERATING EXPENSES:					
Net losses and loss adjustment expenses incurred	353,123	328,879	365,150	24,244	(36,271)
Policyholders' dividends	149,970	150,043	99,975	(73)	50,068
Underwriting expenses	99,130	93,530	80,963	5,600	12,567
Bad debt provision	<u>533</u>	<u>815</u>	<u>1,239</u>	<u>(282)</u>	<u>(424)</u>
Total operating expenses	<u>602,756</u>	<u>573,267</u>	<u>547,327</u>	<u>29,489</u>	<u>25,940</u>
OPERATING LOSS	<u>(176,164)</u>	<u>(192,218)</u>	<u>(197,145)</u>	<u>16,054</u>	<u>4,927</u>
NONOPERATING REVENUES:					
Net investment income	<u>398,179</u>	<u>215,706</u>	<u>418,707</u>	<u>182,473</u>	<u>(203,001)</u>
INCREASE IN NET POSITION	<u>\$ 222,015</u>	<u>\$ 23,488</u>	<u>\$ 221,562</u>	<u>\$ 198,527</u>	<u>\$ (198,074)</u>
NET POSITION—Beginning of year	<u>1,190,639</u>	<u>1,167,151</u>	<u>945,589</u>	<u>23,488</u>	<u>221,562</u>
NET POSITION—End of year	<u>\$ 1,412,654</u>	<u>\$ 1,190,639</u>	<u>\$ 1,167,151</u>	<u>\$ 222,015</u>	<u>\$ 23,488</u>

Financial position as of December 31, 2012

At the end of 2012, total assets increased \$401.8 million from the prior year. Total liabilities increased \$179.8 million for the year, and net position increased \$222.0 million.

Significant changes include:

Cash and cash equivalents—The majority of SAIF's cash accounts consist of short-term investments and money market funds utilized by external investment managers. Cash and cash equivalents increased \$44.5 million from December 31, 2011 to December 31, 2012, primarily due to an increase in the money market fund balances held by the fixed income managers.

Investments—At the end of 2012, investments were \$230.0 million or 5.6 percent higher than at the end of 2011. SAIF's asset allocation was in compliance with the asset allocation policy as of December 31, 2012. Investment holdings (principal and cost) increased \$26.8 million for bonds and decreased \$80 thousand for equities. Bond holdings increased due to the reinvestment of investment income offset somewhat by the withdrawal of bond principal to fund the policyholder dividend payment. The slight decrease in equities was offset by an increase in market values. Market values increased \$139.5 million for bonds and increased \$63.8 million for equities. The BlackRock MSCI ACWI fund had a positive return of 16.8 percent for 2012.

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 SAIF's portfolio.

Accounts and interest receivable—The balance in this line is comprised of investment income receivable, net premiums receivable, accrued retrospective premiums receivable, and other accounts receivable. This balance increased \$11.5 million or 3.3 percent from December 31, 2011 to December 31, 2012.

Accrued investment income decreased \$72 thousand or 0.2 percent from December 31, 2011 to December 31, 2012, primarily due to the low interest rate environment.

Premiums receivable increased \$15.4 million or 5.9 percent in 2012, due to the continued growth in premiums. Net written premiums increased 11.2 percent from 2011 to 2012.

Accrued retrospective premiums receivable decreased \$5.8 million or 14.4 percent due to favorable loss development, primarily for the State of Oregon's retrospectively rated policies.

Other accounts receivable increased \$1.9 million or 12.4 percent, primarily due to a \$1.5 million increase in receivables due from the assigned risk pool, a \$0.2 million increase in premium assessment receivables, and a \$0.2 million increase in reinsurance recoverable.

Other assets—This line had no significant change from 2011 to 2012. A \$1.4 million decrease in amounts due from brokers for securities sold was offset by a \$1.4 million increase in deferred acquisition costs, as a result of the increase in commissions associated with the premium growth and an increase in commission rates effective October 1, 2012.

Reserve for losses and loss adjustment expenses—The total (current and noncurrent) reserve for losses and loss adjustment expenses (LAE) increased \$33.2 million or 1.1

percent from the prior year. Loss reserves decreased \$6.8 million or 0.3 percent and LAE reserves increased \$40.0 million or 11.4 percent during 2012. Loss reserves for the 2012 accident year were offset by favorable loss reserve development of \$148.7 million related to prior accident years. The favorable loss reserve development was attributed primarily to permanent total and permanent partial disability medical loss reserves from recent accident years, which had lower loss development than was expected. Reductions in the tail factors were also a driver. Indemnity loss reserves experienced favorable development as indemnity costs for recent accident years were much lower than expected. The unfavorable LAE development was largely attributable to an increase in selected LAE severity for the current calendar year due to recent increases in employee benefit and retirement costs.

Unearned premiums—The amount of unearned premium for 2012 increased \$14.5 million or 7.9 percent due to the increase in premium.

Accounts payable—The balance in this line is comprised of commissions payable, reinsurance payable, accrued premium assessment, and other accounts payables. This line increased \$0.9 million from 2011 to 2012. The \$1.7 million increase in commission payable and the \$1.9 million increase in premium assessment payable are due to the growth in premium, as well as higher commission rates effective October 1, 2012. Reinsurance payable decreased \$2.4 million due to a decrease in the liability for premiums ceded to the assigned risk pool. Other accounts payable decreased \$0.3 million due to a decline in employee benefits payable caused by a shift to self-funded employee health insurance, and a decrease in advance claim recovery.

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 SAIF's portfolio.

Other liabilities and deposits—The balance in this line is comprised of accrued retrospective premiums payable, premium deposits, amounts due to brokers for security purchases, amounts due to other governments, and compensated absences payable. This balance increased \$14.2 million or 28.6 percent from the prior year due to a \$14.6 million increase in amounts due to brokers for security purchases, a \$1.5 million increase in premium deposits, and a \$0.3 million increase in compensated absences payable. This was offset by a \$1.7 million decrease in the estimated amount of return premium payable on retrospectively rated policies. Amounts due to other governments decreased \$0.5 million due to a reduction in the federal premium assessment.

Operations - year ended December 31, 2012

Significant changes in revenues and expenses include:

Net premiums earned—In 2012, net premiums earned increased \$43.9 million or 12.3 percent. The increase is due to new sales, a 1.9 percent increase to pure premium rates effective January 1, 2012, and an increase in assumed premium due to the Other States Coverage program.

Other income—This line increased \$1.7 million or 7.1 percent in 2012, due to an increase in premium assessment income as a result of the growth in premium.

Net losses and loss adjustment expenses incurred—Net losses incurred for 2012 increased by \$17.9 million from 2011, while net LAE incurred increased \$6.3 million for a total net increase of \$24.2 million. The favorable loss reserve development for 2012 was

attributed primarily to permanent total and permanent partial disability medical loss reserves from recent accident years, which had lower loss development than was expected. Reductions in the tail factors were also a driver. Indemnity loss reserves experienced favorable development as indemnity costs for recent accident years were much lower than expected. LAE incurred increased due to adverse reserve development. The unfavorable LAE development was largely attributable to an increase in selected LAE severity for the current calendar year due to recent increases in employee benefit and retirement costs.

Policyholders' dividends—Substantially all of SAIF's business is written under various participating plans wherein a dividend may be returned to the policyholder. Dividends may be paid to the extent that a surplus is accumulated from premiums, investment gains, and/or loss reserve reductions. In 2012 and 2011, policyholder dividends of \$150.0 million were declared and paid to qualifying policyholders.

Underwriting expense—This line increased by \$5.6 million or 6.0 percent in 2012, due to an increase in premium, as well as an increase in commission rates effective October 1, 2012.

Net investment income—Investment income for 2012 was \$182.5 million higher than the amount recorded for 2011, primarily due to market value increases and higher realized gains. The change in fair value of investments recorded for 2012 was \$203.4 million compared to \$24.9 million for 2011, the result of increased market values for both bonds and equities. Net realized investment gains were \$39.3 million for 2012, compared to net realized gains of \$26.1 million for 2011. For 2012, net realized gains from bonds were \$39.3 million, while net realized gains on equity sales were minimal. Investment income declined \$8.6 million from 2011 to 2012, and has been adversely affected by relatively low yields on high quality securities as bonds that were sold or matured with higher yields were replaced with lower yield securities. In addition, the payment of policyholder dividends during the past three years has reduced the opportunity for investment income.

Economic outlook

It is anticipated that the economy and unemployment rates will continue to slowly improve, keeping premium growth modest during 2013. The 1.7 percent pure premium rate increase approved for 2013 may increase premium collections.

Financial position as of December 31, 2011

At the end of 2011, total assets increased \$37.1 million from the prior year. Total liabilities increased \$13.6 million for the year, and fund equity increased \$23.5 million.

Significant changes include:

Cash and cash equivalents—The majority of SAIF's cash accounts consist of short-term investments and funds utilized by external investment managers. Cash and cash equivalents increased \$2.1 million or 5.1 percent from December 31, 2010 to December 31, 2011.

Investments—At the end of 2011, investments were \$46.2 million or 1.1 percent higher than at the end of 2010. SAIF's asset allocation was in compliance with the asset allocation policy as of December 31, 2011. Investment holdings (principal and cost) increased \$73.7 million for bonds and decreased \$52.3 million for equities. Bond holdings increased due to the reinvestment of investment income offset somewhat by the withdrawal of bond principal to fund the policyholder dividend payment. The decrease in equities was due to a decline in

market value and to withdrawals to fund both the policyholder dividend and operations. Market values increased \$61.8 million for bonds and decreased \$36.8 million for equities. The BlackRock MSCI ACWI fund had a negative return of 7.6 percent for 2011.

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 SAIF's portfolio.

Accounts and interest receivable—The balance in this line is comprised of investment income receivable, net premiums receivable, accrued retrospective premiums receivable, and other accounts receivable. This balance increased \$16.4 million or 4.9 percent from December 31, 2010 to December 31, 2011.

Accrued investment income decreased \$3.5 million or 8.7 percent from December 31, 2010 to December 31, 2011, primarily due to the low interest rate environment.

Premiums receivable increased \$23.6 million or 10.0 percent in 2011, primarily due to the growth in premiums. Net written premiums increased 13.3 percent from 2010 to 2011.

Accrued retrospective premiums receivable decreased \$5.3 million or 11.6 percent due to favorable loss development, primarily for the State of Oregon's retrospectively rated policies.

Other accounts receivable increased \$1.6 million or 11.3 percent, primarily due to a \$1.5 million increase in premium assessment receivables. This was due to the growth in premiums as noted above.

Other assets—This balance increased \$2.1 million from the prior year, primarily due to a \$1.3 million increase in amounts due from brokers for securities sold, and a \$0.8 million increase in deferred acquisition costs as a result of an increase in commissions associated with the premium growth.

Reserve for losses and loss adjustment expenses—The total (current and noncurrent) reserve for losses and loss adjustment expenses (LAE) increased \$14.7 million or 0.5 percent from the prior year. Loss reserves decreased \$21.0 million or 0.8 percent and LAE reserves increased \$35.7 million or 11.3 percent during 2011. Loss reserves for the 2011 accident year were offset by favorable loss reserve development of \$126.7 million related to prior accident years. The favorable loss reserve development was attributed primarily to permanent total and permanent partial disability medical loss reserves from recent accident years which had lower loss development than was expected. Indemnity loss reserves were virtually unchanged. The unfavorable LAE development was largely attributed to an increase in selected LAE severity for the current year.

Unearned premiums—The amount of unearned premium for 2011 increased \$15.8 million or 9.4 percent due to the increase in premium.

Accounts payable—The balance in this line is comprised of commission payable, reinsurance payable, accrued premium assessment, and other accounts payables. The \$4.5 million increase in premium assessment payable and the \$1.1 million increase in commission payable are due to the growth in premium. Other accounts payable increased \$1.8 million due to an increase in employee benefits payable, an increase in policyholder credit balances, and an increase in advance claim recovery due to a third-party settlement

payment received in late 2011 for an injured worker. Reinsurance payable decreased \$0.7 million due to a decrease in the liability for premiums ceded to the assigned risk pool.

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 SAIF's portfolio.

Other liabilities and deposits—The balance in this line is comprised of accrued retrospective premiums payable, premium deposits, amounts due to brokers for security purchases, amounts due to other governments, and compensated absences payable. This balance increased \$4.6 million or 10.2 percent from the prior year primarily due to a \$4.8 million increase in the estimated amount of return premium payable on retrospectively rated policies. The increase was due to favorable loss experience for the majority of the retrospectively rated policies. Amounts due to other governments decreased \$0.3 million due to a reduction in the federal premium assessment.

Operations - year ended December 31, 2011

Significant changes in revenues and expenses include:

Net premiums earned—Net premiums earned in prior years have been declining due to a weak economy and premium rate reductions. Pure premium rates declined an average of 5.9 percent in 2009, 1.3 percent in 2010, and 1.8 percent for 2011. For 2010, premiums earned were 1.8 percent lower than 2009. However, for 2011, net premiums earned increased \$24.2 million or 7.3 percent compared to 2010. The increase is due to new sales and higher reported payrolls by policyholders.

Other income—This line increased \$6.7 million or 39.8 percent in 2011, due to an increase in premium assessment income as a result of the growth in premium.

Net losses and loss adjustment expenses incurred—Net losses incurred for 2011 decreased by \$86.6 million from 2010, while net LAE incurred increased \$50.3 million for a total net decrease of \$36.3 million. The favorable loss reserve development for 2011 was attributed primarily to permanent total and permanent partial disability medical loss reserves from recent accident years which had lower loss development than was expected. Indemnity loss reserves were virtually unchanged. LAE incurred increased due to adverse reserve development. Unfavorable LAE development was largely attributable to an increase in selected LAE severity for the current year.

Policyholders' dividends—Substantially all of SAIF's business is written under various participating plans wherein a dividend may be returned to the policyholder. Dividends may be paid to the extent that a surplus is accumulated from premiums, investment gains, and/or loss reserve reductions. In 2011, policyholder dividends of \$150.0 million were declared and paid to qualifying policyholders. In 2010, policyholder dividends of \$200.5 million were declared and paid to qualifying policyholders, of which \$100.6 million was accrued at December 31, 2009.

Underwriting expense—This line increased by \$12.6 million or 15.5 percent in 2011, due to an increase in commissions as a result of the growth in premium.

Net investment income—Investment income for 2011 was \$203.0 million lower than the amount recorded for 2010, primarily because realized gains for 2011 were less than 2010. Net realized investment gains were \$26.1 million for 2011, compared to gains of \$223.8

million for 2010. The gains experienced in 2010 were primarily due to the need to dispose of a significant share of the equity portfolio to implement a new investment allocation policy. For 2011, realized gains from bonds were \$18.0 million, and equity sales resulted in \$7.9 million in gains. The change in fair value of investments recorded for 2011 was \$24.9 million compared to \$21.5 million for 2010. While investment principal has grown, investment income declined \$10.9 million from 2010 to 2011, and has been adversely affected by relatively low yields on high quality securities. In addition, the payment of policyholder dividends during the past two years has reduced the opportunity for investment income.

Economic outlook

It is anticipated that the economy and unemployment rates will continue to slowly improve, keeping premium levels low but slowly improving during 2012. The 1.9 percent pure premium rate increase approved for 2012 may increase premium collections.

SAIF CORPORATION**STATEMENTS OF NET POSITION
AS OF DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 88,393	\$ 43,883
Investments	4,313,235	4,083,247
Securities lending cash collateral	315,896	199,303
Investment income receivable	36,592	36,663
Premiums receivable, net	273,688	258,336
Accrued retrospective premiums receivable	34,223	39,977
Accounts receivable	17,534	15,598
Other assets	<u>9,192</u>	<u>9,238</u>
Total current assets	<u>5,088,753</u>	<u>4,686,245</u>
NONCURRENT ASSETS—Capital assets, net	<u>15,771</u>	<u>16,515</u>
TOTAL	<u>\$ 5,104,524</u>	<u>\$ 4,702,760</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Reserve for losses and loss adjustment expenses	\$ 243,397	\$ 225,388
Unearned premiums	198,567	184,117
Accrued retrospective premiums payable	33,393	35,072
Policyholders' dividends payable	35	-
Commissions payable	10,723	9,046
Reinsurance payable	3,144	5,496
Accrued premium assessment payable	22,368	20,448
Premium deposits	10,174	8,698
Accounts payable	22,583	22,896
Obligations under securities lending	315,817	199,315
Other liabilities	<u>20,431</u>	<u>6,000</u>
Total current liabilities	<u>880,632</u>	<u>716,476</u>
NONCURRENT LIABILITIES:		
Reserve for losses and loss adjustment expenses	2,809,214	2,794,005
Other postemployment benefits obligation	<u>2,024</u>	<u>1,640</u>
Total noncurrent liabilities	<u>2,811,238</u>	<u>2,795,645</u>
Total liabilities	<u>3,691,870</u>	<u>3,512,121</u>
NET POSITION:		
Net investment in capital assets	15,771	16,515
Unrestricted	<u>1,396,883</u>	<u>1,174,124</u>
Total net position	<u>1,412,654</u>	<u>1,190,639</u>
TOTAL	<u>\$ 5,104,524</u>	<u>\$ 4,702,760</u>

See notes to financial statements.

SAIF CORPORATION**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
OPERATING REVENUES:		
Net premiums earned	\$ 401,350	\$ 357,475
Other income	<u>25,242</u>	<u>23,574</u>
Total operating revenues	<u>426,592</u>	<u>381,049</u>
OPERATING EXPENSES:		
Net losses and loss adjustment expenses incurred	353,123	328,879
Policyholders' dividends	149,970	150,043
Underwriting expenses	99,130	93,530
Bad debt provision	<u>533</u>	<u>815</u>
Total operating expenses	<u>602,756</u>	<u>573,267</u>
OPERATING LOSS	<u>(176,164)</u>	<u>(192,218)</u>
NONOPERATING REVENUES:		
Investment income	403,959	220,827
Investment expenses	<u>(5,780)</u>	<u>(5,121)</u>
Net investment income	<u>398,179</u>	<u>215,706</u>
INCREASE IN NET POSITION	<u>\$ 222,015</u>	<u>\$ 23,488</u>
NET POSITION—Beginning of year	<u>1,190,639</u>	<u>1,167,151</u>
NET POSITION—End of year	<u>\$ 1,412,654</u>	<u>\$ 1,190,639</u>

See notes to financial statements.

SAIF CORPORATION**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Premiums collected, net of reinsurance	\$ 403,646	\$ 359,089
Loss and loss adjustment expenses paid	(319,905)	(314,125)
Underwriting expenses paid	(99,130)	(93,530)
Policyholder dividends paid	(149,935)	(150,043)
Other receipts	<u>26,025</u>	<u>29,281</u>
Net cash used in operating activities	<u>(139,299)</u>	<u>(169,328)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(1,078,628)	(1,126,905)
Proceeds from sales and maturities of investments	1,099,465	1,123,593
Interest received on investments and cash balances	162,909	174,537
Interest received from securities lending	804	805
Interest paid for securities lending	<u>(268)</u>	<u>(310)</u>
Net cash provided by investing activities	<u>184,282</u>	<u>171,720</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(571)	(404)
Proceeds from disposition of capital assets	<u>98</u>	<u>153</u>
Net cash used in capital and related financing activities	<u>(473)</u>	<u>(251)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	44,510	2,141
CASH AND CASH EQUIVALENTS—Beginning of year	<u>43,883</u>	<u>41,742</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 88,393</u>	<u>\$ 43,883</u>

(Continued)

SAIF CORPORATION**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(In thousands)**

	2012	2011
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	<u>\$ (176,164)</u>	<u>\$ (192,218)</u>
Adjustments to reconcile operating loss to net cash provided by		
Operating activities:		
Depreciation and amortization	1,185	1,246
Bad debt provision	533	815
Net changes in assets and liabilities:		
Premiums receivable, net	(15,885)	(24,369)
Accrued retrospective premiums receivable	5,755	5,264
Accounts receivable	(1,936)	(1,588)
Other assets	(1,403)	(771)
Reserve for losses and loss adjustment expenses	33,218	14,754
Unearned premiums	14,450	15,830
Accrued retrospective premiums payable	(1,680)	4,767
Policyholders' dividends payable	35	-
Commissions payable	1,677	1,133
Reinsurance payable	(2,352)	(722)
Accrued premium assessment payable	1,920	4,543
Premium deposits	1,476	30
Accounts payable	(313)	1,772
Other liabilities	(198)	(194)
Other postemployment benefits obligation	<u>383</u>	<u>380</u>
Total adjustments	<u>36,865</u>	<u>22,890</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (139,299)</u>	<u>\$ (169,328)</u>
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES: Investments acquired and sold through conversions and tax free exchange transactions	<u>\$ 50,414</u>	<u>\$ 43,995</u>

See notes to financial statements.

SAIF CORPORATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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 Longshore and Harbor Workers' Compensation Act, Jones Act, and Federal Employers Liability Law. SAIF has partnered with Zurich American Insurance Company and United States Insurance Services to provide other states coverage effective February 1, 2011. SAIF's Board of Directors is appointed by the governor of the State of Oregon and consists of Oregon business and community leaders not otherwise in the employ of SAIF. Certain members of SAIF's Board of Directors are SAIF policyholders or are employed by SAIF policyholders. The transactions between SAIF and these policyholders were within SAIF's standard terms and conditions.

SAIF writes business on a direct basis as well as through agents. Premiums written on a direct basis were 29.8 percent and 31.7 percent of standard premium during 2012 and 2011, respectively. SAIF issues workers' compensation insurance policies to individual Oregon employers including state agencies.

The Oregon Department of Consumer and Business Services (DCBS) enforces workers' compensation laws under the Oregon Revised Statutes (ORS). Under the reporting requirements of the DCBS, Insurance Division, SAIF is subject to Risk Based Capital (RBC) 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 was \$284.4 million and \$276.2 million at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the statutory capital and surplus of SAIF exceeded the minimum RBC requirements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting—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 discretely presented 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 a special purpose government engaged solely in business-type activities. Accordingly, SAIF follows the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

SAIF adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and thus no longer follows statements of the Financial Accounting Standards Board issued prior to November 30, 1989.

Investments—SAIF reports investments at fair value on the statement of net position 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. For some debt securities, fair value cannot be determined in this manner. For these securities, a similar “benchmark” security is used. The benchmark security has a coupon rate and maturity date comparable to the debt security being valued, and its market risk is similar considering current market conditions. As of December 31, 2012 and 2011, the percent of SAIF’s debt securities priced using the benchmark method was 28.2 percent and 25.8 percent, respectively.

Cash and cash equivalents—Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. SAIF places its temporary cash investments with the Oregon Short-Term Fund (OSTF), an external cash and investment pool. SAIF’s participation in this fund is involuntary. This fund is not registered with the Securities and Exchange Commission and is not rated. The OSTF 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 OSTF. By statute, the OSTF may hold securities with maturities no greater than three years. Audited financial statements and monthly compliance summaries, which include information about the OSTF’s maturity distribution and credit quality, may be obtained at the Oregon State Treasury’s web site: [http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-\(OSTF\).aspx](http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-(OSTF).aspx). As of December 31, 2012 and 2011, SAIF’s balance in the OSTF was \$27.6 million and \$28.4 million, respectively.

Oregon’s State Treasurer employs the services of two external investment managers to manage SAIF’s fixed income portfolios. The cash balances of the fixed income managers are invested in the SSgA Prime Money Market Fund which had a fund credit quality rating of AAAM. This fund’s stated objectives are 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 Prime Money Market Fund as of December 31, 2012 and 2011, was 25 days and 19 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 financial institutions approved by the State of Oregon and limits the amount 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 many different industries and geographic regions.

Capital assets—Capital assets are stated at historical 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 recorded as other income.

Internal and external costs incurred to develop internal-use computer software and web sites during the application development stage are capitalized; costs incurred during the preliminary project stage and post-implementation/operation stage are expensed as incurred.

Capital assets are capitalized and depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Premiums—Premiums are based on individual employers’ reported payroll using predetermined, DCBS-approved insurance rates based on employee risk classifications and are recognized as income on a pro rata basis over the coverage period, which is generally one year. Ceded premiums are recognized consistent with the underlying policies. 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 of \$0.9 million and \$1.4 million, at December 31, 2012 and 2011, respectively. Premiums receivable consists of both billed and unbilled amounts. Unbilled premiums receivable primarily represent premiums recorded as written at the policy inception date and not yet billed, as well as an estimate of the difference between amounts earned ratably on installment-billed policies and the amount billed on the policy. Unbilled premiums receivable also include estimated billings on payroll reporting policies that 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 collectability 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, 2012 and 2011 were \$268.9 million and \$253.9 million, respectively.

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 as policyholders’ premium deposits. However, policyholders may pledge surety bonds and securities, as well as letters of credit, in lieu of cash deposits. Premium deposits at December 31, 2012 and 2011, were \$10.2 and \$8.7 million, respectively.

In addition to its regular premium plans, SAIF offers employers retrospective premium rating plans under which premiums are adjusted annually for up to 10½ 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 10½ years. The estimate of the net accrued premiums receivable for retrospective rating plans as of December 31, 2012 and 2011, is as follows (dollars in thousands):

	2012	2011
Accrued retrospective premiums receivable	\$ 34,223	\$ 39,977
Accrued retrospective premiums payable	<u>(33,393)</u>	<u>(35,072)</u>
Net	<u>\$ 830</u>	<u>\$ 4,905</u>

SAIF estimates accrued retrospective premiums receivable and payable by reviewing historical loss and premium development patterns at various stages of maturity and using these historical patterns to arrive at the best estimate of return and additional retrospective premiums on all open retrospectively rated policies. Premiums written on retrospective workers’ compensation policies for 2012 and 2011 were \$88.0 million and \$92.9 million, respectively, or 21.2 percent and 24.9 percent of net premiums written, respectively.

Reserve for losses and loss adjustment expenses—The reserve for losses and LAE is generally based on past experience. 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 losses and LAE at December 31, 2012 and 2011, is a reasonable estimate of the ultimate net costs of settling claims and claim 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, 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).

Premium deficiency—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. At December 31, 2012 and 2011, no reserve for premium deficiency was required to be recorded.

Policyholders' dividends—Substantially all of SAIF's business is written under various participating plans wherein a dividend may be returned to the policyholder. Dividends may be paid to the extent that a surplus is accumulated from premiums, investment gains, and/or loss reserve reductions. In 2012 and 2011, policyholder dividends of \$150.0 million were declared and paid to qualifying policyholders.

Taxes and assessments—The Oregon Department of Justice has determined that SAIF is exempt from federal and state 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 DCBS. Such assessments constitute an in-lieu-of-tax relative to premiums. Premium assessments were \$23.2 million and \$22.0 million, including \$22.4 million and \$20.4 million of accrued premium assessments, for the years ended December 31, 2012 and 2011, respectively.

Deferred acquisition costs—Acquisition costs, such as commissions and other costs related to acquiring new business, are deferred and amortized to income as premiums are earned. Deferred acquisition costs at December 31, 2012 and 2011 were \$9.1 million and \$7.7 million, respectively, and have been included within other assets on the statement of net position. Amortization expense for the years ended December 31, 2012 and 2011, was \$17.4 million and \$15.0 million, respectively, and is recorded as a component of underwriting expenses.

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, the reported amounts of revenues and expenses during the reporting period, and disclosures of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

New accounting pronouncements—In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting

Principles Board Opinions, and Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure, issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. SAIF implemented this statement for the fiscal year ended December 31, 2012. There was no significant impact on the financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. SAIF implemented this statement for the fiscal year ended December 31, 2012. The impact on the financial statements is that the balance sheet is now referred to as the statement of net position and fund equity is now referred to as net position.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflow of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement No. 4—*Elements of Financial Statements*. The requirements of this statement are effective for SAIF's 2013 financial statements. SAIF is currently evaluating the impact of this standard on the financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. This statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This statement also amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for operating lease payments that vary from a straight-line basis, the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. The requirements of this statement are effective for SAIF's 2013 financial statements. SAIF is currently evaluating the impact of this standard on the financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and

required supplementary information requirements about pensions also are addressed. The requirements of this statement are effective for SAIF's 2014 financial statements. SAIF is currently evaluating the impact of this standard on the financial statements.

In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. This statement requires the use of carrying values to measure the assets and liabilities in a government merger. This statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. The requirements of this statement are effective for SAIF's 2014 financial statements. SAIF is currently evaluating the impact of this standard on the financial statements.

Reclassifications—Certain reclassifications have been made to prior year amounts in order to conform with current year presentation.

3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash and cash equivalents—SAIF's cash is held in demand accounts with the State Treasurer, State Street Bank and Trust Company, and U.S. Bank. The cash held by the State Treasurer is invested in the OSTF, a cash and investment pool that is available for use by all state funds and eligible local governments. Cash equivalents held by State Street Bank and Trust Company consist of \$51.8 million in the SSgA Prime Money Market fund, and a \$3.8 million repurchase agreement maturing January 2, 2013.

SAIF's cash and cash equivalents totaled \$88.4 million and \$43.9 million as of December 31, 2012 and 2011, respectively, and are composed of the following (dollars in thousands):

	2012	2011
Cash balances		
Oregon Short-Term Fund	\$ 27,621	\$ 28,368
State Street Bank and Trust Company	112	106
U.S. Bank	<u>5,031</u>	<u>4,847</u>
	32,764	33,321
Cash equivalents		
State Street Bank (Barclay's Capital Repo)	3,800	-
State Street Bank (BlackRock money market fund)	-	1
State Street Bank (SSgA prime money market fund)	<u>51,829</u>	<u>10,561</u>
	55,629	10,562
Total cash and cash equivalents	<u>\$ 88,393</u>	<u>\$ 43,883</u>

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. State Treasurer demand deposit accounts and investments of the OSTF held in state banks are insured up to the Federal Deposit Insurance (FDIC) amount of \$250 thousand. Where balances exceed the FDIC amount, the balances are covered by collateral held in a multiple financial institution collateral pool administered by the Oregon State Treasury in the Public Funds Collateralization Program. The cash held by both State Street Bank and Trust Company (State Street) and U.S. Bank is in noninterest bearing accounts, and is FDIC insured under the Dodd-Frank Wall Street Reform and Consumer Protection Act through December 31, 2012.

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 ORS 293.726, the investment funds are to be 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. Equity investments are limited to not more than 50 percent 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 a range of 7 to 13 percent of the market value of invested assets with a target allocation of 10 percent.

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, 2012 and 2011, were \$38 thousand and \$1.5 million, respectively. Due to brokers for security purchases at December 31, 2012 and 2011, were \$14.6 million and \$4 thousand, respectively.

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 27, 2010, provides that a duration target be used to manage interest rate risk. The policy calls for the portfolio duration to be within 20 percent of the benchmark duration. The benchmark duration as of December 31, 2012, was 5.39 years, with an acceptable range of 4.31 to 6.47 years. As of that date, the fixed income portfolio’s duration was 5.30 years.

The following 2012 maturity distribution schedule includes \$1.0 billion in interest-rate sensitive securities. As of December 31, 2012, SAIF held \$480.5 million of U.S. Federal Agency mortgage-backed securities and \$279.4 million of collateralized mortgage obligations (CMOs). These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. As of December 31, 2012, SAIF held \$251.0 million of asset-backed securities which consisted primarily of automobile loans, student loans, and credit card receivables. The value of these securities can be volatile as interest rates fluctuate. Additional risk inherent with these securities is the unpredictability of default on loans that are the collateral for the debt.

The following schedule represents the fixed income investments by maturity date as of December 31, 2012 and 2011, using the segmented time distribution method. 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):

2012	Less Than 1 Year	1-5 Years	6-10 Years	More Than 10 Years	Fair Value
Bonds:					
U.S. Treasury obligations	\$ 224,505	\$ 23,176	\$ 58,564	\$ 12,334	\$ 318,579
U.S. federal agency mortgage securities	99,679	177,606	70,871	132,308	480,464
U.S. federal agency debt	-	8,455	3,522	1,757	13,734
Corporate bonds	34,970	613,151	732,982	651,141	2,032,244
Municipal bonds	4,082	29,843	3,356	85,856	123,137
Collateralized mortgage obligations	41,165	170,176	36,372	31,638	279,351
Asset-backed securities	112,075	78,569	31,936	28,416	250,996
International debt securities	<u>10,247</u>	<u>100,591</u>	<u>152,463</u>	<u>108,885</u>	<u>372,186</u>
Total bonds	<u>\$ 526,723</u>	<u>\$1,201,567</u>	<u>\$1,090,066</u>	<u>\$1,052,335</u>	<u>\$3,870,691</u>
Equity securities:					
BlackRock MSCI ACWI IMI index fund					<u>\$ 442,544</u>
Total equity securities					<u>442,544</u>
Other invested assets					<u>-</u>
Total investments					<u>\$4,313,235</u>

2011	Less Than 1 Year	1-5 Years	6-10 Years	More Than 10 Years	Fair Value
Bonds:					
U.S. Treasury obligations	\$ 19,995	\$ 61,202	\$ 98,366	\$ -	\$ 179,563
U.S. federal agency mortgage securities	105,428	214,722	119,295	126,684	566,129
U.S. federal agency debt	-	8,618	3,563	1,699	13,880
Corporate bonds	67,716	521,282	712,262	592,828	1,894,088
Municipal bonds	2,780	24,243	3,242	96,277	126,542
Collateralized mortgage obligations	25,843	125,456	25,282	52,501	229,082
Asset-backed securities	73,577	139,271	45,264	50,733	308,845
International debt securities	<u>2,972</u>	<u>146,206</u>	<u>145,287</u>	<u>91,803</u>	<u>386,268</u>
Total bonds	<u>\$ 298,311</u>	<u>\$1,241,000</u>	<u>\$1,152,561</u>	<u>\$1,012,525</u>	<u>\$3,704,397</u>
Equity securities:					
BlackRock MSCI ACWI IMI index fund					<u>\$ 378,850</u>
Total equity securities					<u>378,850</u>
Other invested assets					<u>-</u>
Total investments					<u>\$4,083,247</u>

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. The policy seeks to maintain an overall fixed income portfolio quality of at least "A" or higher.

The majority of SAIF's debt securities as of December 31, 2012 and 2011, were rated by Moody's and Standard & Poor's, which are credit rating providers. The following schedule represents the ratings of debt securities by investment type as of December 31, 2012 and 2011, using either Moody's or Standard & Poor's rating scale (dollars in thousands):

2012

Quality Ratings

	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	Unrated	Fair Value
Bonds:												
U.S. Treasury obligations	\$ -	318,579	-	-	-	-	-	-	-	-	-	\$ 318,579
U.S. federal agency mortgage securities	-	480,464	-	-	-	-	-	-	-	-	-	480,464
U.S. federal agency debt	-	10,211	-	-	-	-	-	-	-	-	3,523	13,734
Corporate bonds	10,790	157,277	736,777	886,096	173,585	47,555	3,728	-	-	-	16,436	2,032,244
Municipal bonds	-	43,094	50,879	11,398	-	-	-	-	-	-	17,766	123,137
Collateralized mortgage obligations	79,518	65,660	20,417	2,132	528	1,923	1,881	3,121	-	7,409	96,762	279,351
Asset-backed securities	104,840	90,413	1,087	-	-	-	-	-	-	416	54,240	250,996
International debt securities	8,053	18,503	118,822	181,520	34,598	3,015	6,664	-	-	-	1,011	372,186
Total bonds	\$ 203,201	\$ 1,184,201	\$ 927,982	\$ 1,081,146	\$ 208,711	\$ 52,493	\$ 12,273	\$ 3,121	\$ -	\$ 7,825	\$ 189,738	\$ 3,870,691

2011

Quality Ratings

	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	Unrated	Fair Value
Bonds:												
U.S. Treasury obligations	\$ -	179,563	-	-	-	-	-	-	-	-	-	\$ 179,563
U.S. federal agency mortgage securities	-	566,129	-	-	-	-	-	-	-	-	-	566,129
U.S. federal agency debt	-	10,317	-	-	-	-	-	-	-	-	3,563	13,880
Corporate bonds	13,297	158,191	764,153	737,138	161,588	39,352	4,869	3,397	-	-	12,103	1,894,088
Municipal bonds	2,126	59,458	43,661	8,188	-	-	-	-	-	-	13,109	126,542
Collateralized mortgage obligations	78,254	72,763	2,797	-	-	661	4,018	6,369	-	1,493	62,727	229,082
Asset-backed securities	141,696	80,410	2,803	-	-	-	439	-	-	-	83,497	308,845
International debt securities	8,156	30,968	134,081	181,417	16,048	10,810	-	-	483	-	4,305	386,268
Total bonds	\$ 243,529	\$ 1,157,799	\$ 947,495	\$ 926,743	\$ 177,636	\$ 50,823	\$ 9,326	\$ 9,766	\$ 483	\$ 1,493	\$ 179,304	\$ 3,704,397

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 limitations 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 percent of the outstanding fixed income obligations of the issuer.
- Issuer level restrictions shall not apply to U.S. government and agency obligations, including agency-backed mortgages (no limit) and private mortgage-backed and asset-backed securities, which shall be limited to 10 percent per issuer.
- Obligations of other national governments are limited to 10 percent per issuer.

As of December 31, 2012 and 2011, SAIF did not have a concentration of credit risk in any one issuer that exceeded the policy outlined above.

Securities on deposit—U.S. Treasury obligations with a fair value of \$7.6 million and \$7.7 million at December 31, 2012 and 2011, respectively, were on deposit with the Federal Reserve as required by the U.S. Department of Labor under the Longshore and Harbor Workers' Compensation Act. In addition, certificates of deposit with a fair value of \$571 thousand were on deposit at U.S. Bank as required by the DCBS at December 31, 2012 and 2011.

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

During 2012 and 2011, State Street loaned SAIF's fixed income securities and received cash and noncash collateral denominated in U.S. dollars. Borrowers were required to deliver collateral for each loan equal to at least 102 percent of the fair value of the loaned security. SAIF did not impose any restrictions on the amount of the loans State Street made on its behalf. Securities received as collateral may not be sold or pledged by SAIF, except in the event of borrower default. 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.

Cash collateral received for securities loaned is invested in the State Street Bank and Trust Company Oregon Short-Term Investment Fund (the 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. No income from the Fund was assigned to another fund by the custodial agent during 2012 and 2011. At December 31, 2012 and 2011, the Fund had an average life-final maturity of 112 days and 86 days, respectively.

At December 31, 2012 and 2011, the cash collateral held was \$315.9 million and \$199.3 million, respectively. At December 31, 2012 and 2011, the fair value, including accrued investment income related to the securities on loan, was \$316.9 million and \$195.3 million,

respectively. For 2012 and 2011, securities lending income was \$0.8 million, and securities lending expense was \$0.3 million.

4. RESERVE FOR LOSSES 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 LAE. In estimating the reserve for losses and LAE, 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 losses and LAE at December 31, 2012 and 2011 (dollars in thousands):

	2012	2011
Gross reserve for losses and loss adjustment expenses—beginning of year	\$3,157,315	\$3,152,189
Less reinsurance recoverable—beginning of year	<u>(137,922)</u>	<u>(147,550)</u>
Net reserve for losses and loss adjustment expenses—beginning of year	<u>3,019,393</u>	<u>3,004,639</u>
Incurred losses and loss adjustment expenses:		
Provision for insured events of the current year	501,852	455,593
Provision for insured events of prior years	<u>(148,729)</u>	<u>(126,714)</u>
Total incurred losses	<u>353,123</u>	<u>328,879</u>
Loss and loss adjustment expense payments attributable to:		
Insured events of the current year	116,457	103,973
Insured events of prior years	<u>203,448</u>	<u>210,152</u>
Total payments	<u>319,905</u>	<u>314,125</u>
Net reserve for losses and loss adjustment expenses—end of year	3,052,611	3,019,393
Plus reinsurance recoverable—end of year	<u>135,243</u>	<u>137,922</u>
Gross reserve for losses and loss adjustment expenses—end of year	<u>\$3,187,854</u>	<u>\$3,157,315</u>

The reserve for losses and LAE increased \$33.2 million in 2012, which was net of favorable development of \$148.7 million. Loss reserves decreased \$6.8 million as compared to the prior year. Loss reserves for the 2012 accident year were offset by favorable loss reserve development in prior accident years. The favorable loss reserve development was attributed primarily to permanent total and permanent partial disability medical loss reserves from recent accident years, which had lower loss development than was expected. Reductions in the tail factors were also a driver. Indemnity loss reserves experienced favorable development as indemnity costs for recent accident years were much lower than expected.

LAE reserves increased \$40.0 million. The unfavorable LAE development was largely attributable to an increase in selected LAE severity for the current calendar year due to recent increases in employee benefit and retirement costs.

The reserve for losses and LAE increased \$14.7 million in 2011, which was net of favorable development of \$126.7 million. The favorable development was attributed primarily to

permanent total and permanent partial disability medical loss reserves from recent accident years, which had lower loss development than was expected. Indemnity loss reserves were virtually unchanged. LAE reserves increased \$35.7 million. The unfavorable LAE development was largely attributable to an increase in selected LAE severity.

SAIF discounts the indemnity reserve for known unpaid fatal and permanent total disability losses on a tabular basis using the 1999 United States Life Tables, the 1980 United States of America Railroad Retirement Board Remarriage Table, and a discount rate of 3.5 percent. SAIF does not discount any incurred but not reported reserves, medical unpaid losses, or unpaid LAE. Gross reserves subject to tabular discounting were \$259.5 million and \$260.3 million for 2012 and 2011, respectively. The discounts were \$89.4 million and \$90.0 million as of December 31, 2012 and 2011, respectively.

Anticipated salvage and subrogation of \$29.0 million and \$29.6 million was included as a reduction of the reserve for losses and LAE at December 31, 2012 and 2011, respectively.

SAIF's exposure to asbestos claims arose from the sale of workers' compensation policies. Reserves of \$26.1 million and \$27.6 million for losses and LAE are related to asbestos claims as of December 31, 2012 and 2011, respectively. Amounts paid for asbestos-related claims were \$0.8 million at December 31, 2012 and 2011.

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 \$35 million per occurrence with a \$10 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 2012, SAIF had reinsurance protection for 85 percent of losses in excess of 20 percent of 2011 direct written premium for acts of foreign and domestic terrorism through the Terrorism Risk Insurance Program Reauthorization Act.

The following amounts have been deducted (added) in the accompanying financial statements as a result of reinsurance ceded for 2012 and 2011 (dollars in thousands):

	2012	2011
Reserve for losses and loss adjustment expenses	\$ 47,765	\$ 47,148
Premiums earned	990	1,002
Losses and loss adjustment expenses incurred	1,768	(3,344)

Of the \$47.8 and \$47.1 million recoverable, SAIF had a reinsurance recoverable from an individual reinsurer of \$22.5 million and \$18.7 million, respectively as of December 31, 2012 and 2011.

In November 2010, SAIF received formal approval from the DCBS for implementation of its Other States Coverage program. Beginning February 1, 2011, SAIF partnered with Zurich American Insurance Company and United States Insurance Services (USIS) to provide other states coverage. Zurich issues policies covering the non-Oregon operation of SAIF's customers

and manages claims arising from those policies. SAIF reinsures those policies in full. USIS, a broker licensed in all fifty states, provides marketing and administrative services.

The following amounts are included in the accompanying financial statements as a result of participation in other states coverage in 2012 and 2011 (dollars in thousands):

Other States Coverage	2012	2011
Assumed:		
Reserve for losses and loss adjustment expenses	\$ 3,051	\$ 1,281
Unearned premiums	4,519	2,395
Premiums written	8,770	3,954
Premiums earned	6,646	1,559
Losses and loss adjustment expenses incurred	2,977	1,372
Commission expense	1,359	581

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 conditions, poor loss experience, or the inherently dangerous nature of the work. SAIF cedes such business to the Plan. In addition, SAIF is required to assume its share of premiums and losses from the Plan based on SAIF's voluntary market share.

The following amounts are included in the accompanying financial statements as a result of participation in the Plan in 2012 and 2011 (dollars in thousands):

NWCRP	2012	2011
Assumed:		
Reserve for losses and loss adjustment expenses	\$ 67,956	\$ 70,800
Unearned premiums	3,705	2,527
Premiums written	17,081	14,280
Premiums earned	15,903	13,927
Losses and loss adjustment expenses incurred	6,397	8,182
Commission expense	6,525	5,626
Ceded:		
Reserve for losses and loss adjustment expenses	\$ 87,478	\$ 90,774
Unearned premiums	4,738	4,002
Premiums written	9,274	8,794
Premiums earned	8,538	8,960
Losses and loss adjustment expenses incurred	3,537	1,251
Commission expense	4,021	2,615

6. LEASE COMMITMENTS

SAIF leases office space in several locations under noncancelable operating leases expiring during various years through 2019. Lease expense was \$1.2 million as of December 31, 2012 and 2011.

SAIF's future minimum lease payments under operating leases at December 31, 2012, are as follows (dollars in thousands):

2013	\$ 1,227
2014	1,145
2015	1,176
2016	1,195
2017	1,199
2018-2019	<u>1,291</u>
Total minimum payments	<u>\$ 7,233</u>

Certain rental commitments have renewal options extending through the year 2028. 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 \$344 thousand on leases due in the future under noncancelable subleases as of December 31, 2012.

7. RISK MANAGEMENT

The State of Oregon administers property and casualty insurance programs covering state government agencies through its Insurance Fund, an internal service 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 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 \$20 million.

SAIF participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each participating state entity based on its share of services provided in a prior period. The total statewide assessment of each type of coverage is based on independent biennial actuarial forecasts and administrative expenses, less any available fund balance of the Insurance Fund from the prior biennium. SAIF's assessment was \$255 thousand as of December 31, 2012 and 2011.

SAIF's employees do not participate in the State of Oregon's health insurance plans.

8. CONTINGENCIES

SAIF has entered into structured settlements wherein SAIF has purchased annuities for 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 \$3.5 million and \$4.0 million at December 31, 2012 and 2011, respectively.

During the normal 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 Oregon Department of Justice. Some of these potential liabilities become actual liabilities when one or more future events occur or fail to occur. To the extent that the future event is likely to occur or fail to occur, and a reasonable estimate of the loss can be made, an estimated liability would be recorded on SAIF's financial statements. Management believes that these matters do not materially impact the financial statements.

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. SAIF does not perform the investing function and has no fiduciary accountability for the plan. Thus, plan assets and any related liability to plan participants have been excluded from the financial statements.

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. The PERS Board of Trustees under the guidelines of ORS Chapter 238 administers PERS. The PERS retirement allowance, payable monthly for life, may be selected from multiple retirement benefit options. Options include survivorship benefits and lump-sum refunds. The basic benefit formula is 1.67 percent 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 by writing to PERS, Fiscal Services Division, PO Box 23700, Tigard, Oregon 97281-3700. The report may also be accessed online at: http://oregon.gov/PERS/pages/section/financial_reports/financials.aspx.

Beginning January 1, 2004, all covered employees are required by state statute to contribute 6.0 percent of their salary to the Individual Account Program (IAP), 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 a percentage of each covered employee's salary to fund the PERS program. For the year ended December 31, 2012, SAIF's contribution rate of each covered employee's salary was 9.55 percent. Rates are subject to change as a result of subsequent actuarial valuations.

SAIF employees hired on or 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 (cost sharing multiple-employer 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 8.05 percent of each covered employee's salary to the Pension Program and 6.0 percent to the Individual Account Program. Rates are subject to change as a result of subsequent actuarial valuations.

SAIF participates, along with other State of Oregon agencies, in paying the debt service for State of Oregon general obligation bonds issued in October 2003 to reduce an unfunded PERS liability. The bonds are scheduled to mature 25 years after the date of issuance. Currently, the repayment rate is 6.33 percent of payroll each month. The payment rate is recalculated each state fiscal biennium.

The total amount contributed by SAIF for all plans for the years ended December 31, 2012, 2011, and 2010, consist of the following (dollars in thousands):

	2012	2011	2010
Employer contributions:			
Debt service	\$ 3,649	\$ 3,370	\$ 3,338
PERS-Pension Program	3,954	2,361	883
OPSRP-Pension Program	<u>1,318</u>	<u>793</u>	<u>377</u>
Total employer contributions	<u>8,921</u>	<u>6,524</u>	<u>4,598</u>
Employee contributions paid by SAIF:			
PERS-IAP	2,478	2,496	2,571
OPSRP-IAP	<u>982</u>	<u>867</u>	<u>796</u>
Total employee contributions	<u>3,460</u>	<u>3,363</u>	<u>3,367</u>
Total contributions	<u>\$ 12,381</u>	<u>\$ 9,887</u>	<u>\$ 7,965</u>

For the years ended December 31, 2012, 2011, and 2010, SAIF's employer contributions were equal to the annual required contributions.

11. OTHER POSTEMPLOYMENT BENEFIT PLAN

Plan description—SAIF administers a single-employer defined benefit healthcare plan. SAIF employees retiring under Oregon PERS are eligible to receive medical coverage for self and eligible dependents until age 65. Retirees must pay the premium for the coverage elected. Premiums for coverage are identical for active and retired employees, except to the extent that SAIF pays all or a portion of its active employees' premiums. Participating retirees pay their own monthly premiums based on a blended premium rate since retirees are pooled together with active employees for insurance rating purposes. Benefit provisions are established by SAIF.

Funding policy—SAIF's funding policy provides for contributions at amounts sufficient to fund benefits on a pay-as-you-go basis. For the years ended December 31, 2012 and 2011, respectively, retired plan members contributed \$715 thousand and \$851 thousand through their required contributions, and the required contribution rate per retired member was an average of \$614 and \$717 per month.

Annual OPEB cost and net OPEB obligation—SAIF's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of 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 normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The following table shows the components of SAIF's annual OPEB cost for the years ended December 31, 2012, 2011, and 2010, the amount actually contributed, and changes in SAIF's net OPEB obligation to the plan (dollars in thousands):

	2012	2011	2010
Annual required contribution	\$ 911	\$ 875	\$ 762
Interest on net OPEB obligation	90	69	49
Adjustment to ARC	<u>(124)</u>	<u>(96)</u>	<u>(68)</u>
Annual OPEB cost (expense)	877	848	743
Contributions made	<u>493</u>	<u>468</u>	<u>376</u>
Increase in net OPEB obligation	384	380	367
Net OPEB obligation - beginning of year	<u>1,640</u>	<u>1,260</u>	<u>893</u>
Net OPEB obligation - end of year	<u>\$ 2,024</u>	<u>\$ 1,640</u>	<u>\$ 1,260</u>
Percent of annual OPEB cost contributed	56.2%	55.2%	50.6%

Actuarial methods and assumptions—Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress shown as required supplementary information presents multi-year trend information about whether the actuarial value of assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and participating members to that point. Actuarial calculations reflect a long-term perspective and include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

The postemployment healthcare benefit obligation was determined as part of the actuarial valuation prepared by a consulting actuary as of January 1, 2011, using the projected unit credit cost method. Significant assumptions used in the actuarial valuation include a 5.5 percent investment rate of return. The annual medical healthcare cost trend rate will increase 6.75 percent in the first year, 6.5 percent in the second year, 6.0 percent in the third year, 5.75 percent for the fourth through twenty-fifth year, 5.5 percent for the twenty-sixth through thirtieth year, and 5.25 percent thereafter. The unfunded actuarial accrued liability (UAAL) is being amortized as a level percentage of projected payroll on an open basis for 15 years. As GASB Statement No. 45 was implemented prospectively, there was no net OPEB liability at transition on January 1, 2007.

Funding progress information—The funded status as of the most recent actuarial valuation date is as follows (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Annual Covered Payroll ((b-a)/c)
01/01/2007	\$0	\$2,973	\$2,973	0.0%	\$50,229	5.9%
01/01/2009	\$0	\$5,701	\$5,701	0.0%	\$57,228	10.0%
01/01/2011	\$0	\$6,980	\$6,980	0.0%	\$56,948	12.3%

(Unaudited)
REQUIRED SUPPLEMENTARY INFORMATION
POSTEMPLOYMENT HEALTHCARE BENEFIT PLAN
SCHEDULE OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS
For the years ended December 31, 2012 and 2011
(In thousands)

The Schedule of Funding Progress and the Schedule of Employer Contributions present multi-year trend information comparing the actuarial value of plan assets to the actuarial accrued liability, and the actual contributions to the annual required contributions.

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Liability (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Annual Covered Payroll ((b-a)/c)
01/01/2007	\$0	\$2,973	\$2,973	0.0%	\$50,229	5.9%
01/01/2009	\$0	\$5,701	\$5,701	0.0%	\$57,228	10.0%
01/01/2011	\$0	\$6,980	\$6,980	0.0%	\$56,948	12.3%

Schedule of Employer Contributions

	2012	2011	2010
Annual required contribution	\$ 911	\$ 875	\$ 762
Interest on net OPEB obligation	90	69	49
Adjustment to ARC	(124)	(96)	(68)
Annual OPEB cost (expense)	877	848	743
Contributions made	493	468	376
Increase in net OPEB obligation	384	380	367
Net OPEB obligation - beginning of year	1,640	1,260	893
Net OPEB obligation - end of year	\$ 2,024	\$ 1,640	\$ 1,260
Percent of annual OPEB cost contributed	56.2%	55.2%	50.6%

Summary of Key Actuarial Methods and Assumptions

Actuarial valuation date	As of January 1, 2011
Actuarial cost method	Projected Unit Credit Cost Method
Amortization	15 years
Discount rate	5.50%
Projected payroll growth rate	3.75%
Health care cost trend rate	The annual medical healthcare cost trend rate will increase 6.75 percent in the first year, 6.5 percent in the second year, 6.0 percent in the third year, 5.75 percent for the fourth through twenty-fifth year, 5.5 percent for the twenty-sixth through thirtieth year, and 5.25 percent thereafter.

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