

Labor & Industries Investment Overview

Presented to

Washington State Investment Board

by Conning Asset Management

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L&I's long term portfolio strategy

L&I's four Funds managed as separate portfolios

Cash

- ◆ Needed to pay benefits
- ◆ Low yields
- ◆ Coordinate cash needs with L&I

Bonds

- ◆ Provide income and cash flows
- ◆ Revised duration targets
- ◆ Insurance accounting uses amortized values
- ◆ Transaction activity:
 - Maintain duration targets
 - Maximize investment income
 - Control risk
 - Total return opportunities

Stocks

- ◆ Long-term capital appreciation
- ◆ 85% U.S., 15% international for diversification
- ◆ Low cost index funds

L&I Consolidated Portfolio

September 30, 2004

(Market Values in Millions)

Fixed Income

Cash	\$68	1%
Treasuries	\$966	10%
Agencies	\$229	2%
Credit	\$5,117	53%
CMBS	\$536	5%
Mortgage backed	\$1,041	11%
Asset backed	\$71	1%
Total fixed income	\$8,028	83%

Equities

Wilshire 5000 (85%)	\$1,380	14%
MSCI EAFE (15%)	\$250	3%
Total equities	\$1,630	17%

Total portfolio	\$9,658	100%
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Changes in L&I's financials led to an investment strategy review

- ◆ Declining contingency reserve led to very long duration targets for 608 & 610
 - Overweighting long bonds in period of low rates
 - Losing exposure to entire yield curve
 - Treasuries hitting upper limits in guidelines
- ◆ Strategic asset allocation review using Dynamic Financial Analysis tool
 - Objectives: ***Minimize long term premium rates***
Minimize short term premium rate volatility
 - Detailed model of L&I's balance sheet and future business
 - Tested alternative strategies for 1,000s of economic and capital market scenarios
- ◆ Recommended changes
 - Fixed duration targets, instead of recalculating each quarter based on new loss reserves
 - Shorten 608 and 610 target duration to 9, extend 609 to 6
 - Set equity allocations by Fund at 10% for 608 and 610, 30% for 609 (~17% total allocation)
- ◆ After review by SIB staff and L&I, presented recommendations to Board in April 2004
- ◆ Periodically review investment strategy with L&I and SIB

L&I's investment strategy differs from the Retirement Funds

L&I's investment strategy addresses the unique needs of a **workers' compensation insurer**

- ◆ Insurance underwriting is risky
- ◆ Current benefits pay out over decades; exact amount and timing is uncertain
- ◆ Future payments subject to medical and wage inflation, legislative and judicial changes
- ◆ Even small changes in underlying trends compound over many years
- ◆ Under statutory (insurance) accounting bonds are valued at amortized cost
- ◆ Equities are valued at market; changes affect the contingency reserve
- ◆ Contingency reserve covers insurance risks, investment risks and law changes

L&I's strategic portfolio objectives

Maintain the solvency of the funds

- ◆ Contingency reserve of \$788 million at June 30, 2004

Maintain premium rate stability

- ◆ Strategic Asset Allocation review focused on premium rate stability
- ◆ SIB manages book yield to provide reliable income stream
- ◆ From 1999-2003, investment income was 37% of total income

Ensure sufficient assets are available to fund the ultimate liabilities

- ◆ Cash needs coordinated with L&I
- ◆ Premium rate setting includes investment income assumptions

Subject to the above, earn a maximum return at a prudent level of risk

- ◆ Fund returns are evaluated against their Comparable Market Indices
- ◆ Investment Guidelines limit many key risks
- ◆ Active management of the Funds controls risks

L&I's investment returns

- ◆ Total return is **not** L&I's primary objective
 - Investment income pays claims, supports premium rates
 - Changes in bond prices do not affect L&I's financials
- ◆ Total return and book income often conflict in the short term
- ◆ Total return helps assess risk levels
- ◆ Comparable Market Indices (CMIs) are a blend of:
 - Lehman Government indices
 - Lehman Credit indices
 - Wilshire 5000 equity index
 - MSCI EAFE equity index
- ◆ CMIs approximate the Funds' sector allocations, duration targets and equity allocations
- ◆ CMIs do not include cash or mortgage backed

Labor and Industries Annualized Total Returns through 9/30/04						
	Inception	1 Year	3 Years	5 Years	10 Years	Cumulative
Fund 608	7.43%	7.22%	7.71%	7.90%	8.56%	124.05%
CMI	7.29%	7.71%	8.64%	8.09%	8.42%	120.72%
<i>diff, bps</i>	+14	-49	-93	-19	+15	+333
Fund 609	7.41%	6.34%	5.81%	5.80%	8.19%	123.47%
CMI	7.48%	7.36%	6.81%	6.14%	8.29%	125.07%
<i>diff, bps</i>	-7	-101	-100	-34	-10	-160
Fund 610	8.55%	5.15%	8.37%	9.37%	9.94%	151.63%
CMI	8.30%	4.86%	8.85%	9.27%	9.64%	145.26%
<i>diff, bps</i>	+25	+29	-49	+10	+30	+637

Investments are critical for L&I

Labor and Industries					
June 30, 2004 Financial Statements					
Balance Sheet - Assets			Liabilities		
Bonds and cash	\$7,260	78%	Estimated future benefits	\$7,968	85%
Stocks	1,656	18%	Other liabilities	578	6%
Investments	<u>\$8,916</u>	96%	Total liabilities	<u>\$8,546</u>	92%
Other assets	418	4%	Contingency reserve	788	8%
Total assets	<u>\$9,335</u>	100%	Total liabilities and reserve	<u>\$9,335</u>	100%
Income Statement - Revenues			Expenses		
Net premiums earned	\$1,127	71%	Benefits incurred	\$1,517	
Investment income	432	27%	Administrative expenses	123	
Other	18	1%	Total expenses	<u>\$1,640</u>	
Recurring revenues	<u>\$1,577</u>	100%			
Net realized gains/losses on bonds	93		Net income	\$373	
Net gains/losses on equities	343				
Total revenues	<u>\$2,012</u>				

- ◆ **96%** of total assets
- ◆ **27%** of recurring revenues and 26% of expenses
- ◆ Underwriting loss of \$495 million more than offset by total investment gain of \$868 million

Insurance industry issues

- ◆ Investment income declined 4 of the last 6 years
- ◆ Book yields have declined 6 out of 6 years; offset by asset growth in 2 years
- ◆ Breakeven on underwriting generates return on capital under 10%
- ◆ In the late 70s, breakeven underwriting generated returns over 17%
- ◆ At current yields, 15% returns on capital require combined ratios of 90%-95%
- ◆ Underwriting results haven't been that good since the early 1950s

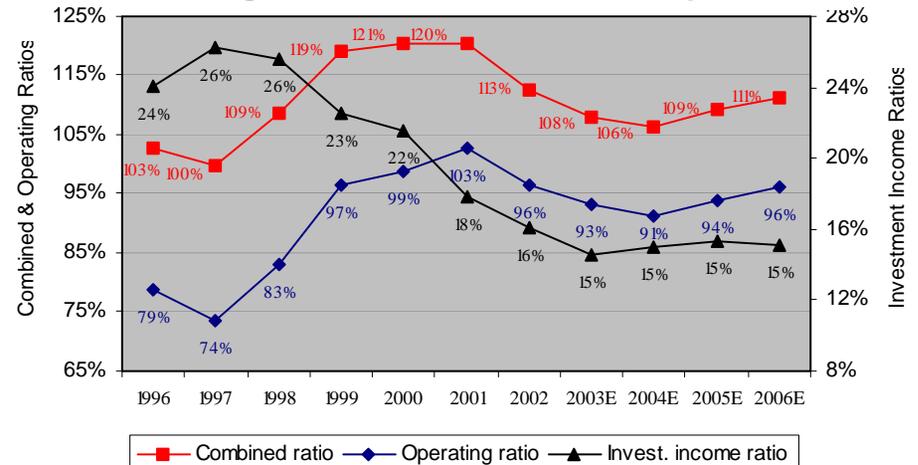
Low interest rates are a major issue for p/c insurers.

10 Year Treasury Yield



Source: Bloomberg

Falling Yields Erode Workers' Comp Profits



Source: Conning Research & Consulting 2nd Quarter 2004 P/C Industry Forecast, Workers' Comp

L&I's peer groups

- ◆ Two peer groups:
 - 21 state funds
 - 15 private insurers
- ◆ Updated through year end 2003 (Ohio, Montana as of 6/30/03)
- ◆ Column on right is percentage of net written premiums in workers' comp
- ◆ Due to varied reporting formats, detailed information was not available for all of the peers for all time periods

Sources for all peer data:

- ◆ OneSource Information Services database
- ◆ Insurance company and state fund financial statements
- ◆ A.M. Best's Averages and Aggregates

	Invested Assets	Loss & LAE Reserves	Surplus	Net Written Premiums	% NWP WComp
Labor & Industries	8,657,397	8,206,433	650,438	1,066,562	100%
State Funds					
Arizona State Compensation Fund	2,679,544	1,916,046	620,187	341,020	94%
Beacon Mutual Insurance Co (RI)	381,729	254,150	109,986	149,822	100%
Compsource Oklahoma	837,982	642,762	160,451	222,729	100%
Hawaii Employers Mutual Insurance Co	93,790	61,475	12,417	69,016	100%
Idaho State Insurance Fund	356,222	231,095	82,938	159,333	100%
Kentucky Employers Mutual Insurance	213,275	141,206	54,052	110,293	100%
Louisiana Workers Compensation Corp	701,231	293,115	342,228	185,566	100%
Maine Employers Mutual Insurance Co	363,368	215,403	140,941	142,644	100%
Missouri Employers Mutual Insurance Co	189,547	120,947	44,954	149,370	100%
Montana State Fund (FY03)	569,896	389,800	145,199	117,777	100%
New Mexico Mutual Casualty Co	134,873	81,402	56,320	54,777	100%
New York State Insurance Fund	8,736,290	7,262,402	1,587,256	1,434,904	100%
North Dakota Workers Compensation	975,414	577,500	389,996	88,590	100%
Ohio Bureau of Workers' Comp (FY03)	15,531,428	15,981,075	552,379	1,723,294	100%
Pinnacol Assurance (CO)	1,429,255	1,024,429	327,298	495,348	100%
SAIF Corp (OR)	2,817,434	2,421,874	376,229	312,344	100%
State Compensation Insurance Fund (CA)	14,435,384	12,807,671	2,085,877	7,636,566	100%
State Fund Mutual Insurance Co (MN)	157,883	122,129	35,063	80,832	100%
State Workers' Insurance Fund (PA)	1,456,753	1,228,458	164,707	278,462	100%
Texas Mutual Insurance Company	1,995,898	932,754	857,123	665,257	100%
Workers Compensation Fund of Utah	904,591	600,599	293,447	229,906	100%
Maximum	15,531,428	15,981,075	2,085,877	7,636,566	100%
Simple average	2,617,228	2,252,681	401,859	697,517	100%
Minimum	93,790	61,475	12,417	54,777	94%

Comparables

Accident Fund Insurance Co	1,220,946	759,438	398,380	441,574	100%
American Home Assurance Co (AIG)	8,681,247	6,388,455	3,621,899	6,027,996	26%
Amerisure Insurance Company	391,428	247,761	114,872	162,889	51%
Argonaut Insurance Group	1,446,706	1,132,757	447,674	602,419	31%
Commerce & Industry Insurance Co (AIG)	2,623,244	1,759,667	1,243,292	1,608,901	27%
Continental Casualty Group (CNA)	28,997,585	16,381,913	6,045,822	6,894,081	16%
Crum & Forster Insurance (Fairfax)	2,998,951	2,253,854	1,107,435	889,380	30%
Employers Insurance Co of Nevada	999,964	510,102	338,656	104,752	100%
Hartford Fire Group	21,846,732	13,818,517	9,085,440	8,876,812	18%
Liberty Mutual Group	26,685,049	18,018,807	7,215,899	12,514,360	25%
New Jersey Manufacturers Group	4,219,942	2,266,822	1,747,473	1,252,214	28%
PMA Capital Insurance Group	1,850,191	1,077,717	500,617	1,013,061	47%
Travelers Casualty & Surety Company	8,870,764	7,075,905	3,045,833	3,473,909	13%
Zenith National Insurance Group	1,440,426	990,877	459,805	786,683	93%
Zurich American Insurance Co	12,228,388	8,766,567	3,675,591	6,931,391	15%
Maximum	28,997,585	18,018,807	9,085,440	12,514,360	100%
Simple average	8,300,104	5,429,944	2,603,246	3,438,695	41%
Minimum	391,428	247,761	114,872	104,752	13%

A.M. Best's Composites (2003)

Property-Casualty Industry	967,703,877	445,422,423	353,848,845	415,299,327	11%
Workers' Compensation Composite	39,713,443	29,690,315	9,464,144	16,215,764	NA

Profitability measures

Compared to its peers, L&I has:

- ◆ High benefits (\$1.34 per \$1 premium)
- ◆ Low expenses (6¢ per \$1 premium)
- ◆ High investment income; offsets the underwriting loss
- ◆ High return-on-surplus, due entirely to the small contingency reserve

Ratios are measured against premiums:

- ◆ Loss ratio = benefit expense to premiums
- ◆ Expense = expenses of running L&I
- ◆ LAE (loss adjustment expense) = administrative costs of paying benefits; also shown relative to benefits expense (indicated with *)
- ◆ Combined ratio measures underwriting profitability; >100% implies a loss
- ◆ Operating ratio measures overall profitability; under 100% implies profits

Ohio's ROS was -110%, largely due to premium rebates. Surplus dropped from \$4.5 billion at FY01 to \$500 million at FY03.

	Loss Ratio	LAE Ratio	LAE Ratio *	Exp Ratio	PH Div. Ratio	Combined Ratio	Inv. Inc. Ratio	Operating Ratio	Return on Surplus
Labor & Industries	134%	2%	2%	4%	0%	140%	41%	99%	21%
State Funds									
Arizona State Compensation Fund	99%	11%	12%	10%	15%	136%	37%	98%	6%
Beacon Mutual Insurance Co (RI)	59%	19%	31%	28%	2%	108%	10%	97%	7%
Comsource Oklahoma	99%	12%	12%	12%	0%	123%	14%	110%	-1%
Hawaii Employers Mutual Insurance Co	55%	17%	31%	13%	0%	85%	3%	82%	122%
Idaho State Insurance Fund	77%	10%	13%	16%	3%	105%	6%	98%	6%
Kentucky Employers Mutual Insurance	72%	13%	18%	19%	0%	91%	8%	82%	10%
Louisiana Workers Compensation Corp	42%	18%	43%	25%	5%	91%	16%	74%	12%
Maine Employers Mutual Insurance Co	77%	10%	13%	18%	3%	108%	10%	98%	-2%
Missouri Employers Mutual Insurance	59%	10%	16%	27%	0%	95%	5%	90%	49%
Montana State Fund (FY03)	105%	13%	13%	15%	3%	136%	23%	114%	-9%
New Mexico Mutual Casualty Co	73%	12%	16%	26%	2%	112%	9%	103%	-9%
New York State Insurance Fund	79%	11%	14%	21%	8%	119%	27%	92%	17%
North Dakota Workers Compensation	163%	11%	6%	12%	0%	185%	41%	144%	-10%
Ohio Bureau of Workers' Comp (FY03)	167%	28%	17%	16%	0%	211%	33%	177%	-110%
Pinnacle Assurance (CO)	77%	4%	5%	20%	0%	100%	16%	84%	32%
SAIF Corp (OR)	116%	12%	11%	19%	0%	147%	31%	116%	-9%
State Compensation Insurance Fund (CA)	72%	11%	15%	16%	0%	100%	7%	93%	40%
State Fund Mutual Insurance Co (MN)	74%	14%	20%	18%	0%	107%	8%	99%	1%
State Workers' Insurance Fund (PA)	136%	15%	11%	9%	0%	160%	22%	138%	-43%
Texas Mutual Insurance Company	63%	8%	14%	21%	4%	96%	11%	85%	17%
Workers Compensation Fund of Utah	66%	9%	14%	25%	1%	101%	19%	82%	19%
Maximum	167%	28%	43%	28%	15%	211%	41%	177%	122%
Weighted average	87%	13%	15%	17%	1%	119%	15%	104%	-2%
Minimum	42%	4%	5%	9%	0%	85%	3%	74%	-110%
Comparables									
Accident Fund Insurance Co	65%	11%	17%	23%	4%	103%	10%	92%	6%
American Home Assurance Co (AIG)	64%	14%	22%	19%	0%	97%	5%	93%	5%
Amerisure Insurance Company	61%	15%	24%	28%	1%	104%	9%	95%	2%
Argonaut Insurance Group	56%	14%	25%	33%	0%	103%	9%	94%	21%
Commerce & Industry Insurance Co (AIG)	66%	15%	22%	17%	0%	98%	7%	90%	8%
Continental Casualty Group (CNA)	86%	34%	40%	40%	1%	161%	24%	136%	-28%
Crum & Forster Insurance (Fairfax)	57%	27%	48%	25%	0%	109%	9%	100%	23%
Employers Insurance Co of Nevada	24%	15%	65%	54%	5%	98%	24%	74%	18%
Hartford Fire Group	79%	18%	23%	28%	0%	125%	19%	106%	0%
Liberty Mutual Group	64%	16%	25%	28%	0%	108%	12%	97%	9%
New Jersey Manufacturers Group	57%	20%	35%	11%	13%	101%	14%	86%	8%
PMA Capital Insurance Group	71%	12%	17%	32%	0%	114%	8%	107%	-16%
Travelers Casualty & Surety Company	58%	9%	16%	26%	0%	93%	17%	76%	24%
Zenith National Insurance Group	54%	16%	29%	24%	0%	94%	7%	87%	19%
Zurich American Insurance Co	66%	16%	23%	20%	0%	102%	6%	96%	8%
Maximum	86%	34%	65%	54%	13%	161%	24%	136%	24%
Weighted average	69%	18%	26%	27%	1%	114%	13%	101%	2%
Minimum	24%	9%	16%	11%	0%	93%	5%	74%	-28%
A.M. Best's Composites (2003)									
Property-Casualty Industry	62%	13%	17%	25%	0%	100%	10%	90%	10%
Workers' Compensation Composite	68%	12%	16%	21%	1%	103%	9%	93%	15%

Leverage

- ◆ AZ, NY, ND, OH, and OR also discount reserves, understating their leverage.
- ◆ State funds generally have more insurance and investment leverage.
- ◆ L&I's insurance leverage (premiums and benefit reserves to surplus) is high. This is a commonly used measure of risk.
- ◆ A private insurer with the same premiums and benefit reserves would require **billions** more in surplus.
- ◆ Risk-based Capital (RBC) measures capital adequacy; higher is better. Below 200% indicates problems.

Only 5 of the 21 funds have ratings from A. M. Best. Reasons for lack of a rating include:

NR-1 *insufficient data*

NR-3 *rating procedure inappropriate*

NR-4 *company request*

NR-5 *not formally followed*

	Insurance Leverage			RBC	Best's	Invest. Leverage	
	Premium	Reserves	Total	Ratio	Rating	Surplus	Premium
Labor & Industries	1.6	12.6	14.3	NA	NA	13.3	8.1
State Funds							
Arizona State Compensation Fund	0.5	3.1	3.6	474%	NR-3	4.3	7.9
Beacon Mutual Insurance Co (RI)	1.4	2.3	3.7	613%	NR-3	3.5	2.5
Compsource Oklahoma	1.4	4.0	5.4	223%	NR-3	5.2	3.8
Hawaii Employers Mutual Insurance Co	5.6	5.0	10.5	153%	NR-1	7.6	1.4
Idaho State Insurance Fund	1.9	2.8	4.7	665%	NR-3	4.3	2.2
Kentucky Employers Mutual Insurance	2.0	2.6	4.7	331%	A-	3.9	1.9
Louisiana Workers Compensation Corp	0.5	0.9	1.4	1074%	A	2.0	3.8
Maine Employers Mutual Insurance Co	1.0	1.5	2.5	684%	A	2.6	2.5
Missouri Employers Mutual Insurance Co	3.3	2.7	6.0	297%	NR-5	4.2	1.3
Montana State Fund (FY03)	0.8	2.7	3.5	829%	NR-3	3.9	4.8
New Mexico Mutual Casualty Co	1.0	1.4	2.4	796%	A-	2.4	2.5
New York State Insurance Fund	0.9	4.6	5.5	NA	NA	5.5	6.1
North Dakota Workers Compensation	0.2	1.5	1.7	NA	NA	2.5	11.0
Ohio Bureau of Workers' Comp (FY03)	3.1	28.9	32.1	NA	NR-3	28.1	9.0
Pinnacol Assurance (CO)	1.5	3.1	4.6	291%	NA	4.4	2.9
SAIF Corp (OR)	0.8	6.4	7.3	297%	NR-3	7.5	9.0
State Compensation Insurance Fund (CA)	3.7	6.1	9.8	115%	NR-4	6.9	1.9
State Fund Mutual Insurance Co (MN)	2.3	3.5	5.8	409%	NR-3	4.5	2.0
State Workers' Insurance Fund (PA)	1.7	7.5	9.1	-133%	NA	8.8	5.2
Texas Mutual Insurance Company	0.8	1.1	1.9	831%	NR-3	2.3	3.0
Workers Compensation Fund of Utah	0.8	2.0	2.8	510%	A-	3.1	3.9
Maximum	5.6	28.9	32.1	1074%	A	28.1	11.0
Weighted average	1.7	5.6	7.3	198%	NR	6.5	3.8
Minimum	0.2	0.9	1.4	-133%	A-	2.0	1.3
Comparables							
Accident Fund Insurance Co	1.1	1.9	3.0	518%	A	3.1	2.8
American Home Assurance Co (AIG)	1.7	1.8	3.4	283%	A++	2.4	1.4
Amerisure Insurance Company	1.4	2.2	3.6	482%	A	3.4	2.4
Argonaut Insurance Group	1.3	2.5	3.9	276%	A	3.2	2.4
Commerce & Industry Insurance Co (AIG)	1.3	1.4	2.7	346%	A++	2.1	1.6
Continental Casualty Group (CNA)	1.1	2.7	3.8	363%	A	4.8	4.2
Crum & Forster Insurance (Fairfax)	0.8	2.0	2.8	508%	A-	2.7	3.4
Employers Insurance Co of Nevada	0.3	1.5	1.8	301%	A-	3.0	9.5
Hartford Fire Group	1.0	1.5	2.5	497%	A+	2.4	2.5
Liberty Mutual Group	1.7	2.5	4.2	427%	A	3.7	2.1
New Jersey Manufacturers Group	0.7	1.3	2.0	1001%	A++	2.4	3.4
PMA Capital Insurance Group	2.0	2.2	4.2	314%	B+	3.7	1.8
Travelers Casualty & Surety Company	1.1	2.3	3.5	417%	A+	2.9	2.6
Zenith National Insurance Group	1.7	2.2	3.9	330%	A-	3.1	1.8
Zurich American Insurance Co	1.9	2.4	4.3	301%	A	3.3	1.8
Maximum	2.0	2.7	4.3	1001%	A++	4.8	9.5
Weighted average	1.3	2.1	3.4	408%	A+	3.2	2.4
Minimum	0.3	1.3	1.8	276%	B+	2.1	1.4
A.M. Best's Composites (2003)							
Property-Casualty Industry	1.2	1.3	2.4	NA	NA	2.7	2.3
Workers' Compensation Composite	1.7	3.1	4.9	NA	NA	4.2	2.4

Asset allocation

- ◆ Asset allocations vary widely based on objectives and risk tolerances.
- ◆ L&I's asset allocation is within the peer ranges, with above average allocations to BBB-rated bonds and equities.
- ◆ Equities provide potential capital appreciation.
- ◆ BBB-rated bonds provide higher investment income.

	Cash	A-AAA Bonds	BBB Bonds	High Yield	Prfd Common	Real Estate	Other
Labor & Industries	2%	60%	19%	1%	0%	18%	0%
State Funds							
Arizona State Compensation Fund	0%	73%	8%	1%	0%	12%	6%
Beacon Mutual Insurance Co (RI)	-1%	81%	7%	0%	1%	7%	0%
Compsource Oklahoma	0%	68%	10%	0%	0%	16%	6%
Hawaii Employers Mutual Insurance Co	0%	92%	0%	0%	0%	8%	0%
Idaho State Insurance Fund	3%	75%	8%	0%	0%	12%	0%
Kentucky Employers Mutual Insurance	3%	80%	7%	0%	0%	10%	0%
Louisiana Workers Compensation Corp	0%	74%	1%	3%	2%	17%	0%
Maine Employers Mutual Insurance Co	4%	77%	4%	2%	2%	11%	1%
Missouri Employers Mutual Insurance Co	0%	89%	3%	0%	0%	7%	0%
Montana State Fund (FY03)	6%	65%	10%	1%	0%	12%	5%
New Mexico Mutual Casualty Co	0%	77%	4%	0%	0%	18%	0%
New York State Insurance Fund	0%	87%	3%	0%	0%	9%	1%
North Dakota Workers Compensation	0%	63%	NA	NA	0%	36%	0%
Ohio Bureau of Workers' Comp (FY03)	13%	56%	NA	NA	0%	31%	0%
Pinnacol Assurance (CO)	7%	79%	5%	0%	0%	7%	0%
SAIF Corp (OR)	3%	63%	10%	7%	1%	14%	1%
State Compensation Insurance Fund (CA)	7%	92%	0%	0%	0%	0%	0%
State Fund Mutual Insurance Co (MN)	1%	95%	0%	1%	0%	3%	0%
State Workers' Insurance Fund (PA)	0%	89%	0%	0%	0%	11%	0%
Texas Mutual Insurance Company	-1%	54%	12%	6%	0%	28%	1%
Workers Compensation Fund of Utah	3%	78%	0%	0%	1%	14%	1%
Maximum	13%	95%	12%	7%	2%	36%	6%
Weighted average	6%	74%	3%	1%	0%	15%	1%
Minimum	-1%	54%	0%	0%	0%	0%	0%

Comparables

Accident Fund Insurance Co	-3%	79%	4%	4%	0%	13%	0%
American Home Assurance Co (AIG)	1%	69%	1%	1%	3%	10%	15%
Amerisure Insurance Company	1%	80%	7%	2%	10%	0%	0%
Argonaut Insurance Group	2%	82%	3%	0%	0%	10%	2%
Commerce & Industry Insurance Co (AIG)	4%	61%	2%	1%	6%	7%	20%
Continental Casualty Group (CNA)	19%	58%	11%	5%	1%	1%	5%
Crum & Forster Insurance (Fairfax)	68%	10%	2%	10%	0%	10%	1%
Employers Insurance Co of Nevada	12%	61%	6%	0%	0%	21%	0%
Hartford Fire Group	2%	69%	19%	5%	1%	0%	4%
Liberty Mutual Group	0%	77%	7%	5%	1%	6%	4%
New Jersey Manufacturers Group	-1%	93%	1%	0%	0%	4%	0%
PMA Capital Insurance Group	2%	78%	16%	1%	1%	0%	0%
Travelers Casualty & Surety Company	-1%	86%	7%	3%	2%	0%	3%
Zenith National Insurance Group	3%	67%	14%	3%	2%	4%	6%
Zurich American Insurance Co	1%	87%	4%	0%	0%	7%	0%
Maximum	68%	93%	19%	10%	10%	21%	20%
Weighted average	6%	71%	9%	4%	1%	4%	4%
Minimum	-3%	10%	1%	0%	0%	0%	0%

A.M. Best's Composites (2003)

Property-Casualty Industry	3%	64%	6%	2%	1%	13%	4%
Workers' Compensation Composite	0%	88%	NA	NA	1%	9%	1%

Stock allocation trends

- Equity allocations are generally lower, as pressures on income and capital caused many companies to lessen their exposure:
 - Low interest rates
 - Declining stock markets
 - Poor underwriting results
 - Adverse reserve development
- L&I's equity allocation has remained stable around its target allocation.

Several companies with the high equity allocations in 1999 have reduced their allocations:

- Ohio lowered equities from 35% to 26%.
- Argonaut sold equities in 2003 after strengthening reserves.
- CNA sold two large equity holdings in 2000. Pressure on capital from losses and adverse reserve development kept them from reinvesting in equities.
- Liberty Mutual sold equities following several years of capital losses and adverse reserve development.
- Zurich sold equities in 2002 and 2003 after several years of poor underwriting and investment results.

Common Stock Allocation

	2003	2002	2001	2000	1999	5 Yr Avg.
Labor & Industries	18%	15%	17%	15%	16%	16%
State Funds						
Arizona State Compensation Fund	12%	6%	8%	10%	12%	9%
Beacon Mutual Insurance Co (RI)	7%	4%	5%	5%	5%	5%
Compsource Oklahoma	16%	12%	15%	NA	NA	14%
Hawaii Employers Mutual Insurance Co	8%	4%	4%	1%	0%	3%
Idaho State Insurance Fund	12%	11%	12%	NA	NA	12%
Kentucky Employers Mutual Insurance	10%	7%	7%	6%	3%	7%
Louisiana Workers Compensation Corp	17%	14%	12%	11%	14%	14%
Maine Employers Mutual Insurance Co	11%	8%	8%	7%	9%	9%
Missouri Employers Mutual Insurance Co	7%	6%	8%	8%	4%	7%
Montana State Fund (FY03)	13%	13%	5%	NA	NA	10%
New Mexico Mutual Casualty Co	18%	15%	17%	18%	13%	16%
New York State Insurance Fund	7%	5%	3%	0%	0%	3%
North Dakota Workers Compensation	36%	36%	37%	NA	NA	36%
Ohio Bureau of Workers' Comp (FY03)	26%	28%	32%	34%	35%	31%
Pinnacle Assurance (CO)	7%	5%	2%	1%	1%	3%
SAIF Corp (OR)	14%	11%	14%	17%	21%	15%
State Compensation Insurance Fund (CA)	0%	0%	0%	0%	0%	0%
State Fund Mutual Insurance Co (MN)	3%	0%	0%	9%	10%	5%
State Workers' Insurance Fund (PA)	11%	9%	12%	NA	NA	11%
Texas Mutual Insurance Company	28%	22%	24%	25%	22%	24%
Workers Compensation Fund of Utah	14%	12%	13%	13%	18%	14%
Maximum	36%	36%	37%	34%	35%	36%
Weighted average	13%	14%	17%	20%	20%	17%
Minimum	0%	0%	0%	0%	0%	0%

Private Insurers

Accident Fund Insurance Co	13%	9%	12%	15%	13%	12%
American Home Assurance Co (AIG)	10%	12%	12%	14%	17%	13%
Amerisure Insurance Company	0%	0%	0%	0%	0%	0%
Argonaut Insurance Group	10%	16%	25%	31%	30%	22%
Commerce & Industry Insurance Co (AIG)	7%	0%	0%	1%	3%	2%
Continental Casualty Group (CNA)	1%	2%	4%	6%	14%	5%
Crum & Forster Insurance (Fairfax)	10%	5%	4%	4%	4%	6%
Employers Insurance Co of Nevada	21%	22%	23%	25%	NA	23%
Hartford Fire Group	0%	2%	5%	5%	5%	3%
Liberty Mutual Group	6%	6%	9%	10%	11%	8%
New Jersey Manufacturers Group	4%	4%	6%	6%	5%	5%
PMA Capital Insurance Group	0%	0%	0%	0%	2%	0%
Travelers Casualty & Surety Company	0%	0%	1%	0%	1%	1%
Zenith National Insurance Group	4%	3%	3%	3%	3%	3%
Zurich American Insurance Co	7%	8%	18%	18%	19%	14%
Maximum	21%	22%	25%	31%	30%	23%
Weighted average	4%	4%	7%	8%	10%	7%
Minimum	0%	0%	0%	0%	0%	0%

Surplus exposures

- Under insurance accounting, changes in the market values of equities affect a company's surplus. (Changes in the market value of bonds do not, unless the bonds are sold.)
- Without Ohio, the state fund average equity-to-surplus is 50%.
- L&I is one of several companies that have very high equity to surplus ratios.

Market Valued Assets as a % of Surplus

Labor & Industries	Market Valued Assets as a % of Surplus					Insurance
	Preferred	Common	High Yield	Ri. Est.	Total	Leverage
	0%	239%	15%	0%	254%	14.3
State Funds						
Arizona State Compensation Fund	0%	50%	3%	4%	56%	3.6
Beacon Mutual Insurance Co (RI)	4%	24%	0%	0%	29%	3.7
Compsource Oklahoma	0%	80%	0%	0%	80%	5.4
Hawaii Employers Mutual Insurance Co	0%	62%	0%	0%	62%	10.5
Idaho State Insurance Fund	0%	52%	0%	0%	52%	4.7
Kentucky Employers Mutual Insurance	0%	39%	0%	0%	39%	4.7
Louisiana Workers Compensation Corp	4%	35%	6%	0%	46%	1.4
Maine Employers Mutual Insurance Co	5%	27%	5%	0%	37%	2.5
Missouri Employers Mutual Insurance Co	0%	28%	2%	0%	30%	6.0
Montana State Fund (FY03)	0%	48%	6%	0%	54%	3.5
New Mexico Mutual Casualty Co	0%	44%	0%	0%	44%	2.4
New York State Insurance Fund	2%	50%	1%	0%	53%	5.5
North Dakota Workers Compensation	0%	90%	0%	0%	90%	1.7
Ohio Bureau of Workers' Comp (FY03)	8%	861%	0%	0%	869%	32.1
Pinnacol Assurance (CO)	0%	32%	2%	0%	33%	4.6
SAIF Corp (OR)	10%	105%	55%	0%	169%	7.3
State Compensation Insurance Fund (CA)	0%	0%	0%	0%	0%	9.8
State Fund Mutual Insurance Co (MN)	0%	15%	3%	0%	18%	5.8
State Workers' Insurance Fund (PA)	0%	96%	0%	0%	96%	9.1
Texas Mutual Insurance Company	0%	65%	13%	2%	80%	1.9
Workers Compensation Fund of Utah	2%	45%	0%	8%	54%	2.8
Maximum	10%	861%	55%	8%	869%	32.1
Weighted average	0%	100%	5%	1%	106%	7.3
Minimum	0%	0%	0%	0%	0%	1.4

Comparables

Accident Fund Insurance Co	0%	39%	12%	3%	55%	3.0
American Home Assurance Co (AIG)	8%	24%	2%	0%	34%	3.4
Amerisure Insurance Company	35%	0%	8%	0%	43%	3.6
Argonaut Insurance Group	1%	32%	1%	0%	34%	3.9
Commerce & Industry Insurance Co (AIG)	13%	15%	2%	0%	30%	2.7
Continental Casualty Group (CNA)	3%	5%	23%	0%	31%	3.8
Crum & Forster Insurance (Fairfax)	0%	26%	26%	0%	52%	2.8
Employers Insurance Co of Nevada	0%	62%	0%	0%	62%	1.8
Hartford Fire Group	2%	0%	13%	0%	15%	2.5
Liberty Mutual Group	2%	21%	17%	0%	40%	4.2
New Jersey Manufacturers Group	0%	11%	0%	0%	11%	2.0
PMA Capital Insurance Group	4%	0%	4%	0%	9%	4.2
Travelers Casualty & Surety Company	7%	1%	8%	0%	16%	3.5
Zenith National Insurance Group	7%	11%	10%	0%	28%	3.9
Zurich American Insurance Co	0%	24%	0%	0%	24%	4.3
Maximum	35%	62%	26%	3%	62%	4.3
Weighted average	3%	12%	12%	0%	27%	3.4
Minimum	0%	0%	0%	0%	9%	1.8

A.M. Best's Composites (2003)

Property-Casualty Industry	3%	36%	5%	0%	44%	2.4
Workers' Compensation Composite	4%	36%	0%	1%	41%	4.9

Bond sector allocation

- State funds tend to be somewhat conservative, with higher allocations to Treasuries.
- Many state funds are tax exempt entities and do not benefit from municipal bonds. (Funds may hold small allocations of taxable municipal bonds, or muni bonds to support in-state development.)

Maine is one of the few taxable funds, so it benefits from munis.

	% of Bond Portfolio						
	Treas	Corp	MBS	CMO	ABS	Non US	Muni
Labor & Industries	19%	62%	8%	10%	1%	1%	0%
State Funds							
Arizona State Compensation Fund	34%	43%	14%	1%	5%	0%	3%
Beacon Mutual Insurance Co (RI)	54%	40%	1%	0%	0%	1%	3%
Compsource Oklahoma	44%	31%	12%	10%	3%	0%	1%
Hawaii Employers Mutual Insurance Co	10%	64%	1%	0%	22%	0%	2%
Idaho State Insurance Fund	67%	26%	2%	0%	2%	2%	1%
Kentucky Employers Mutual Insurance	18%	49%	8%	6%	12%	1%	8%
Louisiana Workers Compensation Corp	17%	26%	47%	8%	1%	0%	0%
Maine Employers Mutual Insurance Co	2%	20%	13%	4%	8%	0%	53%
Missouri Employers Mutual Insurance Co	33%	23%	17%	3%	23%	0%	1%
Montana State Fund (FY03)	28%	53%	13%	6%	0%	0%	0%
New Mexico Mutual Casualty Co	19%	67%	9%	0%	4%	0%	1%
New York State Insurance Fund	43%	38%	0%	11%	6%	0%	2%
North Dakota Workers Compensation	NA	NA	NA	NA	NA	NA	NA
Ohio Bureau of Workers' Comp (FY03)	NA	NA	NA	NA	NA	NA	NA
Pinnacol Assurance (CO)	13%	44%	1%	39%	3%	0%	0%
SAIF Corp (OR)	19%	37%	33%	3%	5%	2%	0%
State Compensation Insurance Fund (CA)	37%	33%	20%	4%	0%	0%	5%
State Fund Mutual Insurance Co (MN)	15%	12%	24%	12%	6%	0%	32%
State Workers' Insurance Fund (PA)	51%	13%	24%	6%	0%	0%	6%
Texas Mutual Insurance Company	9%	53%	17%	3%	4%	0%	14%
Workers Compensation Fund of Utah	66%	10%	6%	0%	0%	0%	18%
Maximum	67%	67%	47%	39%	23%	2%	53%
Weighted average	36%	35%	15%	7%	3%	0%	5%
Minimum	2%	10%	0%	0%	0%	0%	0%

Comparables

Accident Fund Insurance Co	22%	37%	35%	1%	4%	0%	1%
American Home Assurance Co (AIG)	6%	6%	0%	0%	3%	6%	79%
Amerisure Insurance Company	24%	29%	31%	8%	1%	0%	7%
Argonaut Insurance Group	48%	25%	10%	5%	5%	0%	8%
Commerce & Industry Insurance Co (AIG)	0%	3%	0%	0%	0%	0%	96%
Continental Casualty Group (CNA)	8%	38%	15%	9%	0%	1%	28%
Crum & Forster Insurance (Fairfax)	42%	56%	0%	0%	0%	0%	1%
Employers Insurance Co of Nevada	30%	26%	35%	0%	5%	4%	0%
Hartford Fire Group	1%	37%	3%	0%	16%	3%	39%
Liberty Mutual Group	16%	36%	33%	2%	2%	2%	9%
New Jersey Manufacturers Group	40%	16%	0%	0%	1%	0%	43%
PMA Capital Insurance Group	20%	44%	16%	7%	13%	0%	0%
Travelers Casualty & Surety Company	2%	15%	13%	15%	4%	0%	50%
Zenith National Insurance Group	36%	45%	8%	0%	2%	0%	10%
Zurich American Insurance Co	37%	23%	11%	10%	11%	0%	8%
Maximum	48%	56%	35%	15%	16%	6%	96%
Weighted average	13%	31%	15%	5%	6%	2%	28%
Minimum	0%	3%	0%	0%	0%	0%	0%

A.M. Best's Composites (2003)

Property-Casualty Industry	17%	30%	9%	9%	0%	0%	36%
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Bond portfolio maturity

- ◆ Average maturities vary due to differing liquidity needs, risk tolerances, and reserve payment patterns.
- ◆ Financial reports do not always address differences between stated vs. expected maturities.
- ◆ State funds tend to have longer reserve durations (due to their use of structured settlements, position as insurer of last resort, claims management practices, and lack of control over staffing levels).
- ◆ L&I has longer than average reserve durations, and has a longer than average bond maturity structure.
- ◆ Note that L&I's 14.6 year average *maturity* is a different measure than L&I's *duration* targets of 6 and 9.

	% of Bond Portfolio					Avg.
	<=1 Yr	>1-5 Yrs	>5-10 Yrs	>10-20 Yrs	>20 Yrs	
Labor & Industries	1%	23%	19%	18%	39%	14.6
State Funds						
Arizona State Compensation Fund	11%	37%	22%	20%	10%	8.3
Beacon Mutual Insurance Co (RI)	7%	49%	30%	7%	7%	6.5
Compsource Oklahoma	23%	34%	26%	13%	5%	6.2
Hawaii Employers Mutual Insurance Co	18%	55%	18%	3%	6%	5.0
Idaho State Insurance Fund	7%	65%	23%	3%	3%	4.9
Kentucky Employers Mutual Insurance	4%	33%	36%	18%	9%	8.6
Louisiana Workers Compensation Corp	25%	30%	38%	6%	1%	5.1
Maine Employers Mutual Insurance Co	8%	28%	35%	28%	1%	7.9
Missouri Employers Mutual Insurance Co	10%	51%	30%	4%	5%	5.8
Montana State Fund (FY03)	2%	31%	38%	25%	4%	8.6
New Mexico Mutual Casualty Co	16%	66%	12%	4%	2%	4.1
New York State Insurance Fund	5%	30%	25%	17%	23%	11.1
North Dakota Workers Compensation	NA	NA	NA	NA	NA	NA
Ohio Bureau of Workers' Comp (FY03)	NA	NA	NA	NA	NA	NA
Pinnacol Assurance (CO)	8%	25%	48%	17%	3%	7.6
SAIF Corp (OR)	18%	31%	22%	13%	16%	8.6
State Compensation Insurance Fund (CA)	8%	43%	27%	15%	7%	7.4
State Fund Mutual Insurance Co (MN)	20%	46%	32%	2%	0%	4.2
State Workers' Insurance Fund (PA)	4%	36%	19%	18%	23%	11.0
Texas Mutual Insurance Company	13%	48%	36%	3%	1%	4.8
Workers Compensation Fund of Utah	15%	41%	40%	4%	0%	5.0
Maximum	25%	66%	48%	28%	23%	11.1
Weighted average	9%	38%	28%	15%	11%	8.3
Minimum	2%	25%	12%	2%	0%	4.1

Comparables						
Accident Fund Insurance Co	10%	20%	23%	34%	13%	10.7
American Home Assurance Co (AIG)	11%	24%	46%	12%	7%	7.8
Amerisure Insurance Company	18%	45%	21%	9%	7%	6.2
Argonaut Insurance Group	33%	43%	21%	3%	0%	3.6
Commerce & Industry Insurance Co (AIG)	7%	25%	54%	12%	2%	7.2
Continental Casualty Group (CNA)	24%	7%	9%	14%	47%	14.8
Crum & Forster Insurance (Fairfax)	29%	16%	13%	13%	30%	11.0
Employers Insurance Co of Nevada	6%	30%	24%	17%	23%	11.1
Hartford Fire Group	6%	19%	36%	27%	13%	10.4
Liberty Mutual Group	11%	18%	27%	27%	17%	11.0
New Jersey Manufacturers Group	17%	59%	17%	8%	0%	4.2
PMA Capital Insurance Group	21%	40%	23%	4%	12%	6.7
Travelers Casualty & Surety Company	10%	23%	44%	15%	7%	8.2
Zenith National Insurance Group	27%	28%	31%	6%	7%	6.1
Zurich American Insurance Co	10%	51%	27%	7%	5%	6.0
Maximum	33%	59%	54%	34%	47%	14.8
Weighted average	14%	22%	26%	18%	20%	10.4
Minimum	6%	7%	9%	3%	0%	3.6

A.M. Best's Composites (2003)						
Property-Casualty Industry	14%	30%	31%	15%	9%	7.9

Bond portfolio quality

- ◆ High quality bonds predominate in p/c portfolios
- ◆ Only a few companies have allocations to high yield bonds (Oregon, Texas and Crum & Foster)

Low number = high quality

NAIC 1 = A to AAA

NAIC 2 = BBB

NAIC 3 = BB

NAIC 4 = B

NAIC 5 = C to CCC

NAIC 6 = D

- *NAIC 1 and 2 qualify for amortized cost accounting*

- *NAIC 3-6 require lower of cost or market*

	% of Bond Portfolio						Avg.
	NAIC 1	NAIC 2	NAIC 3	NAIC 4	NAIC 5	NAIC 6	
Labor & Industries	75%	23%	1%	0%	0%	0%	1.3
State Funds							
Arizona State Compensation Fund	89%	10%	0%	0%	0%	0%	1.1
Beacon Mutual Insurance Co (RI)	92%	8%	0%	0%	0%	0%	1.1
Compsource Oklahoma	87%	13%	0%	0%	0%	0%	1.1
Hawaii Employers Mutual Insurance Co	100%	0%	0%	0%	0%	0%	1.0
Idaho State Insurance Fund	91%	9%	0%	0%	0%	0%	1.1
Kentucky Employers Mutual Insurance	92%	8%	0%	0%	0%	0%	1.1
Louisiana Workers Compensation Corp	95%	1%	2%	2%	0%	0%	1.1
Maine Employers Mutual Insurance Co	93%	5%	0%	2%	0%	0%	1.1
Missouri Employers Mutual Insurance Co	96%	3%	0%	0%	0%	0%	1.0
Montana State Fund (FY03)	85%	13%	2%	0%	0%	0%	1.2
New Mexico Mutual Casualty Co	95%	5%	0%	0%	0%	0%	1.1
New York State Insurance Fund	96%	4%	0%	0%	0%	0%	1.0
North Dakota Workers Compensation	NA	NA	NA	NA	NA	NA	NA
Ohio Bureau of Workers' Comp (FY03)	NA	NA	NA	NA	NA	NA	NA
Pinnacol Assurance (CO)	94%	5%	0%	0%	0%	0%	1.1
SAIF Corp (OR)	78%	12%	5%	3%	1%	0%	1.4
State Compensation Insurance Fund (CA)	100%	0%	0%	0%	0%	0%	1.0
State Fund Mutual Insurance Co (MN)	99%	0%	0%	0%	0%	0%	1.0
State Workers' Insurance Fund (PA)	100%	0%	0%	0%	0%	0%	1.0
Texas Mutual Insurance Company	76%	17%	6%	2%	0%	0%	1.4
Workers Compensation Fund of Utah	100%	0%	0%	0%	0%	0%	1.0
Maximum	100%	17%	6%	3%	1%	0%	1.4
Weighted average	95%	4%	1%	0%	0%	0%	1.1
Minimum	76%	0%	0%	0%	0%	0%	1.0
Comparables							
Accident Fund Insurance Co	90%	5%	3%	1%	0%	0%	1.2
American Home Assurance Co (AIG)	97%	2%	1%	0%	0%	0%	1.0
Amerisure Insurance Company	89%	8%	3%	0%	0%	0%	1.1
Argonaut Insurance Group	96%	4%	0%	0%	0%	0%	1.0
Commerce & Industry Insurance Co (AIG)	96%	2%	0%	1%	0%	0%	1.1
Continental Casualty Group (CNA)	84%	11%	3%	1%	1%	0%	1.2
Crum & Forster Insurance (Fairfax)	46%	8%	22%	4%	18%	2%	2.5
Employers Insurance Co of Nevada	91%	9%	0%	0%	0%	0%	1.1
Hartford Fire Group	74%	20%	4%	1%	0%	0%	1.3
Liberty Mutual Group	86%	8%	3%	2%	0%	0%	1.2
New Jersey Manufacturers Group	99%	1%	0%	0%	0%	0%	1.0
PMA Capital Insurance Group	82%	17%	1%	0%	0%	0%	1.2
Travelers Casualty & Surety Company	90%	7%	2%	1%	0%	0%	1.1
Zenith National Insurance Group	80%	16%	3%	1%	0%	0%	1.3
Zurich American Insurance Co	95%	5%	0%	0%	0%	0%	1.0
Maximum	99%	20%	22%	4%	18%	2%	2.5
Weighted average	86%	10%	3%	1%	0%	0%	1.2
Minimum	46%	1%	0%	0%	0%	0%	1.0
A.M. Best's Composites (2003)							
Property-Casualty Industry	89%	9%	1%	1%	0%	0%	1.2

The Conning team

Scott E. Daniels, CPA, CFA, is a Managing Director in Conning's Insurance Advisory unit. He is responsible for providing asset-liability and integrated risk management advisory services to property-casualty insurance companies. Mr. Daniels works with a number of state workers' compensation funds, including both advisory clients and portfolio management clients.

Robert A. Painter, ACAS is an Assistant Vice President in the property-casualty Insurance Advisory unit of Conning Asset Management. Mr. Painter has extensive experience with Dynamic Financial Analysis, as well as actuarial work at several major insurance companies.

Susan D. Royles, CFA, is a Senior Vice President and Portfolio Manager. In addition to insurance portfolio management, Ms. Royles' experience also includes credit analysis for both public bonds and private placements.

Other State Fund team members (Conning has 12 AASCIF clients as of 9/30/04)

Portfolio Managers

Len Carlson
Larry Cook
John Gauthier
Karen Kelleher
Paul Sellier
Dawn Silvia

Insurance Advisory

Angela Baker
Dan Isaac
Steve Sonlin

Analysts

Credit analysts
Indexed equity managers
Risk managers
Sector analysts
Traders