

STATE COMPENSATION INSURANCE FUND

2005 ANNUAL REPORT

STATE
COMPENSATION
INSURANCE
FUND

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FINANCIAL HIGHLIGHTS

December 31, 2005 and 2004 (In thousands)

	<u>2005</u>	<u>2004</u>	Percent Change
Assets	21,674,187	18,973,214	14.24%
Premiums Earned	5,946,401	7,918,319	-24.90%
Net Investment Income	802,630	636,671	26.07%
Compensation & Medical Benefits	4,152,685	5,528,283	-24.88%
Claim Expenses	862,918	841,684	2.52%
Net Income (before policyholders' dividends)	1,018,582	909,570	11.99%
Policyholders' Surplus	3,785,052	2,862,495	32.23%
Policyholder Dividends Paid	(2)	168	-101.19%
Premiums Earned to Policyholders' Surplus Ratio	1.571022274	2.7662298	
Policyholders' Surplus	3,785,052	2,862,495	32.23%
Special Surplus for retroactive reinsurance	576,256	319,756	80.22%
Unassigned Surplus	3,208,796	2,542,739	26.19%

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors State Compensation Insurance Fund:

We have audited the accompanying statutory statements of admitted assets, liabilities, and policyholders' surplus of State Compensation Insurance Fund (State Fund) as of December 31, 2005 and 2004, and the related statutory statement of operations and changes in policyholders' surplus and cash flows for the years then ended. These financial statements are the responsibility of State Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As described more fully in note 1 to the financial statements, State Fund prepared these financial statements using accounting practices prescribed or permitted by the Insurance Department of the State of California, which practices differ from U.S. generally accepted accounting principles. The effects on the financial statements of the variances between the statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of State Fund as of December 31, 2005 and 2004, or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of State Fund as of December 31, 2005 and 2004, and the results of its operations and its cash flow for the years then ended on the basis of accounting described in note 1.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on supplemental schedules I and II is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

May 4, 2006

STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND POLICYHOLDERS' SURPLUS (STATUTORY BASIS)

December 31, 2005 (Dollar amounts in thousands)

Admitted Assets

	<u>2005</u>	<u>2004</u>
Bonds, at amortized cost		
Bonds, at amortized cost	\$18,300,849	\$16,428,679
Money market fund	323,875	250,983
Real estate	175,636	175,768
Short-term investments	245,627	—
Collateral for loaned securities	1,285,599	928,024
Cash	281,390	306,211
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Total cash and investments	20,612,976	18,089,665
Premiums in the course of collection	149,136	154,593
Earned but unbilled premium	164,226	244,491
Reinsurance receivable	26,205	9,047
Accrued interest and dividends	190,577	165,120
Guarantee fund recoupments	269,373	160,071
Due from adjusting contracts	56,231	66,423
Data processing equipment, at cost less accumulated depreciation	8,063	7,856
Other assets	197,400	75,948
	<hr/>	<hr/>
Total admitted assets	\$21,674,187	18,973,214

Liabilities and Policyholders' Surplus

Estimated liabilities for:		
Losses	\$15,457,641	\$13,958,848
Loss adjustment expenses	1,743,321	1,500,486
Retroactive reinsurance ceded	(1,217,384)	(1,035,000)
Collateral for loaned securities	1,282,378	927,218
Unearned premiums	228,177	311,793
Reinsurance premiums payable	13,420	35,633
Dividends declared and unpaid	3,100	3,100
Guarantee fund assessments liability	8,728	31,824
Amounts held in trust	82,679	84,641
Other liabilities	287,075	292,176
	<hr/>	<hr/>
Total liabilities	17,889,135	16,110,719
Special surplus for retroactive reinsurance	576,256	319,756
Unassigned surplus	3,208,796	2,542,739
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Policyholders' surplus	3,785,052	2,862,495
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Total liabilities and policyholders' surplus	\$21,674,187	\$18,973,214

See accompanying notes to statutory basis financial statements.

STATEMENTS OF OPERATIONS AND CHANGES IN POLICYHOLDERS' SURPLUS (STATUTORY BASIS)

Years Ended December 31, 2005 and 2004 (Dollar amounts in thousands)

	<u>2005</u>	<u>2004</u>
Net premiums earned	\$5,946,401	\$7,918,319
Losses incurred	4,152,685	5,528,283
Loss adjustment expenses incurred	862,918	841,684
Underwriting and administrative expenses	906,662	1,209,942
Total underwriting deductions	<u>5,922,265</u>	<u>7,579,909</u>
Net underwriting income	<u>24,136</u>	<u>338,410</u>
Investment income	871,472	671,731
Net realized capital gains (losses)	3,661	(378)
Investment expenses	(72,503)	(34,682)
Net investment income	<u>802,630</u>	<u>636,671</u>
Other income (loss):		
Retroactive reinsurance gain	256,500	—
Loss on premium charge-offs	(64,684)	(65,511)
Net income, before policyholders' dividends	<u>1,018,582</u>	<u>909,570</u>
Dividends to policyholders	<u>(2)</u>	<u>(3,932)</u>
Net income	<u>1,018,584</u>	<u>913,502</u>
Policyholders' surplus, beginning of year	2,862,495	2,085,877
Change in nonadmitted assets	(97,528)	(152,271)
Change in unrealized gains and losses	207	662
Change in provision for reinsurance	1,294	14,725
Policyholders' surplus, end of year	<u>\$3,785,052</u>	<u>\$2,862,495</u>

See accompanying notes to statutory basis financial statements.

STATEMENTS OF CASH FLOWS (STATUTORY BASIS)

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

	<u>2005</u>	<u>2004</u>
Premiums collected net of reinsurance	\$5,850,825	\$7,795,260
Net investment income	833,369	662,085
Other income (expense)	191,816	(65,511)
Benefits and loss related payments	(2,671,049)	(3,193,630)
Other underwriting expense	(1,715,381)	(1,764,153)
Dividends paid to policyholders	2	(168)
	<hr/>	<hr/>
Net cash provided by operations	2,489,582	3,433,883
	<hr/>	<hr/>
Proceeds from investments sold, matured, or repaid:		
Bonds	2,709,102	1,336,722
Money market fund	5,733,120	5,983,774
Other	4,589	662
Cost of investments acquired:		
Bonds	(4,633,073)	(5,176,034)
Money market fund	(5,806,012)	(5,762,049)
Other	(4,238)	(9,829)
	<hr/>	<hr/>
Net cash used in investments	(1,996,512)	(3,626,754)
	<hr/>	<hr/>
Other cash provided	85,311	273,800
	<hr/>	<hr/>
Net cash provided by financing and miscellaneous sources	85,311	273,800
	<hr/>	<hr/>
Net change in cash and short-term investment	578,381	80,929
Cash, short-term investments, and cash collateral for loaned securities, beginning of year	1,234,235	1,153,306
	<hr/>	<hr/>
Cash, short-term investments, and cash collateral for loaned securities, end of year	\$1,812,616	\$1,234,235

See accompanying notes to statutory basis financial statements.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS)

December 31, 2005 and 2004 (Dollar amounts in thousands)

1. Summary of Significant Accounting Policies

A. History and Business

State Compensation Insurance Fund (State Fund) is a public enterprise fund established by the State of California through legislation enacted in 1913 to provide an available market for workers' compensation insurance to employers located in California. The State of California is not liable for any obligations of State Fund.

As a result of recent market conditions, State Fund believes that its market share of all workers' compensation insurance written in the State of California has decreased significantly.

State Fund is vulnerable to catastrophes, such as earthquakes and terrorist acts, which have not had significant adverse effects on operations in the past, but could present risks in the future. State Fund purchases reinsurance protection, as more fully described in note 7, to mitigate losses from catastrophic events.

B. Basis of Presentation

The statutory basis financial statements of State Fund have been prepared in conformity with accounting practices prescribed or permitted by the California Department of Insurance (CDI), and in accordance with the National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual, to the extent those practices and procedures do not conflict with the California Insurance Code. California Insurance Code Section 11558 requires companies to maintain a prescribed minimum reserve of loss and loss adjustment expenses for certain liability coverage, including workers' compensation insurance. This requirement differs from NAIC statutory practices, which do not have such a minimum reserve requirement. This difference between the CDI and NAIC does not impact statutory surplus as of December 31, 2005 and 2004, since carried loss and loss adjustment expense reserves exceed the minimum prescribed requirement.

Statutory accounting practices differ in certain respects from the U.S. generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB). The significant differences from GASB are as follows:

- Investment securities are carried principally at amortized cost, whereas under GASB such securities would be carried at estimated fair value with changes in fair value reflected in net income.
- Policy acquisition costs, including premium taxes, are charged to current operations as incurred, whereas related premium income is recognized on a pro-rata basis over the periods covered by the policies. Under GASB, policy acquisition costs would be deferred and amortized to income on the same basis as premium income is recognized.
- Certain assets designated as "nonadmitted assets" are excluded from total assets. These assets, the change in which is credited or charged directly to policyholders' surplus, consist principally of the following: premiums in the course of collection which remain outstanding over 90 days; nonoperating internally developed software costs; 10% of earned but unbilled premiums (EBUB) in excess of collateral specifically held an identifiable on a per policy basis; office furniture and equipment, and prepaid expenses. Under GASB, these assets would be included in total assets to the extent realizable.
- Gains on the retroactive reinsurance contract are recognized in income and established as segregated surplus. GASB requires the gains to be deferred and recognized over the estimated settlement period of the reinsured losses, using either a recovery or interest method.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

December 31, 2005 and 2004 (Dollar amounts in thousands)

- Policyholders' dividends are accrued when declared, whereas under GASB, they are accrued based on amounts to be paid.
- Fees received for processing the claims of other self-insured State of California departments are netted against loss adjustment expenses, whereas under GASB, they are recorded as other income.
- Self-rent is included as income and expense, whereas it is excluded under GASB.
- The statement of cash flows differs in certain respects from the presentation required by GASB, including the presentation of the changes in cash, short-term investments, and collateral for loaned securities, instead of cash and cash equivalents. Short-term investments include securities with maturities, at the time of acquisition, of one year or less. In addition, there is no reconciliation between net income and cash from operations as there would be under GASB.
- A provision for reinsurance is recorded as a liability with a corresponding adjustment to unassigned surplus for the reinsurance recoverables from unauthorized reinsurance carriers with inadequate collateral and reinsurance receivables over 90 days. Under GASB, such a provision for reinsurance is not recognized.
- Reinsurance recoverable, including retroactive reserves ceded on the loss portfolio transfer, is deducted from the liability for unpaid claims or losses, whereas under GASB, it is recorded as an asset.

C. Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with statutory accounting principles permitted or prescribed by the CDI requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The most significant estimates inherent in these statutory financial statements are the liabilities for losses and loss adjustment expenses.

D. Investments

Investments are valued in accordance with the requirements of the Securities Valuation Office (SVO) of the NAIC. Short-term investments and investments in money market funds are carried at cost, which approximates fair value. Bonds are principally carried at amortized cost using the scientific to worst constant yield method. Mortgage-backed securities are amortized using anticipated prepayments and are accounted for using the prospective method. Prepayment assumptions for mortgage-backed securities are obtained from various external sources.

The aggregate fair value of fixed income securities is determined from independent quotations obtained from the SVO of the NAIC and independent pricing sources. Realized gains or losses on the sale or maturity of investments are determined on the basis of specific identification and are included in net income.

Below investment grade bonds are carried at the lower of cost or fair value. Declines in the value of investments that are determined to be other than temporary result in a reduction in carrying amount to fair value. The impairment charge is included as a realized loss and a new cost basis for the security is established. To determine whether an impairment is "other than temporary," State Fund considers credit quality, market analysis, current events, and management's judgment.

Loaned securities are recorded at cost and continue to be included in the total investment holdings as of December 31, 2005 and 2004. State Fund receives collateral in the form of cash and securities

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

for the loaned securities from third parties. Cash collateral received is invested in short-term securities, and the fair value of the said securities is recorded on the balance sheet as an asset and a separate liability is recorded representing the obligation to return the collateral.

E. Property and Depreciation

Real estate consists primarily of property occupied by State Fund and is stated at cost less accumulated depreciation. Depreciation on buildings is computed on a straight-line basis over the estimated useful lives of the buildings (50 years). Data processing equipment and capitalized internally developed software are carried at cost less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the assets (3 years). Depreciation on office furniture and equipment is computed on a straight-line basis over the estimated useful lives of the assets (5 years).

The aggregate amount of admitted data processing equipment (net of accumulated depreciation) is limited to 3% of State Fund's policyholders' surplus, adjusted for the carrying value of data processing equipment.

F. Losses and Loss Adjustment Expenses

Management records its best estimate of losses and loss adjustment expenses. These liabilities include the estimated future cost of reported claims, the cost of claims incurred but not reported, and expenses related to investigating and settling claims. State Fund does not discount these liabilities. These liabilities are based on actuarial estimates that are subject to considerable uncertainty. Should State Fund's losses develop in the future differently from their historical loss development or those projected by the actuarial methods, actual losses would vary, perhaps significantly, from such actuarial estimates. Any adjustments to these estimates are reflected in operations when known (see note 6).

Management's estimates are based on its knowledge and experience about past and current events and circumstances, and its assumptions about conditions it expects to exist in the future. Factors relevant to the estimation of liabilities for losses and loss adjustment expenses include the estimation of the ultimate frequency and severity of losses, the level of future medical cost inflation over long periods of time, the future legal and regulatory environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed quarterly by a nationally-recognized consulting actuarial firm (the Appointed Actuary). The Appointed Actuary is retained in accordance with CDI regulatory provisions as the designee to issue a statement of actuarial opinion that has been reviewed with the board of directors as required by actuarial standards of practice.

G. Revenue Recognition and Unearned Premiums

State Fund records as premiums written deposit premiums and any subsequent additional premiums at the time related billings are issued to policyholders. Deposit premiums are a percentage of estimated annual premiums and are earned on a prorata basis over the policy term. Unearned premiums are the unexpired portion of deposit premiums. State Fund records an estimate for earned but unbilled premium (EBUB) as a direct adjustment to earned premiums. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis is nonadmitted. To the extent that amounts in excess of the 10% are not anticipated to be collected, they are written off against operations in the period that the determination is made.

State Fund considers anticipated investment income when determining the existence of a premium deficiency.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

H. Guaranty Fund and Other Assessments

Under the California Insurance Code, all casualty insurance carriers, including State Fund, are required to participate in the California Insurance Guarantee Association (C.I.G.A.) and the Workers' Compensation Administration Revolving Fund (W.C.A.). C.I.G.A. was established to protect the claimants of insolvent insurance companies. W.C.A. was established to partially fund administration of the workers' compensation system. In 1992, a Workers' Compensation Fraud Assessment was instituted by the State of California to provide funding for investigation and prosecution of workers' compensation fraud. Assessments are determined based on premiums written as defined by the applicable insurance code section. In 2003, Assembly Bill No. 227 (AB227) created additional assessments for Uninsured Employers Benefits Trust (U.E.B.T.) and Subsequent Injuries Benefits Trust (S.I.B.T.) Funds. The U.E.B.T. Fund pays for benefits provided to injured employees of illegally uninsured employers while the S.I.B.T. Fund pays for benefits to workers who have suffered serious injury and who are suffering from previous and serious permanent disabilities or physical impairments. All casualty insurance companies, including State Fund, are required by law to bill their policyholders a premium surcharge for recoupment of C.I.G.A., W.C.A, Fraud, U.E.B.T., and S.I.B.T. assessments. Upon payment of an assessment, State Fund establishes a receivable for the related collections of surcharges from policyholders, which is recorded under the "guarantee fund recoupments" account for C.I.G.A., and under the "other assets" account for W.C.A, Fraud, U.E.B.T., and S.I.B.T. The amounts collected from the policyholders in excess of the assessment result in a payable to the assessing agency, which is recorded under the "guarantee fund assessments liability" account for C.I.G.A., and under the "other liabilities" account for W.C.A, Fraud, U.E.B.T., and S.I.B.T.

State Fund recorded the following receivables for surcharge recoupments for the guarantee fund and other assessments as of December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
C.I.G.A.	\$269,373	\$160,071
Other assessments (W.C.A., Fraud, U.E.B.T., and S.I.B.T.)	77,607	61,991
Total	<u>\$346,980</u>	<u>222,062</u>

State Fund surcharged amounts in excess of paid guarantee fund and other assessments to policyholders and recorded the following liabilities representing surcharges payable to the agencies based on assessments as of December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
C.I.G.A.	\$8,728	\$31,824
Other assessments (W.C.A., Fraud, U.E.B.T., and S.I.B.T.)	23,899	35,260
Total	<u>\$32,627</u>	<u>\$67,084</u>

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

State Fund has an obligation to fund C.I.G.A. for State Fund's portion of worker's compensation insolvencies. State Fund expects to be assessed annually for at least the next five years at a rate of 2% of direct premiums written. Due to State Fund's inability to estimate future premiums, State Fund has not recorded the ultimate liability of these assessments and the related recoupment receivable from policyholders for these future assessments.

Under the U.S. Longshoremen's and Harbor Workers' (L&H) Compensation Act, all carriers and self insurers writing U.S. L&H policies, including State Fund, are required to make payments into a Special Fund based on a prorated assessment determined by the Secretary of the U.S. Department of Labor. The Special Fund was created to protect injured employees or their survivors by providing for subsequent injuries as defined by the Act. State Fund recorded a liability of \$14,000, included in the "other liabilities" account as of December 31, 2005 and 2004, for future assessments under the U.S. L&H Compensation Act.

I. Due from Adjusting Contracts

State Fund has an agreement with the State of California Department of Personnel Administration (DPA) to adjust the claims and process the payments related to those claims on behalf of state agencies. State Fund pays compensation benefits to the injured workers and medical benefits to the health providers. State Fund is reimbursed by the state agencies for compensation and medical benefits paid, and the cost of processing claims. State Fund records a receivable for these reimbursements. All agencies make deposits in a trust account that is held by State Fund for future billings. The deposit in the trust account related to future billings is recorded as amounts held in trust.

J. Retirement and Post-retirement Benefit Plans

All State Fund employees participate with other State of California (the State) employees in the State pension and other postretirement (medical and dental) benefit plans administered by the Public Employees' Retirement System of the State of California (CALPERS). State Fund has no legal obligation for the plans. CALPERS assesses pension expense to participating State agencies based on relative salaries paid to State agency employees to the total salaries paid to all State employees. CALPERS also assesses other postretirement benefit expense based on relative number of State agency employees to all State employees. State Fund was assessed pension expense of \$67,979 and \$63,034, and assessed other postretirement benefits expense of \$29,209 and \$23,240 for the years ended December 31, 2005 and 2004, respectively.

K. Income taxes

State Fund is exempt from income taxation under the Internal Revenue Code. State Fund pays premium taxes to the State of California.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

2. Matters Relating to the California Department of Insurance

California law imposes risk-based capital (RBC) requirements on admitted California insurance companies. These RBC requirements set forth a calculation to determine the required levels of policyholders' surplus and provide certain consequences for failure to meet these requirements. The CDI has asserted that it has the authority under the RBC statute to order State Fund to take certain actions in the event State Fund fails to meet the RBC requirements. Since State Fund was created under the provisions of the state constitution and established by the legislature, rather than as an admitted carrier that is a licensee of the CDI, State Fund does not believe the Insurance Commissioner has any authority to control the operations of State Fund. However, State Fund voluntarily submitted to the CDI an RBC plan in 2003 for reducing its insurance exposure and increasing its policyholders' surplus. An updated RBC plan was submitted to the CDI in August 2005. Management believes State Fund has more than sufficient assets to pay claims and other liabilities as they become due. State Fund filed a suit against the Insurance Commissioner (*SCIF v. Garamendi*) for a formal legal determination of the issue. The San Francisco County Superior Court issued a ruling that State Fund was subject to the RBC statute, California Insurance Code Section 739 et seq, as a matter of law that was confirmed by the Court's Final Statement of Decision on March 25, 2005, thereby concluding Phase I of the trial. State Fund and CDI have agreed to a stay of all proceedings in this case, including any appeals to August 15, 2006 in order to pursue the resolution of all outstanding issues.

As of December 31, 2005, State Fund's RBC results show a total adjusted capital of \$3,785,052, which exceeded the minimum RBC requirements; therefore no action is required by State Fund or the CDI. This compares to the total adjusted capital of \$2,862,495 as of December 31, 2004, which was within the Company Action Level of the RBC requirements. A significant factor in the RBC calculation for 2004 was the premium growth experienced by State Fund. State Fund has limited ability to restrict growth due to its mission to insure employers who cannot obtain coverage from traditional insurance carriers.

The CDI conducted limited scope examinations on State Fund's loss reserves as of December 31, 2004 and 2003 but has not issued a final report on its findings. However, in its October 2004 Senate Bill (SB) 228 Report to the Legislature and the Governor, the CDI commented on the financial condition of State Fund as of December 31, 2003 and subsequent 2004 financial activity. In this SB228 Report, the CDI stated that its actuaries estimated that State Fund's loss reserves were inadequate by \$754 million as of December 31, 2003. The CDI and State Fund have continued discussions with respect to loss reserve adequacy, including the CDI's review State Fund's reserve position as of December 31, 2005. Management of State Fund does not believe that resolution of these matters will result in RBC regulatory actions beyond those already contemplated in the submitted plans.

A regulatory exam by the CDI for the three-year period ended December 31, 2005 is currently in process. Management does not anticipate any material impact to the ongoing operations of State Fund as a result of this exam.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

3. Investment Securities

The amortized cost and estimated fair values of investments in bonds as of December 31, 2005 and 2004 are as follows:

2005

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Treasury securities and U.S. government sponsored enterprise securities	\$5,399,251	\$6,559	\$(72,778)	\$5,333,032
Obligations of states and political subdivisions	494,073	3,954	(6,751)	491,276
Public utilities	570,364	8,577	(6,149)	572,792
Corporate debt securities	5,466,865	51,905	(95,453)	5,423,317
Special revenue	754,173	10,732	(8,450)	756,455
Other government	49,920	—	(1,543)	48,377
Mortgage-backed securities	5,566,203	14,511	(89,339)	5,491,375
Totals	\$18,300,849	96,238	(280,463)	18,116,624

2004

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Treasury securities and U.S. government sponsored enterprise securities	\$4,772,008	\$40,403	\$(23,795)	\$4,788,616
Obligations of states and political subdivisions	485,115	9,482	(3,466)	491,131
Public utilities	555,752	23,078	(1,038)	577,792
Corporate debt securities	5,182,225	127,850	(29,254)	5,280,821
Special revenue	648,882	7,481	(4,655)	651,708
Other government	49,894	—	(444)	49,450
Mortgage-backed securities	4,734,803	54,981	(5,773)	4,784,011
Totals	\$16,428,679	\$263,275	\$(68,425)	\$16,623,529

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

Included in the mortgage-backed securities as of December 31, 2005 and 2004 are the following:

2005

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FNMA	\$2,439,672	\$3,161	\$(42,595)	\$2,400,238
GNMA	402,278	9,209	(2,420)	409,067
FHLMC	2,724,253	2,141	(44,324)	2,682,070
Totals	\$5,566,203	\$14,511	\$(89,339)	\$5,491,375

2004

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
FNMA	\$2,305,513	\$20,606	\$(3,453)	\$2,322,666
GNMA	493,474	18,778	(170)	512,082
FHLMC	1,935,816	15,597	(2,150)	1,949,263
Totals	\$4,734,803	\$54,981	\$(5,773)	\$4,784,011

Quarterly, State Fund reviews its investment portfolio to determine whether or not declines in fair value are other than temporary. Factors in addition to average cost and fair value, including credit quality, market analysis, current events and management's judgment, are used to determine whether securities are considered other than temporarily impaired. The securities that are considered to be other than temporarily impaired are written down to current fair value as of the last business day of the respective quarter.

As of December 31, 2005 and 2004, 748 and 266 securities were in an unrealized loss position, which resulted in an unrealized loss of \$280,463 and \$68,425, respectively. State Fund management believes the unrealized loss position at the end of 2005 and 2004 was a result of the ongoing increases in interest rates over the past two years, rather than due to any inherent erosion of credit quality of State Fund's portfolio holdings. State Fund has the ability to hold the investments for a period of time sufficient to allow it to recover its costs. As of December 31, 2005, the weighted average quality of the \$19.8 billion bond portfolio was a Standard & Poors AA+. State Fund concluded that the gross unrealized losses of \$280,463 as of December 31, 2005 were temporary in nature.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

The tables below reflect the summary of temporarily impaired financial instruments as of December 31, 2005 and 2004.

<u>2005</u>	12 months or under		Over 12 months		Total	
	Amortized cost	Gross unrealized gains	Amortized cost	Gross unrealized gains	Amortized cost	Gross unrealized gains
U.S. Treasury securities and U.S. government sponsored enterprise securities	\$2,789,959	\$(30,309)	\$1,869,349	\$(42,469)	\$4,659,308	\$(72,778)
Obligations of states and political subdivisions	146,842	(2,546)	438,830	(4,205)	585,672	(6,751)
Public utilities	285,508	(4,321)	82,485	(1,828)	367,993	(6,149)
Corporate debt securities	2,107,895	(44,559)	1,865,894	(50,894)	3,973,789	(95,453)
Special revenue	234,916	(4,680)	197,401	(3,770)	432,317	(8,450)
Other government	—	—	49,920	(1,543)	49,920	(1,543)
Mortgage-backed securities	4,272,383	(74,684)	487,490	(14,655)	4,759,873	(89,339)
	\$9,837,503	\$(161,099)	\$4,991,369	\$(119,364)	\$14,828,872	\$(280,463)

<u>2004</u>	12 months or under		Over 12 months		Total	
	Amortized cost	Gross unrealized gains	Amortized cost	Gross unrealized gains	Amortized cost	Gross unrealized gains
U.S. Treasury securities and U.S. government sponsored enterprise securities	\$3,011,169	\$(23,795)	—	—	\$3,011,169	\$(23,795)
Obligations of states and political subdivisions	155,773	(2,145)	31,004	(1,321)	186,777	(3,466)
Public utilities	136,710	(1,038)	—	—	136,710	(1,038)
Corporate debt securities	2,195,807	(16,644)	344,105	(12,611)	2,539,912	(29,255)
Special revenue	329,762	(4,268)	11,327	(386)	341,089	(4,654)
Other government	49,894	(444)	—	—	49,894	(444)
Mortgage-backed securities	1,283,226	(4,818)	47,782	(955)	1,331,008	(5,773)
	\$7,162,341	\$(53,152)	\$434,218	\$(15,273)	\$7,596,559	\$(68,425)

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

The amortized cost and estimated fair values of bonds as of December 31, 2005, by contractual maturity, are shown below. 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.

2005

	Amortized cost	Estimated fair value
	<hr/>	<hr/>
Due in one year or less	\$1,975,077	\$1,963,128
Due after one year through five years	6,866,968	6,803,210
Due after five years through ten years	3,160,792	3,122,679
Due after ten years	731,809	736,232
Mortgage-backed securities	5,566,203	5,491,375
	<hr/>	<hr/>
	\$18,300,849	\$18,116,624

Proceeds from sales and redemptions of investments in bonds during 2005 were \$2,709,102. Gross gains of \$11,083 and gross losses of \$7,436 were realized on these sales. Proceeds from sales and redemptions of investments in bonds during 2004 were \$1,336,722. Gross gains of \$1,829 and gross losses of \$2,207 were realized on these sales.

State Fund's investment policies limit concentration of credit risk by requiring diversification of its investments in any one issuer, industry, or geographic region. Per California Insurance Code Section 11788, the State Treasurer's Office is the custodian of State Fund's long-term investment holdings.

As of December 31, 2005 and 2004, State Fund had \$3 million on deposit with the Federal Reserve Bank of Saint Louis (FRBSL) to satisfy the U.S. Department of Labor regulations relating to State Fund's issuance of U.S. L&H policies.

The CDI permits State Fund to lend a certain portion of its securities to broker/dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. When State Fund securities are initially loaned, State Fund receives cash collateral equivalent to 102% of the fair value of the securities loaned. Such cash collateral, which is unrestricted, is adjusted daily and is required at all times to equal at least 100% of the fair value of securities loaned. If additional collateral is required to maintain the 100% level, State Fund will receive securities as additional pledged collateral. The securities received as collateral are not permitted to be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with State Fund's investment guidelines, cash collateral is invested in short-term investments with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and State Fund. The aggregate fair value of loaned securities was \$1,263,339 and \$912,553 as of December 31, 2005 and 2004, respectively. Cash collateral received in respect to these loans was \$1,282,378 and \$927,218 as of December 31, 2005 and 2004, respectively. A liability is established to record State Fund's obligation to return the cash collateral received. A related asset equal to the fair value of the reinvested cash collateral is also recognized. The fair value of the reinvested cash collateral was \$1,285,599 and \$928,024 as of December 31, 2005 and 2004, respectively.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

4. Fair Value of Financial Instruments

The carrying value of short-term investments, receivables, and payable, approximate fair value due to the short maturities of these investments. The fair value of investments securities is discussed above in note 3.

5. Data Processing Equipment

Data processing equipment as of December 31, 2005 and 2004 is comprised of the following:

	<u>2005</u>	<u>2004</u>
Data processing equipment and software	\$104,380	\$97,719
Office furniture and equipment	94,100	65,007
	<hr/>	<hr/>
	198,480	162,726
Accumulated depreciation	(110,893)	(97,386)
	<hr/>	<hr/>
	87,587	65,340
Less nonadmitted assets	(79,524)	(57,484)
	<hr/>	<hr/>
	\$8,063	\$7,856

Depreciation expense was \$13,506 and \$13,233 for the years ended December 31, 2005 and 2004, respectively. The cost of assets retired or otherwise disposed of, and the related accumulated depreciation thereon, are removed from the accounts with any gain or loss realized upon sale or disposal, credited, or charged to operations.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

6. Estimated Liabilities for Losses and Loss Adjustment Expenses

The table below reflects the changes in the estimated liabilities for losses and loss adjustment expenses as of December 31, 2005 and 2004. Ceded loss and loss adjustment expense reserves are netted against loss and loss adjustment expense reserves, rather than shown as gross reinsurance recoverable.

	<u>2005</u>	<u>2004</u>
Estimated liabilities for losses and loss adjustment expenses as of January 1, net of reinsurance recoverables of \$284,567 and \$488,344, respectively	\$15,459,334	\$12,807,671
Add incurred related to:		
Current year	4,801,760	6,110,922
Prior years	213,843	259,045
Total incurred	5,015,603	6,369,967
Less paid related to:		
Current year	499,097	613,075
Prior years	2,774,878	3,105,229
Total paid	3,273,975	3,718,304
Estimated liabilities for losses and loss adjustment expenses as of December 31, net of reinsurance recoverables of \$264,796 and \$284,567, respectively	\$17,200,962	\$15,459,334

State Fund writes workers' compensation insurance, a line that exposes State Fund to long-term liabilities with a potential for significant reserve variability. Management has identified the major risk factors in reserve estimation as the growth and contraction of business written by State Fund in recent years, recently enacted legislative changes affecting the line of business (i.e., reform), exposure to the retroactive impact of future legislative, regulatory and judicial decisions, and medical inflation.

State Fund had a significant increase in business volume during the 2002 – 2003 calendar years. New business added during those years may exhibit different development characteristics than State Fund's historical business. Following that period of growth, in 2004 – 2005 a significant number of accounts returned to the private insurance market. This growth and contraction of business changes the mix of business over time, impacts development patterns, and contributes an element of uncertainty to loss reserve projections.

Also, in November 2003, the California Legislature passed Assembly Bill 227 and Senate Bill 228, representing a major reform of the workers' compensation system. This was followed in April 2004 by the further reforms of Senate Bill 899. These bills provide for major changes in benefit levels and the administration of claims, impacting both new claims and open claims from earlier accident years. Management has considered the impact of these reforms in estimating future liabilities; however, the breadth of the changes and their impact on loss development patterns, and the potential for future legislative, regulatory or judicial decisions to retroactively impact currently estimated liabilities, add a level of uncertainty to a current estimate of future liabilities.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

Lastly, the workers' compensation benefit program provides medical care for the lifetime of the claimant in some cases. This exposes any current estimate of future liability to the uncertainties of future medical inflation.

These risk factors, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried estimated liability for losses and loss adjustment expenses.

The total amount of loss reserves no longer carried due to the purchase of annuities, with the claimant as payee, was \$345,141 and \$284,341 as of December 31, 2005 and 2004, respectively. State Fund remains liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities.

Loss reserves eliminated by annuities issued by the following companies exceeded 1% of Policyholder's Surplus:

	<u>2005</u>	<u>2004</u>
Genworth Financial	\$108,507	—
Hartford Life Insurance	38,403	—
Aviva Life Insurance Company	43,395	43,706
GE Financial Assurance	—	92,996
Total	<u>\$190,305</u>	<u>\$136,702</u>

7. Reinsurance

State Fund cedes insurance risk relating to its workers' compensation business to several reinsurance companies. Reinsurance agreements are used to limit State Fund's maximum liability on insurance claims and catastrophes, thereby mitigating the risk associated with such claims and catastrophes. In accordance with statutory accounting practices, the reinsured risks are treated as though State Fund is not liable for covered losses; however, State Fund remains liable to the extent reinsuring companies are unable to meet their treaty obligations. In 2005, State Fund maintained catastrophe reinsurance of \$2.19 billion in excess of \$10 million for a non-TRIA catastrophic event, i.e., an event not caused by an act of international terrorism. In respect to events certified by the federal government as acts of international terrorism, State Fund was covered in 2005 by a combination of private reinsurance and the Federal Terrorism Reinsurance Act (TRIA) for losses in excess of \$327 million retention. During 2004, State Fund maintained an underlying per occurrence coverage in aggregate excess of \$50 million, with \$5 million in excess of \$5 million retention; catastrophe coverage for a maximum of \$1.735 billion in excess of \$10 million; and three layers of terrorism coverage for a maximum of \$701 million in excess of \$234 million.

For the years ended December 31, 2005 and 2004, total earned premiums ceded under the reinsurance contracts were \$191,483 and \$266,739, respectively. Based upon the estimated reinsurance recoverable under the reinsurance treaties, State Fund's liabilities for unpaid claims on a case basis were reduced by \$264,796 and \$284,567 as of December 31, 2005 and 2004, respectively, including \$87,073 and \$52,629 recoverable from American Reinsurance Company and Reliastar Life Insurance Company, respectively, as of December 31, 2005 and \$60,737 and \$82,101 recoverable from Reliastar Life Insurance Company and American Reinsurance Company, respectively, as of December 31, 2004.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

Certain of the reinsurance treaties have a “no claims bonus” clause where, in the event that no claims arise under the treaties, the reinsurers will allow State Fund to commute the treaty, which entitles State Fund to a return premium. The “no claims bonus” is calculated between four and six months after the expiration of the treaties. The payment of the return premium by the reinsurers to State Fund constitutes the commutation of the treaties, and such payment once effected is regarded as a full and final release of the reinsurers from all liability under the treaties. State Fund did not set up a receivable for the “no claims bonus,” as the clause had not been exercised as of December 31, 2005 and 2004. However, on March 10, 2005, State Fund exercised the “no claims bonus” provision of the 2004 reinsurance treaties. As a result, a total of \$41,387 was received and recognized as income for the year ended December 31, 2005. Since State Fund had not exercised the “no claims bonus” provision of the 2005 reinsurance treaties as of December 31, 2005, no amount was recorded.

As of December 31, 2005, State Fund commuted reinsurance recoverables (with the companies listed below) of \$16,743. These are reflected as losses incurred and loss adjustment expenses incurred amounting to \$16,625 and \$118, respectively.

Continental Casualty Co.	\$16,420
Lincoln National Life Insurance Co.	323
	<hr/>
Total	\$16,743

As of December 31, 2005, State Fund wrote off reinsurance balances due (from the companies listed below) of \$19,539. These are reflected as losses incurred and loss adjustment expenses incurred amounting to \$19,441 and \$98, respectively.

Chartwell Reinsurance Co.	\$16,965
Trenwick America Reinsurance Co.	2,548
Others	26
	<hr/>
Total	\$19,539

In August 2002, State Fund entered into a Loss Portfolio Transfer agreement with XL Re Ltd. and ACE Bermuda Ltd. (the Reinsurers). The retroactive reinsurance agreement reinsures losses incurred for accident years 1980 through 1998. Under the agreement, State Fund retains the first \$950,000 of aggregate losses under the treaty. The Reinsurers have the liability for the first layer of coverage, which does not exceed 90% of \$1,150,000 in aggregate. Upon exhaustion of the first layer, State Fund will retain net \$200,000 of aggregate losses in excess of \$2,100,000. The Reinsurers will then have the liability for any aggregate amount in excess of \$2,300,000 or second layer up to 90% of \$300,000 of aggregate losses. State Fund recorded a deposit of \$13,500 (net of 10% retention) with the Reinsurers. The maximum amount recoverable from the Reinsurers is 90% of \$1,450,000.

NOTES TO FINANCIAL STATEMENTS (STATUTORY BASIS) CONTINUED

Years ended December 31, 2005 and 2004 (Dollar amounts in thousands)

Under the agreement, State Fund ceded loss reserves of \$1,035,000 and paid \$728,744, thus recognizing a retroactive gain of \$319,756. The gain was recorded as a component of policyholders' surplus, segregated from unassigned surplus and reported as special surplus for retroactive reinsurance. The special surplus arising from the transaction will be considered to be earned surplus and transferred to unassigned funds (surplus) when cash recoveries from the Reinsurers exceeds the total consideration paid by State Fund for the loss portfolio transfer.

As of December 31, 2005, State Fund carried gross loss reserves for the subject losses of \$2.6 billion. This exceeded State Fund's retention of \$2.3 billion and resulted in additional reserves ceded of \$270 million (net of 10% State Fund retention). Accordingly, State Fund recognized an additional retroactive gain of \$256.5 million (net of the \$13.5 million deposit with the Reinsurers). As a result, the special surplus for retroactive reinsurance increased from \$319.8 million in 2004 to \$576.3 million in 2005.

As of December 31, 2005, cumulative paid losses were \$1.047 billion, which exceeded the \$950 million retention. This resulted to a total receivable of \$87.6 million (net of 10% State Fund retention) from the Reinsurers, of which \$12.7 million and \$4.1 million were collected from the Reinsurers on October 10, 2005 and December 9, 2005, respectively.

8. Commitments and Contingencies

As of December 31, 2005 and 2004, State Fund was committed under the terms of 28 and 29 renewable leases for various offices, respectively, and various vehicle and other leases.

The following is a summary of the minimum annual lease commitments as of December 31, 2005:

Year	
2006	\$50,586
2007	42,959
2008	31,277
2009	24,302
2010	17,466
Thereafter	17,671
	<hr/>
	\$184,261

The district office leases generally require additional payments comprising State Fund's prorata share of increases in real estate taxes and building operating expenses. Rental expense under such leases was \$30,957 and \$28,101 in 2005 and 2004, respectively. Total office rental expense charged to operations, which includes an allocation of rental value to space owned and occupied by State Fund, was \$58,292 and \$53,696 in 2005 and 2004, respectively. Vehicle and other lease expenses charged to operations were \$32,084 and \$34,563 in 2005 and 2004, respectively.

State Fund expects to fund C.I.G.A. for guarantee fund assessments for at least the next five years at a rate of 2% of future direct premiums written.

In the normal course of business, State Fund is subject to various claims and litigation. In the opinion of State Fund management, the amount of ultimate liability with respect to these suits and claims will not materially affect the results of operations and the financial position of State Fund.

SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULES AND INVESTMENT RISK INTERROGATORIES—SCHEDULE 1

December 31, 2005 (Dollar amounts in thousands)

State Fund's total admitted assets as filed in the 2005 Annual Statement is \$21,674,187.

State Fund's 10 largest exposures to a single issuer/borrower/investment, excluding U.S. government, U.S. government agency securities, and those U.S. government money market funds are as follows:

Investment	Investment category	Amount	Percentage of total admitted assets
Ontario (Province of)	State, territories, and possessions	\$112,814	0.5%
American Honda Finance	Industrial	99,998	0.5%
United Health Group, Inc.	Industrial	99,568	0.5%
IBM Corporation	Industrial	94,081	0.4%
National Rural Utilities	Industrial	93,266	0.4%
SLM Corporation	Industrial	90,758	0.4%
First Data Corporation	Industrial	88,104	0.4%
United Technologies Corp.	Industrial	85,115	0.4%
Consolidated Ed Co. NY	Industrial	84,957	0.4%
E.I. Du Pont De Nemours	Industrial	84,082	0.4%

The amounts and percentages of State Fund's total admitted assets held in bonds by NAIC rating are as follows:

Rating	Amount	Percentage of total admitted assets
NAIC – 1	\$19,832,076	91.5%
NAIC – 2		—
NAIC – 3		—
NAIC – 4		—
NAIC – 5		—
NAIC – 6		—

State Fund does not have any preferred stocks.

State Fund does not hold any foreign investments other than Canadian investments.

State Fund's equity interest is as follows:

Investment	Amount	Percentage of total admitted assets
Blackrock Institutional Funds – Money Market Fund	\$323,875	1.5%

See accompanying independent auditors' report.

SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULES AND INVESTMENT RISK INTERROGATORIES—SCHEDULE 11

December 31, 2004 (Dollar amounts in thousands)

State Fund's total admitted assets as filed in the 2004 Annual Statement is \$18,973,214.

State Fund's 10 largest exposures to a single issuer/borrower/investment, excluding U.S. government, U.S. government agency securities, and those U.S. government money market funds are as follows:

Investment	Investment category	Amount	Percentage of total admitted assets
Ontario (Province of)	State, territories, and possessions	\$112,827	0.6%
Alcoa, Inc.	Industrial	85,496	0.5%
Target Corporation	Industrial	84,241	0.4%
Honeywell International	Industrial	84,079	0.4%
General Electric Capital Corporation	Industrial	82,546	0.4%
American Express	Industrial	80,997	0.4%
SLM Corporation	Industrial	80,660	0.4%
First Data Corporation	Industrial	80,540	0.4%
American Honda Finance	Industrial	79,998	0.4%
United Health Group, Inc.	Industrial	79,943	0.4%

The amounts and percentages of State Fund's total admitted assets held in bonds by NAIC rating are as follows:

Rating	Amount	Percentage of total admitted assets
NAIC – 1	\$16,428,679	86.6%
NAIC – 2		—
NAIC – 3		—
NAIC – 4		—
NAIC – 5		—
NAIC – 6		—

State Fund does not have any preferred stocks.

State Fund does not hold any foreign investments other than Canadian investments.

State Fund's equity interest is as follows:

Investment	Amount	Percentage of total admitted assets
Blackrock Institutional Funds – Money Market Fund	\$250,983	1.3%

See accompanying independent auditors' report.

SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULES AND INVESTMENT RISK INTERROGATORIES—SCHEDULE III

December 31, 2005 (Dollar amounts in thousands)

State Fund had the following amounts subject to securities lending agreements:

At Year End	% of total admitted assets	At end of each quarter		
		1st Qtr.	2nd Qtr.	3rd Qtr.
\$1,262,517	5.8%	\$989,542	1,310,638	1,283,391

State fund had the following invested assets as of December 31, 2005:

	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount (in thousands)	Percentage	Amount (in thousands)	Percentage
Bonds:				
U.S. treasury securities	\$2,107,719	10.2%	\$2,107,719	10.2%
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	49,920	0.2	49,920	0.2
Issued by U.S. government sponsored agencies	3,291,532	16.0	3,291,532	16.0
Foreign government (including Canada)				
Securities issued by states, territories and possessions, and political subdivisions in the U.S.:				
States, territories, and possessions general obligations	352,436	1.7	352,436	1.7
Political subdivisions of U.S. State, territories, and possessions general obligations	141,637	0.7	141,637	0.7
Revenue and assessment obligations	754,173	3.7	754,173	3.7
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Guaranteed by GNMA	247,124	1.2	247,124	1.2
Issued by FNMA and FHLMC	3,814,548	18.5	3,814,548	18.5
All other	169,929	0.8	169,929	0.8
CMOs and REMICs:				
Issued by FNMA, FHLMC, or GNMA	1,334,603	6.5	1,334,603	6.5
Other debt and other fixed income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	5,908,204	28.7	5,908,204	28.7
Unaffiliated foreign securities	129,024	0.6	129,024	0.6
Money Market Funds	323,875	1.6	323,875	1.6
Real estate investments	175,636	0.8	175,636	0.8
Cash,	1,812,616	8.8	1,812,616	8.8
	\$20,612,976	100.0%	\$20,612,976	100.0%

SUPPLEMENTAL SUMMARY INVESTMENT SCHEDULES AND INVESTMENT RISK INTERROGATORIES—SCHEDULE IV

December 31, 2004 (Dollar amounts in thousands)

State Fund had the following amounts subject to securities lending agreements:

At Year End	% of total admitted assets	At end of each quarter		
		1st Qtr.	2nd Qtr.	3rd Qtr.
\$896,115	4.7%	\$676,152	856,290	936,593

State fund had the following invested assets as of December 31, 2004:

	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount (in thousands)	Percentage	Amount (in thousands)	Percentage
Bonds:				
U.S. treasury securities	\$1,682,708	9.3%	\$1,682,708	9.3%
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	125,211	0.7	125,211	0.7
Issued by U.S. government sponsored agencies	3,013,983	16.6	3,013,983	16.6
Foreign government (including Canada)				
Securities issued by states, territories and possessions, and political subdivisions in the U.S.:				
States, territories, and possessions general obligations	362,177	2.0	362,177	2.0
Political subdivisions of U.S. State, territories, and possessions general obligations	122,938	0.7	122,938	0.7
Revenue and assessment obligations	648,882	3.6	648,882	3.6
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Guaranteed by GNMA	366,022	1.8	336,022	1.8
Issued by FNMA and FHLMC	3,917,271	21.7	3,917,271	21.7
All other	172,189	1.0	172,189	1.0
CMOs and REMICs:				
Issued by FNMA, FHLMC, or GNMA	309,321	1.7	309,321	1.7
Other debt and other fixed income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	5,658,951	31.3	5,658,951	31.3
Unaffiliated foreign securities	79,026	0.4	79,026	0.4
Money Market Funds	250,983	1.4	250,983	1.4
Real estate investments	175,768	1.0	175,768	1.0
Cash and cash collateral for investments	1,234,235	6.8	1,234,235	6.8
Total cash and investments	\$18,089,665	100.0%	\$18,089,665	100.0%

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(707) 586-5000

Oxnard
(805) 988-8600

Riverside
(951) 697-7300

Group Insurance

Monterey Park
(800) 252-0419

Sacramento
(800) 423-0303

Walnut Creek
(800) 533-6868

Special Programs

Alternative Dispute Resolution
Program Administration
(323) 981-6620

Claims Management Service
(714) 565-7000

Customer Service Center

Policy Services
Toll-Free Number
(877) 405-4545

24-Hour Claims Reporting
Toll-Free Number
(888) 222-3211

Fraud Reporting Hotline
1(888) STOP FRAUD
Or (888) 786-7372

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