FINANCIAL AUDIT

Commonwealth of Pennsylvania
Harrisburg, Pennsylvania

Department of Labor and Industry
State Workers' Insurance Fund

For the Years Ended December 31, 2021
and December 31, 2020

November 2022

TIMOTHY L. DeFOOR • AUDITOR GENERAL •

Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General

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BACKGROUND

The State Workers' Insurance Fund (SWIF) is a self-sustaining fund operating within the Pennsylvania Department of Labor and Industry for the purpose of providing workers' compensation insurance to employers, including those refused policies by private insurance firms. SWIF is subject to underwriting rules, classifications, and rates promulgated by rating bureaus authorized by the State Insurance Commissioner. A board consisting of the Secretary of Labor and Industry, the State Treasurer, and the Insurance Commissioner oversees operations of the fund.

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TIMOTHY L. DEFOOR
AUDITOR GENERAL

Independent Auditor's Report

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying Statements of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF) as of December 31, 2021, and December 31, 2020, and the related Statements of Operations and Changes in Surplus-statutory basis and the Statements of Cash Flows-statutory basis for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of SWIF as of December 31, 2021, and December 31, 2020, and the results of its operations and its cash flows for the years then ended in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania as described in Note A.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of SWIF and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter – Basis of Accounting

We draw attention to Note A of the financial statements, which describes the basis of accounting. As described in Note A to the financial statements, the financial statements are prepared by SWIF in accordance with statutory accounting practices as prescribed or permitted by the Insurance Department of Pennsylvania, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Insurance Department of Pennsylvania. The effects on the financial statements of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Emphasis of Matter – Insurance Loss Liability

As discussed in Note E, the insurance loss liability of SWIF is based on actuarial analysis of historical experience adjusted to estimate the impact of Act 44 of 1993 and Act 57 of 1996 and changes in claims management practices adopted by SWIF management. Because of the length of time required for the actual insurance loss liability to be determined and the uncertainty regarding whether the adjusted data will be supported by future claim payments, the actual liability may vary significantly from the estimated amount provided for in the Statements of Admitted Assets, Liabilities and Surplus-statutory basis.

Responsibilities of Management for the Financial Statements

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SWIF's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the statutory financial statements that collectively comprise SWIF's financial statements. The management's discussion and analysis is presented for purposes of additional analysis and is not a required part of the statutory financial statements. Such information is the responsibility of management. Our opinion on the statutory financial statements does not cover the supplementary information, and we do not express an opinion or any form of assurance thereon.

Other Information

Management is responsible for the other information included in the annual report. The other information comprises the background section but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated November 30, 2022, on our consideration of SWIF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SWIF's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWIF's internal control over financial reporting and compliance.

Restriction on Use

Our report is intended solely for the information and use of the board of directors and management of SWIF, others within the entity, and for filing with the Insurance Department of Pennsylvania, and is not intended to be and should not be used by anyone other than these specified parties.

Timothy L. DeFoor

Timothy L. DeFoor
Auditor General
November 30, 2022

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS

Assets and Liabilities

The State Workers' Insurance Fund (SWIF) disclosed total admitted assets of $1.460 billion as of December 31, 2021. This was an increase of $26 million over the $1.434 billion reported in 2020. Total investments increased from $1.392 billion in 2020 to $1.415 billion in 2021 or a $23 million increase. This increase was supplemented by an increase in total receivables.

SWIF's total liabilities decreased to $1.185 billion, a decrease of $90 million or 7.06% from the prior year. Net unpaid losses decreased as of year-end 2021 to $881 million from $971 million in the prior year, a decrease of $90 million or 9.3%. This decrease was due to an actuarial adjustment to SWIF's incurred but not reported and bulk reserves that occurred in 2021. Unpaid loss adjustment expenses increased by $4.3 million. All other liabilities decreased $4.7 million.

Surplus

Surplus as regards policyholders was $274 million, an increase of $115 million or 72.3% for 2021 as compared to the reported surplus of $159 million in 2020. SWIF's net income before other changes in surplus for 2021 was $71 million versus a net income in 2020 of $116 million. The improvement to SWIF's surplus was largely due to the net income of $71 million.

SWIF continues to discount its loss reserves at a discount rate of 2%.

SWIF has a surplus due to a change in an actuarial estimate. We have implemented several initiatives to keep the surplus positive, as outlined below in the section titled Future Initiatives.

Operational Results

SWIF recorded net income before other changes in surplus of $71 million for 2021. This is a decrease of $45 million as compared to the 2020 net income of $116 million. The earned premiums decreased by $18 million or 17% to $91 million in 2021, from $109 million in 2020. This decline in earned premium was compounded by an increase in underwriting expense of $9 million. This led to a decrease in underwriting gain of $28 million. The decrease in underwriting gain was complemented by a $15 million decrease in net investment income.

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Net investment income decreased 26.8% or $15 million to $41 million. During 2021, SWIF had a decrease in its investment portfolio performance as total yield decreased to 1.6% from 9.2% in 2020. The 2021 yield of SWIF's fixed income portfolio was -1.1%, and equity yield was 24.3%.

During 2021, SWIF also had a $9 million net loss in charged off premium that reduced SWIF's overall net income. This premium was ruled uncollectible and charged off through the Pennsylvania Attorney General's Office.

Future Initiatives

SWIF'S Compromise and Release Initiative continues to produce savings in future reserves. During 2021, 333 claims were settled that resulted in loss reserve savings of $23.4 million.

SWIF continues to closely monitor staffing levels as a means of controlling personnel expense. As of year-end 2021, the SWIF staffing level decreased from 199 employees to 179.

SWIF contracted with Hoover Rehabilitation Inc. in May 2013 for the Medical Bill Repricing, Preferred Provider Organization, Pharmacy Benefit Management, and Durable Medical Equipment. During 2021, SWIF realized net savings below medical bill fee schedule of 11.91% for medical bill payment savings of $6.4 million.

During 2021, SWIF's Customer Service Unit handled 42,676 of the 48,494 calls received or 88% of all calls. This unit eliminates the need to transfer calls to the Underwriting, Claims, Auditing, and Accounting Divisions. This unit also handled 2,373 first report of injury calls.

SWIF is currently engaged in a project to update its information technology platform. The current operating system, Power Comp, is being replaced by Guidewire, an industry leading property casualty tool. This installation is being performed by Deloitte in conjunction with the Employment, Banking, and Revenue Delivery Center in the Pennsylvania Office of Administration, Office for Information Technology, and the SWIF staff. The new platform, along with an organizational transformation effort, will bring SWIF more in line with the best practices of the workers' compensation insurance market. As part of this upgrade, SWIF will offer an interactive customer portal that will allow for enhanced customer services to both claimants and policyholders.

Effective April 2021, SWIF increased its Commercial Loss Cost Multiplier (LCM) from 3.187 to 3.569 and Coal LCM from 1.904 to 1.944.

SWIF is the third-party administrator for the Commonwealth's Uninsured Employers Guarantee Fund and the Self-Insurance Guarantee Fund which resulted in annual revenue of $624,598 for 2021.

SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

SWIF's minimum premium remained at $612 for 2021.

SWIF collected $4,373,406 in past due premium during 2021 through its credit card program titled SWIFPay. This includes dollars from the SWIFPhone program that was launched in May of 2019.

STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS (statutory basis)

ADMITTED ASSETS		(Expressed in Thousands) 2021		2020
Investments				
Bonds	$	1,166,173	$	1,193,574
Stocks		186,171		149,834
Short-term investments		63,057		49,050
Total Investments – Note B	$	1,415,401	$	1,392,458
Cash				
On deposit in Treasury Department	$	613	$	2,447
Receivables				
Uncollected premiums in course of collection	$	4,416	$	4,987
Premiums, agents' balances, and installments booked but deferred and not yet due		27,959		25,302
Reinsurance recoverable on loss payments		754		430
Interest due and accrued on investments		7,709		8,627
Funds held by or deposited with reinsurance companies		14		14
Other amounts receivable under reinsurance contracts		2,713		0
Accrued retrospective premiums		(24)		123
Total receivables	$	43,541	$	39,483
Total Admitted Assets	$	1,459,555	$	1,434,388
LIABILITIES AND SURPLUS				
Liabilities				
Net unpaid losses – Notes C and E	$	881,187	$	970,797
Unpaid loss adjustment expenses		241,182		236,926
Reinsurance payable		13		16
Premium deficiency reserve		1,191		5,693
Accrued administrative expenses		7,328		5,021
Unearned premiums		35,045		33,773
Ceded reinsurance premiums payable		0		63
Policyholders' premium credit balances		9,557		8,477
Restricted account – Commonwealth Self Insurance		2,594		2,557
Policyholder deposits		1,169		1,300
Net payable for securities		4,528		8,314
Other liabilities		1,268		2,130
Total liabilities	$	1,185,062	$	1,275,067
Surplus				
Unassigned surplus (deficit) – Note F		274,493		159,321
Total surplus (deficit) as regards policyholders	$	274,493	$	159,321
Total Liabilities and Surplus	$	1,459,555	$	1,434,388

~ The notes to the financial statements are an integral part of these statements. ~

STATEMENTS OF OPERATIONS AND CHANGES IN SURPLUS (statutory basis)

(Expressed in Thousands)

		2021		2020
Underwriting Income				
Premiums earned	$	91,079	$	109,447
Underwriting Expenses				
Losses incurred	$	4,337	$	6,412
Loss adjustment expenses		35,463		12,923
Other		16,771		18,460
Change in premium deficiency reserve		(4,502)		5,062
Total underwriting expenses	$	52,069	$	42,857
Net Underwriting Gain (Loss)	$	39,010	$	66,590
Investment Income				
Investment income earned	$	33,400	$	38,862
Net realized capital gains (losses)		9,047		18,068
Total investment income	$	42,447	$	56,930
Investment Expenses	$	1,379	$	1,295
Net Investment Income	$	41,068	$	55,635
Other Income/Expenses				
Other income (expenses)	$	116	$	593
Net loss from premium balances charged off		(8,799)		(7,007)
Total other income/expenses	$	(8,683)	$	(6,414)
Net Income (Loss) Before Other Changes in Surplus	$	71,395	$	115,811
Other Changes in Surplus				
Change in net unrealized capital gain (loss)	$	32,315	$	23,420
Change in nonadmitted assets		11,461		(10,690)
Total other changes in surplus	$	43,776	$	12,730
Net change in surplus (deficit) during the year	$	115,171	$	128,541
Surplus (deficit) at beginning of year	$	159,321	$	30,780
Surplus (deficit) at end of year	$	274,492	$	159,321

~ The notes to the financial statements are an integral part of these statements. ~

STATEMENTS OF CASH FLOWS (statutory basis)

(Expressed in Thousands)

	2021	2020
Cash flows from operating activities:		
Premiums collected net of reinsurance	$ 99,034	$ 93,657
Benefit and loss related payments	(94,459)	(110,274)
Commissions, expenses paid, and aggregate write-ins	(40,347)	(60,654)
Investment income (net of investment expenses)	38,112	41,027
Miscellaneous income (uses)	(8,683)	(6,414)
Net cash from operating activities	$ (6,343)	$ (42,658)
Cash flows from investing activities:		
Proceeds from sale of bonds	$ 869,152	$ 976,378
Payments for purchase of bonds	(838,698)	(945,691)
Payments for purchase of stocks	(4,021)	(2,221)
Miscellaneous proceeds (applications)	(3,787)	3,076
Net cash from investing activities	$ 22,646	$ 31,542
Cash flows from miscellaneous sources:		
Other cash provided (applied)	$ (4,130)	$ 6,133
Net change in cash and short-term investments	$ 12,173	$ (4,983)
Cash and short-term investments at beginning of year	$ 51,497	$ 56,480
Cash and short-term investments at end of year	$ 63,670	$ 51,497

~ The notes to the financial statements are an integral part of these statements. ~

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The State Workers' Insurance Fund (SWIF) prepares its statutory financial statements in accordance with statutory accounting practices as prescribed or permitted by rules and regulations promulgated by the Insurance Department of Pennsylvania. These statutory practices are primarily designed to demonstrate solvency and differ from generally accepted accounting principles (GAAP) in certain significant areas:

- Certain assets, designated as nonadmitted, are not permitted to be reported in the statutory financial statements and are charged directly to surplus. Major nonadmitted assets include premiums due in excess of statutory limitations (three months); expenses for furniture, fixtures, and supplies; and unrealized gains or losses on investments. Under GAAP, these items would be treated as assets net of the related contra accounts of allowance for doubtful accounts, depreciation, and valuation allowances for investments.

- Certain disclosures required under GAAP are not required under SWIF's statutory accounting practices as follows:

    - Securities lending transactions involving the receipt of cash collateral (or securities that may be pledged or sold without default) with an asset and a liability related to the receipt of the collateral reported on SWIF's Balance Sheet.

    - A Statement of Cash Flows which includes a reconciliation of operating income to net cash provided by (used for) operating activities and which excludes short-term investments.

    - Reporting certain investments at fair value in the Balance Sheet with the current year change in fair value recognized as an element of investment income in the Operating Statement.

    - Reporting the net pension liability and related deferred outflows of resources and deferred inflows of resources.

    - Reporting the net other postemployment benefits liability and related deferred outflows of resources and deferred inflows of resources.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

Investments are stated on the basis adopted by the National Association of Insurance Commissioners (NAIC) and are recorded based on trade date. The book/adjusted carrying value of bonds is stated at amortized cost. The book/adjusted carrying value of common stock is reported at market value with market value rates taken from the custodian statement. Preferred stock is reported at cost/amortized cost. Realized investment gains or losses are included in the Statement of Operations and Changes in Surplus. Unrealized investment gains or losses from revaluation of investments (i.e., stocks) are charged directly to surplus. Short-term investments are recorded at cost which approximates fair value.

Premium and Revenue Recognition

Premiums earned and assessments billed to policyholders are recorded as income. Unearned premiums and assessments are recorded as a liability and earned as the policy term expires. Premiums and assessments are booked as written on the effective date of the policy. Assessments paid are classified as expenses.

Loss and Loss Adjustment Expense Reserves

The liability for unpaid losses is based upon individual case estimates adjusted for incurred but not reported losses based on past experience, a probable loss reserve, and statutory minimum requirements as determined by SWIF's Actuarial Committee and independent review by outside actuaries. Loss reserves ceded by the National Workers' Compensation Reinsurance Pool and the Pennsylvania Workers' Compensation Reinsurance Pool and assumed by SWIF are included in loss reserves. The liability for loss adjustment expense is determined by SWIF's Actuarial Committee as a percentage of loss reserves based on past experience.

Use of Estimates

The preparation of the accompanying Statements of Admitted Assets, Liabilities and Surplus-statutory basis requires management to make estimates and assumptions that affect the reported amounts of admitted assets, liabilities, surplus, and disclosure of contingent liabilities at the date of this statutory financial statement. Actual results could differ from those estimates.

NOTE B – INVESTMENTS

GAAP (per Governmental Accounting Standards Board Statement No. 40) requires certain disclosures regarding policies and practices with respect to investments and the risks associated with them. Although these disclosures are not required for the statutory financial statements of SWIF, similar informative disclosures have been provided as follows:

SWIF categorizes investments according to the level of investment risk assumed by the Commonwealth. SWIF has formally adopted a written investment policy. Provisions of the written investment policy and current management of the investments consider custodial credit risk, concentration of credit risk, credit risk, interest rate risk, and foreign currency risk. The identified risks are discussed in detail below.

Custodial Credit Risk – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, SWIF would not be able to recover the value of investment or collateral securities that are in the possession of an outside party. In accordance with a contractual relationship between SWIF and its custodial agents, substantially all investments, where securities are used as evidence of the investment, are held by the custodians in book entry form in the name of the Commonwealth or the custodian. These investments are defined as insured or registered investments for which the securities are held by SWIF or its agent.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of the government's investment in a single issuer. SWIF's investment policy does not place a limit on the concentration of investments in any one issuer.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of a debt instrument is measured by nationally-recognized statistical rating agencies such as Moody's Investors Services (Moody's). SWIF requires fund assets to be invested in investment grade bonds rated BBB/Baa (or equivalent) or better except that investment managers may invest up to 10 percent of the total fixed income portfolio in non-investment grade bonds. The investments rated NR (Not Rated) and WR (Withdrawn Rating) are approximately 2.5 percent of the fixed income portfolio at December 31, 2021. This excludes share balances of $48.6 million in the Treasury Department's unrated short-term investment pools.

NOTE B – INVESTMENTS (Continued)

The following tables disclose aggregate fair value, by major Moody's credit quality rating category at December 31, 2021 and 2020 (amounts in thousands):

December 31, 2021 Investment Type	Amount	Moody's Rating	% Portfolio
US Agency	$ 887	A1	0.06%
US Agency	1,325	A2	0.09%
US Agency	464	Aa1	0.03%
US Agency	787	Aa2	0.05%
US Agency	2,273	Aaa	0.16%
US Agency	1,156	Baa1	0.08%
US Agency	791	Baa2	0.06%
Total US Agency Securities	**$ 7,683**		
US Government Securities	$ 276,037	Aaa	19.23%
Total US Government Securities	**$ 276,037**		
Mortgage-Backed Securities	$ 588	A3	0.04%
Mortgage-Backed Securities	212,849	Aaa	14.83%
Mortgage-Backed Securities	3,802	NR	0.26%
Total Mortgage-Backed Securities	**$ 217,239**		
Asset Backed Securities	$ 1,150	A3	0.08%
Asset Backed Securities	692	Aa1	0.05%
Asset Backed Securities	931	Aa3	0.06%
Asset Backed Securities	4,184	Aaa	0.29%
Asset Backed Securities	527	Ba1	0.04%
Asset Backed Securities	53	Baa3	0.01%
Asset Backed Securities	10,216	NR	0.71%
Total Asset Backed Securities	**$ 17,753**		
Corporate Obligations	$ 65,045	A1	4.53%
Corporate Obligations	89,650	A2	6.24%
Corporate Obligations	84,191	A3	5.86%
Corporate Obligations	14,314	Aa2	1.00%
Corporate Obligations	16,686	Aa3	1.16%
Corporate Obligations	21,033	Aaa	1.46%
Corporate Obligations	9,175	B1	0.64%
Corporate Obligations	1,134	B2	0.08%
Corporate Obligations	28,127	Ba1	1.96%
Corporate Obligations	28,733	Ba2	2.00%

NOTE B – INVESTMENTS (Continued)

December 31, 2021 Investment Type	Amount	Moody's Rating	% Portfolio
Corporate Obligations	23,864	Ba3	1.66%
Corporate Obligations	80,970	Baa1	5.64%
Corporate Obligations	113,956	Baa2	7.94%
Corporate Obligations	89,895	Baa3	6.26%
Corporate Obligations	15,426	NR	1.07%
Corporate Obligations	29	WR	0.01%
Total Corporate Obligations	**$ 682,228**		
Treasury Investment Program	**$ 48,619**	NR	3.39%
Total Fixed Income Securities	**$ 1,249,559**		
Equity Securities	**$ 186,171**	NR	12.97%
Total Portfolio at December 31, 2021	**$ 1,435,730**		100.00%

NOTE B – INVESTMENTS (Continued)

December 31, 2020

Investment Type	Amount	Moody's Rating	% Portfolio
US Agency	$ 1,195	A1	0.08%
US Agency	1,162	A2	0.08%
US Agency	496	Aa1	0.03%
US Agency	2,399	Aa2	0.16%
US Agency	2,348	Aaa	0.16%
US Agency	1,234	Baa1	0.08%
US Agency	779	Baa2	0.05%
Total US Agency Securities	**$ 9,613**		
US Government Securities	$ 238,116	Aaa	16.23%
Total US Government Securities	**$ 238,116**		
Mortgage-Backed Securities	$ 618	A3	0.04%
Mortgage-Backed Securities	240,490	Aaa	16.39%
Mortgage-Backed Securities	79	B3	0.01%
Mortgage-Backed Securities	3,411	NR	0.23%
Total Mortgage-Backed Securities	**$ 244,598**		
Asset Backed Securities	$ 426	A1	0.03%
Asset Backed Securities	1,235	A3	0.09%
Asset Backed Securities	536	Aa3	0.04%
Asset Backed Securities	804	Aaa	0.05%
Asset Backed Securities	448	Ba1	0.03%
Asset Backed Securities	185	Baa3	0.01%
Asset Backed Securities	2,663	NR	0.18%
Total Asset Backed Securities	**$ 6,296**		

NOTE B – INVESTMENTS (Continued)

December 31, 2020 Investment Type		Amount	Moody's Rating	% Portfolio
Corporate Obligations	$	60,521	A1	4.13%
Corporate Obligations		105,812	A2	7.21%
Corporate Obligations		116,463	A3	7.94%
Corporate Obligations		13,798	Aa1	0.94%
Corporate Obligations		27,440	Aa2	1.87%
Corporate Obligations		26,868	Aa3	1.84%
Corporate Obligations		8,006	Aaa	0.55%
Corporate Obligations		8,835	B1	0.60%
Corporate Obligations		1,559	B2	0.11%
Corporate Obligations		35,441	Ba1	2.42%
Corporate Obligations		25,499	Ba2	1.74%
Corporate Obligations		28,182	Ba3	1.92%
Corporate Obligations		89,561	Baa1	6.10%
Corporate Obligations		116,314	Baa2	7.93%
Corporate Obligations		91,451	Baa3	6.23%
Corporate Obligations		14,187	NR	0.97%
Corporate Obligations		210	WR	0.01%
Total Corporate Obligations	**$**	**770,147**		
Treasury Investment Program	**$**	**48,543**	NR	3.31%
Total Fixed Income Securities	**$**	**1,317,313**		
Equity Securities	**$**	**149,834**	NR	10.21%
Total Portfolio at December 31, 2020	**$**	**1,467,147**		100.00%

NOTE B – INVESTMENTS (Continued)

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SWIF measures interest rate risk using duration. As means for limiting SWIF's exposure to fair value losses arising from rising interest rates, SWIF requires investments to have maturities consistent with SWIF's liabilities. SWIF's long-term asset allocation diversifies its fixed income core segment between intermediate duration and longer duration strategies. Duration is a measure of an investment's sensitivity to changes in interest rates. The higher the duration, the greater the changes in fair value when interest rates change. For reporting purposes, SWIF elects to use option-adjusted duration, which takes into account embedded options affecting cash flows. At December 31, 2021 and 2020, SWIF's fixed income portfolio had the following option-adjusted durations by fixed income sector:

December 31, 2021 Investment Type	Amount	Duration (in years)
US Agency Securities	$ 7,683	8.360
US Government Securities	276,037	11.300
Mortgage-Backed Securities	217,239	3.412
Asset Backed Securities	17,753	5.132
Corporate Obligations	682,228	5.211
Treasury Investment Program	48,619	N/A
Total Fixed Income Securities	**$ 1,249,559**	
Equity Securities	186,171	N/A
Total Portfolio Securities	**$ 1,435,730**	

N/A – Indicates duration is not applicable to investment.

NOTE B – INVESTMENTS (Continued)

December 31, 2020 Investment Type	Amount	Duration (in years)
US Agency Securities	$ 9,613	9.241
US Government Securities	238,116	12.770
Mortgage-Backed Securities	244,598	2.910
Asset Backed Securities	6,296	4.996
Corporate Obligations	770,147	5.252
Treasury Investment Program	48,543	N/A
Total Fixed Income Securities	**$ 1,317,313**	
Equity Securities	149,834	N/A
Total Portfolio Securities	**$ 1,467,147**	

N/A – Indicates duration is not applicable to investment.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. All SWIF investments are denominated in US dollars, issued under US laws and regulations, designed for US investors, and traded in US markets.

Securities Lending Program

The Fiscal Code provides the Treasury Department with numerous custodial responsibilities; the securities lending program (SLP) is an integral part of the custodial function. A contract between the Treasury Department and its custodian, acting as lending agent, provides that the custodian lends securities owned by SWIF to independent brokers, dealers, and banks, acting as borrowers.

Lending agreements between the custodian and the borrowers require that the custodian receives collateral from the borrowers in exchange for the securities lent. For collateral received which is not denominated in United States dollars or whose primary trading market is located outside the United States, the fair value of the collateral received must be at least 105 percent of the fair value of the securities lent. The fair value of all other collateral received must be at least 102 percent of the fair value of the securities lent. Securities lent consist of both domestic and foreign equity securities and United States Treasury and foreign debt obligations. Almost all collateral received consists of cash; a very small portion of collateral received consists of letters of credit, United States Treasury, corporate, and/or foreign debt obligations. Collateral is priced to market daily.

NOTE B – INVESTMENTS (Continued)

Additional collateral from borrowers is required if the fair value of the collateral received declines below lending agreement requirements. The lending agent cannot pledge or sell collateral securities received unless the borrower defaults. Accordingly, neither collateral securities received from borrowers nor the related obligations to borrowers are reported.

To the extent collateral received consists of cash, the lending agency may use or invest the cash in accordance with reinvestment guidelines approved by the Treasury Department. Either the participant or the borrower may terminate lending agreements on demand. Lending agreements are typically of very short duration, usually overnight. Therefore, the duration of lending agreements does not generally match the maturities of the investments made with cash collateral. The resulting interest rate risk is mitigated by the lending agent's ability to reallocate lending agreements among SLP participants.

The SLP requires that the lending agent indemnify the Treasury Department for all claims, liabilities, and costs resulting from the lending agent's negligence or intentional misconduct. During the fiscal year ended December 31, 2021, there were no failures by any borrower to return securities lent or pay distributions thereon. Also, there were no losses resulting from a lending agent or borrower default, and there were no Treasury Department restrictions on the amount of loans that could be made.

At December 31, 2021 and 2020 there was no credit risk to the borrowers because the fair value of collateral received was greater than the fair value of the securities lent, consistent with the lending agreements outstanding. The carrying amount and fair value (in thousands) of the securities lent was $15,747 and $13,723, respectively.

NOTE B – INVESTMENTS (Continued)

SWIF's investment securities owned at December 31, 2021 and 2020, were as follows (amounts in thousands):

December 31, 2021	Book/Adjusted Carrying Value	Market Value
Bonds		
Government	$ 371,039	$ 372,985
States, Territories, and Possessions	4,106	4,364
Political Subdivisions of States, Territories, and Possessions	2,549	3,057
Residential Mortgage-Backed Securities	90,422	91,063
Commercial Mortgage-Backed Securities	6,487	6,719
Industrial and Miscellaneous	691,570	709,914
Total Bonds	$ 1,166,173	$ 1,188,102
Common Stocks	$ 186,171	$ 186,171
Short-Term Investments	$ 63,057	$ 63,057

December 31, 2020	Book/Adjusted Carrying Value	Market Value
Bonds		
Government	$ 304,244	$ 319,950
States, Territories, and Possessions	3,932	4,437
Political Subdivisions of States, Territories, and Possessions	2,286	2,998
Residential Mortgage-Backed Securities	138,818	142,312
Commercial Mortgage-Backed Securities	7,842	8,488
Industrial and Miscellaneous	736,452	790,078
Total Bonds	$ 1,193,574	$ 1,268,263
Common Stocks	$ 149,834	$ 149,834
Short-Term Investments	$ 49,050	$ 49,050

NOTE B – INVESTMENTS (Continued)

In accordance with the Fiscal Code, cash balances of most Commonwealth funds, including SWIF, are pooled by the Treasury Department. SWIF's short-term investments were also pooled for the calendar years ended December 31, 2021 and 2020. Pertaining to marketable equity securities, a net unrealized capital gain of $70,842 (in thousands) was reported for December 31, 2021, and a net unrealized capital gain of $38,527 (in thousands) was reported for December 31, 2020.

NOTE C – COMPOSITION OF LOSS RESERVES AND INCURRED BUT NOT REPORTED (IBNR) LOSSES

December 31, 2021
(Amounts in Thousands)

	Coal	Commercial	Total
Loss Reserves			
Indemnity	$ 12,413	$ 175,260	$ 187,673
Medical	3,386	88,181	91,567
Bulk	10,042	747,947	757,989
Total Loss Reserves	$ 25,841	$ 1,011,388	$ 1,037,229
IBNR Loss Reserves	$ 299	$ 32,127	$ 32,426
Net Losses			$ 1,069,655
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			470
Less:			
Discount of Reserves			(185,538)
Recoverable Reinsurance (Including IBNR)			(3,400)
Net Unpaid Losses			$ 881,187

NOTE C – COMPOSITION OF LOSS RESERVES AND INCURRED BUT NOT REPORTED (IBNR) LOSSES (Continued)

December 31, 2020
(Amounts in Thousands)

	Coal	Commercial	Total
Loss Reserves			
Indemnity	$ 13,003	$ 197,741	$ 210,744
Medical	2,929	91,330	94,259
Bulk	10,626	815,088	825,714
Total Loss Reserves	$ 26,558	$ 1,104,159	$ 1,130,717
IBNR Loss Reserves	$ 464	$ 45,611	$ 46,075
Net Losses			$ 1,176,792
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			607
Less:			
Discount of Reserves			(203,564)
Recoverable Reinsurance (Including IBNR)			(3,038)
Net Unpaid Losses			$ 970,797

NOTE D – PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Pension

Plan Description: To provide pension benefits for employees of state government and certain other organizations, the State Employees' Retirement System (SERS) administers a cost-sharing multiple-employer defined benefit retirement plan.

Retirement Benefits: Under the plan, for most employees hired prior to January 1, 2011, retirement benefits vest after 5 years of credited service. Generally, employees who retire at age 60 with three years of service, or with 35 years of service if under the age of 60, are entitled to a normal (unreduced) annual retirement benefit. The general annual benefit is 2 percent of a Class A member's highest three-year average salary multiplied by years of service. This annual benefit is 2.5 percent for Class AA members.

NOTE D – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Act 2010-120 (Act 120), which preserved all benefits in place for members, mandated a number of benefit reductions for new members effective January 1, 2011. The benefit reduction included a new class of membership that accrues benefits at 2 percent of their final average salary instead of the previous 2.5 percent. The new vesting period changed from five to ten years of credited service, and the option to withdraw lump sum accumulated employee contributions was eliminated. The new normal retirement age is 65 for most employees. Act 120 created a new A-3 class of service and an optional A-4 class for most employees that entered SERS membership for the first time on or after January 1, 2011. The general annual benefit for Class A-3 members is 2 percent of the member's highest three-year average salary times years of service while the Class A-4 benefit accrual rate is 2.5 percent.

Contribution Requirements: All member contribution rates are determined by Commonwealth law. The active plan member contribution rate is 6.25 percent of covered payroll for employees in Class AA; for Class A members, the contribution rate is 5 percent. The general membership contribution rate under Act 120 for A-3 and A-4 members is 6.25 percent and 9.3 percent of salary, respectively. The SERS Board has the authority to establish or amend periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll.

Act 120 imposed annual rate increase collars on employer contributions until no longer needed. The fiscal year ended June 30, 2018, marked the first year the actuarially required employer contribution increase was lower than the collar established for the year of 4.5 percent. As a result, the rate caps are no longer in effect.

Summary of Significant Accounting Policies: The SERS financial statements are prepared on the accrual basis of accounting, whereby expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of the related trade date. Member and employer contributions are recognized in the period in which contributions are due, and the employer has a legal requirement to provide contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

SERS issues stand-alone financial statements which are available at www.sers.pa.gov. Written requests for financial statements should be directed to the following address:

State Employees' Retirement System
30 North Third Street, Suite 150
Harrisburg, PA 17101-1716

NOTE D – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2021 and 2020 in relation to the contractually required contributions are as follows:

Year Ended December 31	Contractually Required Contributions	Actual Contributions
2021	$3,968	$3,968
2020	$3,977	$3,977

Additional pertinent information regarding SERS, outside the scope of SWIF reporting, is published each year as part of the Commonwealth of Pennsylvania's Basic Financial Statements included in the Annual Comprehensive Financial Report.

Other Postemployment Benefits

Plan Description: The Commonwealth established and sponsors a Retired Employees Health Program (REHP) plan which provides postemployment benefits other than pensions (OPEB). This plan is administered by the Pennsylvania Employee Benefits Trust Fund (PEBTF), which acts as a third-party administrator and administers the REHP under an administrative agreement with the Commonwealth. The plan is a single employer defined benefit OPEB plan. The SWIF participates in the REHP, which provides a variety of healthcare benefits to eligible retirees. The REHP is provided as part of collective bargaining agreements with most Commonwealth labor unions. All policy decisions and types and levels of benefits for the REHP fall under the purview of the Commonwealth's Executive Board and Secretary of Administration. REHP does not have a governing board. The REHP plan does not issue a stand-alone financial report, nor is it included in the financial statements of a public employee retirement system.

Benefits Provided: Benefit provisions included in the REHP plans are established and may be amended by the establishing sponsor. The REHP plan provides postemployment healthcare benefits to eligible employees. Employees who retire from the Commonwealth and meet one of the following eligibility criteria are eligible to receive REHP benefits:

- 25 or more years of service;
- 20 or more years of service and superannuation age – age 50 for Park Rangers, Capitol Police, and certain enforcement officers, or age 60 for all other employees (age 55 or 65 for employees subject to Act 120 of 2010);
- Disability retirement – requires five years of service (no service requirements for enforcement officers).

NOTE D – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Contribution Requirements: REHP contribution requirements are contractually required and established by the Commonwealth's Office of Administration and the Office of the Budget. The contribution rates are established as a set amount per current active REHP eligible employee per biweekly pay in order to fund the REHP plan. During the period of January 2021, SWIF contributed $230 biweekly, and during the period of July 1, 2021 to December 31, 2021, SWIF contributed $120 for each active employee paid and reported as part of biweekly payroll expenses for its employees.

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2021 and 2020 in relation to the contractually required contributions are as follows:

Year Ended December 31	Contractually Required Contributions	Actual Contributions
2021	$437	$437
2020	$1,301	$1,301

Additional pertinent information on the REHP, outside the scope of SWIF reporting, including overall actuarial liabilities and assumptions related to the Commonwealth, is published each year as part of the Commonwealth of Pennsylvania's Basic Financial Statements included in the Annual Comprehensive Financial Report.

NOTE E – INSURANCE LOSS LIABILITY

The reported insurance loss liability is primarily based on historical claims experience. One of the assumptions used to determine the reported liability amount includes using a discount rate of 2.00 percent at December 31, 2021 and December 31, 2020. There is uncertainty as to whether the reported liability will be supported by future claims experience, including payments; this uncertainty must be considered when evaluating the reported insurance loss liability. Like other private insurance carriers authorized to transact and provide workers' compensation insurance in the Commonwealth, SWIF is required to pay assessments into the Pennsylvania Workers' Compensation Security Fund, a separate special revenue fund established by the Pennsylvania Department of Insurance to authorize and account for the payment of workers' compensation claims to individuals who are insured by insurance carriers that become insolvent.

NOTE E – INSURANCE LOSS LIABILITY (Continued)

For the two calendar years ended December 31, 2021 and 2020, the following summary provides information on prior year reported insurance loss liability, incurred claims and payments, and current year reported insurance loss liability (amounts in thousands).

Year Ended December 31	Prior Year Liability	Incurred Claims		Payments		Current Year Liability
		Current	Prior	Current	Prior	
2021	$1,207,739	$103,317	($63,519)	$25,192	$99,963	$1,122,382
2020	$1,335,373	$129,657	($110,330)	$29,299	$117,662	$1,207,739

NOTE F – SURPLUS AS REGARDS POLICYHOLDERS

By statute, the State Workers' Insurance Board is required to set aside a percentage of premiums to sufficiently maintain the surplus to cover the catastrophe hazard of all the subscribers in the fund and to guarantee the solvency of the fund. The statute also provides that the board shall have the power to reinsure any risk which they may deem necessary. Accordingly, with the assistance of JLT Re Inc., SWIF entered into contracts with several reinsurers to provide catastrophe coverage to its policyholders. The reinsurance is intended to protect and enhance SWIF's capital base.

As a result of this reinsurance program, SWIF's catastrophe reserve is not required as a set aside of the fund's unassigned surplus.

Commonwealth of Pennsylvania
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TIMOTHY L. DEFOOR
AUDITOR GENERAL

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

<u>Independent Auditor's Report</u>

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Statements of Admitted Assets, Liabilities and Surplus-statutory basis of the State Workers' Insurance Fund (SWIF), the related Statements of Operations and Changes in Surplus-statutory basis and the Statements of Cash Flows-statutory basis as of and for the years ended December 31, 2021, and December 31, 2020, and the related notes to the financial statements, and have issued our report thereon dated November 30, 2022.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SWIF's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWIF's internal control. Accordingly, we do not express an opinion on the effectiveness of SWIF's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether SWIF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SWIF's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SWIF's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Timothy L. DeFoor

Timothy L. DeFoor
Auditor General
November 30, 2022

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
STATE WORKERS' INSURANCE FUND
DISTRIBUTION LIST
DECEMBER 31, 2021 AND 2020

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