

# FINANCIAL AUDIT

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Commonwealth of Pennsylvania  
Department of Labor and Industry  
State Workers' Insurance Fund  
Harrisburg, Pennsylvania  
For the Years Ended December 31, 2016  
And December 31, 2015

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December 2017



Commonwealth of Pennsylvania  
Department of the Auditor General  
Eugene A. DePasquale • Auditor General



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**DEPARTMENT OF LABOR AND INDUSTRY  
STATE WORKERS' INSURANCE FUND  
DECEMBER 31, 2016 and 2015**

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**BACKGROUND**

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The State Workers' Insurance Fund (SWIF) is a self-sustaining fund operating within the 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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EUGENE A. DePASQUALE  
AUDITOR GENERAL

## **Independent Auditor's Report**

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

### **Report on the Financial Statements**

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, 2016, and December 31, 2015, 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.

### ***Management's Responsibility 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 Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

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, 2016, and December 31, 2015, 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 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. Our opinion is not modified with respect to this matter.

### ***Emphasis of Matter***

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 1994 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.

## ***Other Matters***

### *Supplementary Information*

Our audit was conducted for the purposes of forming an opinion on the statutory financial statements as a whole. 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 has not been subjected to the auditing procedures applied in the audit of the statutory financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### *Other Information*

The background has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2017, 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering 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 those specified parties.



Eugene A. DePasquale  
Auditor General

December 1, 2017

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**DEPARTMENT OF LABOR AND INDUSTRY  
STATE WORKERS' INSURANCE FUND  
DECEMBER 31, 2016 and 2015**

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**SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**Assets and Liabilities**

The State Workers' Insurance Fund (SWIF) disclosed total admitted assets of \$1.490 billion as of December 31, 2016. This was a decrease of \$18.3 million or 1.2% from 2015. Total investments decreased from \$1.423 billion in 2015 to \$1.417 billion in 2016 or a \$6.7 million decrease. The largest portion of the decrease came from a \$19.8 million decrease in bonds. This decrease in bonds was offset by an increase in stocks of \$12.6 million. Also contributing to the decline in total assets was a decrease in premiums, agents' balances, and installments booked but deferred and not yet due of \$10.6 million.

SWIF's total liabilities decreased to \$1.668 billion, a decrease of \$47.5 million or 2.8% from the prior year. Total unpaid losses decreased as of year-end 2016 to \$1.309 billion from \$1.356 billion in the prior year, a decrease of \$46.9 million or 3.5%. The reserve for loss adjustment expenses increased to \$253.7 million from \$248.0 million. This resulted in a net decrease in loss and loss adjustment expense reserves of \$41.2 million. All other liabilities decreased \$6.3 million mainly due to unearned premiums decreasing from \$75.8 million to \$66.4 million.

**Surplus**

Surplus as regards policyholders was (\$178) million, a decrease in the deficit of \$29.2 million or 14.1% for 2016 as compared to the reported deficit of (\$207.2) million in 2015. SWIF's net income before other changes in surplus for 2016 was \$27.5 million versus a net loss in 2015 of \$10.6 million. The improvement to SWIF's deficit was largely due to the net income of \$27.5 million accompanied by the change in unrealized capital gain of \$7.6 million, offset by the change in nonadmitted assets of (\$5.9) million.

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

SWIF continues to address its negative surplus and has implemented several initiatives to address this issue, as outlined below in the section titled Future Initiatives.



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**DEPARTMENT OF LABOR AND INDUSTRY  
STATE WORKERS' INSURANCE FUND  
DECEMBER 31, 2016 and 2015**

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**SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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**Operational Results**

SWIF recorded a net gain before other changes in surplus of \$27.5 million for 2016. This is an increase of \$38 million as compared to the 2015 net loss of \$10.6 million. Earned premiums decreased by \$28.3 million or 12.7%, to \$194.7 million in 2016 from \$222.9 million in 2015. This decline in earned premium was offset by a decrease in loss and loss adjustment expenses incurred of \$73 million. Losses incurred decreased \$60 million and loss adjustment expenses incurred decreased \$13.1 million. This decline in losses incurred and loss adjustment expense is the direct result of the decline in exposures as well as open claims.

Net investment income declined 4.3% or \$2.2 million to \$50.4 million. The decline was a combination of lower investment income earned as well as lower realized capital gains. During 2016, SWIF had an increase in its investment portfolio performance as total yield rose to 4.1% from 0.4% in 2015. The yield of SWIF's fixed income portfolio was 3.4% and equity yield was 10.8%.

During 2016, SWIF also had a \$5.3 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 2016, 751 claims were settled that resulted in loss reserve savings of \$60.9 million.

SWIF continued to reduce staffing through attrition. During 2016, SWIF's filled complement was reduced by 19 positions from 2015 to 219 as of December 2016.

SWIF contracted with Hoover Rehabilitation Inc. in May 2013 for their Medical Bill Repricing, Preferred Provider Organization (PPO), Pharmacy Benefit Management (PBM), and Durable Medical Equipment (DME). During 2016, SWIF realized net savings below medical bill fee schedule of 12.16% for medical bill payment savings of \$11.9 million. Since inception, this program has realized net savings of \$48.4 million.

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**DEPARTMENT OF LABOR AND INDUSTRY  
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**SWIF MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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During 2016, SWIF's Customer Service Unit handled 73,819 of the 82,343 calls received or 89.7% of all calls. This unit eliminates the need to transfer calls to the Underwriting, Claims, Auditing, and Accounting Divisions. This unit also handled 5,742 first report of injury calls.

SWIF's current computer system went live in 2005. SWIF is developing a request for proposal for a new system, with a planned release in 2017. It is anticipated that the new system will allow for the enhanced use of online capability to provide expanded customer service features for SWIF policyholders and claimants.

Effective April 2016 SWIF increased its Commercial Loss Cost Multiplier (LCM) from 2.702 to 2.789 and Coal LCM from 1.792 to 1.836.

SWIF increased the Pennsylvania Compensation Rating Bureau (PCRB) Loss Cost for fifty-three classifications by 5% effective April 1, 2016. The increase was due to the fact that SWIF's loss experience was worse than the industry loss experience.

SWIF updated its minimum premium on policies to \$492 up to a maximum of \$2,812 to bring its premiums more in line with the expenses incurred in writing and maintaining these policies effective October 2016.

**STATE WORKERS' INSURANCE FUND**  
**STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS**  
**STATUTORY BASIS**  
**DECEMBER 31, 2016 and 2015**

	(Expressed in Thousands)	
<u>ADMITTED ASSETS</u>	<u>2016</u>	<u>2015</u>
<b><u>Investments</u></b>		
Bonds	\$ 1,220,607	\$ 1,240,374
Stocks	135,360	122,799
Short-term investments	60,567	60,077
Total investments - Note B	<u>\$ 1,416,534</u>	<u>\$ 1,423,250</u>
<b><u>Cash</u></b>		
On deposit in Treasury Department	<u>\$ 3,104</u>	<u>\$ 3,272</u>
<b><u>Receivables</u></b>		
Uncollected premiums in course of collection	\$ 5,833	\$ 7,223
Premiums, agents' balances, and installments booked but deferred and not yet due	47,783	58,421
Reinsurance recoverable on loss payments	6,859	6,204
Interest due and accrued on investments	9,244	9,573
Funds held by or deposited with reinsurance companies	14	14
Other amounts receivable under reinsurance contacts	215	130
Administration fee LTV Steel receivable	0	15
Accrued retrospective premiums	206	0
Total receivables	<u>\$ 70,154</u>	<u>\$ 81,580</u>
<b>Total Admitted Assets</b>	<u>\$ 1,489,792</u>	<u>\$ 1,508,102</u>
<b><u>LIABILITIES AND SURPLUS</u></b>		
<b><u>Liabilities</u></b>		
Net unpaid losses – Notes C and E	\$ 1,309,210	\$ 1,356,069
Unpaid loss adjustment expenses	253,653	247,990
Reinsurance payable	34	45
Premium deficiency reserve	0	1,044
Accrued administrative expenses	8,667	11,255
Unearned premiums	66,350	75,835
Policyholders' premium credit balances	11,063	12,207
Restricted account – Commonwealth Self Insurance	2,349	2,322
Policyholder deposits	1,913	2,173
Net payable for securities	10,146	1,873
Other liabilities	4,415	4,459
Total liabilities	<u>\$ 1,667,800</u>	<u>\$ 1,715,272</u>
<b><u>Surplus</u></b>		
Unassigned surplus (deficit) – Note F	<u>\$ (178,008)</u>	<u>\$ (207,170)</u>
Total surplus (deficit) as regards policyholders	<u>\$ (178,008)</u>	<u>\$ (207,170)</u>
<b>Total Liabilities and Surplus</b>	<u>\$ 1,489,792</u>	<u>\$ 1,508,102</u>

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

**STATE WORKERS' INSURANCE FUND**  
**STATEMENTS OF OPERATIONS AND CHANGES IN SURPLUS**  
**STATUTORY BASIS**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015**

	<u>(Expressed in Thousands)</u>	
	<b><u>2016</u></b>	<b><u>2015</u></b>
<b><u>Underwriting Income</u></b>		
Premiums earned	\$ 194,653	\$ 222,908
<b><u>Underwriting Expenses</u></b>		
Losses incurred	\$ 142,850	\$ 202,840
Loss adjustment expenses	46,263	59,331
Other	24,918	25,089
Change in premium deficiency reserve	(1,044)	(6,393)
Total underwriting expenses	<u>\$ 212,987</u>	<u>\$ 280,867</u>
<b>Net Underwriting Gain (Loss)</b>	<u>\$ (18,334)</u>	<u>\$ (57,959)</u>
<b><u>Investment Income</u></b>		
Investment income earned	\$ 41,776	\$ 43,323
Net realized capital gains (losses)	12,577	13,031
Total investment income	<u>\$ 54,353</u>	<u>\$ 56,354</u>
<b><u>Investment Expenses</u></b>	<u>\$ 3,971</u>	<u>\$ 3,723</u>
<b>Net Investment Income</b>	<u>\$ 50,382</u>	<u>\$ 52,631</u>
<b><u>Other Income/Expenses</u></b>		
Other income/(expenses)	\$ 704	\$ 95
Net loss from premium balances charged off	(5,288)	(5,343)
Total other income/expenses	<u>\$ (4,584)</u>	<u>\$ (5,248)</u>
<b><u>Net Income (Loss) Before Other Changes in Surplus</u></b>	<u>\$ 27,464</u>	<u>\$ (10,576)</u>
<b><u>Other Changes in Surplus</u></b>		
Change in net unrealized capital gain (loss)	\$ 7,562	\$ (14,460)
Change in nonadmitted assets	(5,864)	(6,179)
Total other changes in surplus	<u>\$ 1,698</u>	<u>\$ (20,639)</u>
<b>Net change in surplus (deficit) during the year</b>	\$ 29,162	\$ (31,215)
<b>Surplus (deficit) at beginning of year</b>	<u>\$ (207,170)</u>	<u>\$ (175,955)</u>
<b>Surplus (deficit) at end of year</b>	<u>\$ (178,008)</u>	<u>\$ (207,170)</u>

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

**STATE WORKERS' INSURANCE FUND**  
**STATEMENTS OF CASH FLOWS**  
**STATUTORY BASIS**  
**FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015**

	<u>(Expressed in Thousands)</u>	
	<u>2016</u>	<u>2015</u>
<b>Cash flows from operating activities:</b>		
Premiums collected net of reinsurance	\$ 192,236	\$ 211,768
Benefit and loss related payments	(190,461)	(214,805)
Commissions, expenses paid and aggregate write-ins	(66,670)	(56,563)
Investment income (net of investment expenses)	41,270	45,431
Miscellaneous income (uses)	<u>(4,584)</u>	<u>(5,248)</u>
Net cash from operating activities	\$ (28,209)	\$ (19,417)
<b>Cash flows from investing activities:</b>		
Proceeds from sale of bonds	\$ 986,253	\$ 1,139,391
Proceeds from sale of stocks	97,844	93,839
Payments for purchase of bonds	(961,194)	(1,118,430)
Payments for purchase of stocks	(99,087)	(94,455)
Miscellaneous proceeds (applications)	<u>8,275</u>	<u>(475)</u>
Net cash from investing activities	\$ 32,091	\$ 19,870
<b>Cash flows from miscellaneous sources:</b>		
Other cash provided (applied)	<u>\$ (3,560)</u>	<u>\$ (7,526)</u>
<b>Net change in cash and short-term investments</b>	\$ 322	\$ (7,073)
<b>Cash and short-term investments at beginning of year</b>	<u>\$ 63,349</u>	<u>\$ 70,422</u>
<b>Cash and short-term investments at end of year</b>	<u><u>\$ 63,671</u></u>	<u><u>\$ 63,349</u></u>

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

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**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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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 annual required contribution, unfunded actuarial liability, and other information regarding postemployment benefits other than pensions.

#### 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 Operating Statement. 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.

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**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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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.

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**NOTE B - INVESTMENTS**

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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.

**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

**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 and WR represent not rated and withdrawn ratings, respectively, and approximate 4.3 percent of the fixed income portfolio at December 31, 2016, excluding share balances of \$45.4 million in Treasury's unrated short-term investment pools, and including US agency securities, mortgage-backed securities, asset-backed securities, and corporate obligations. The following tables disclose aggregate fair value, by major Moody's credit quality rating category at December 31, 2016 and 2015 (amounts in thousands):

**December 31, 2016**

<b><u>Investment Type</u></b>	<b><u>Amount</u></b>	<b><u>Moody's Rating</u></b>	<b><u>% Portfolio</u></b>
US Agency	\$ 9,941	A1	0.70%
US Agency	2,369	A2	0.17%
US Agency	4,642	Aa1	0.33%
US Agency	1,633	Aa2	0.11%
US Agency	3,807	Aa3	0.27%
US Agency	31,001	Aaa	2.20%
US Agency	306	Baa2	0.02%
US Agency	513	WR	0.04%
US Agency	13,150	NR	0.93%
<b>Total US Agency Securities</b>	<b>\$ 67,362</b>		



**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Government	278,457	Aaa	19.72%
<b>Total US Government Securities</b>	<b>\$ 278,457</b>		
Mortgage Backed Securities	1,361	A1	0.10%
Mortgage Backed Securities	1,432	A2	0.10%
Mortgage Backed Securities	173	A3	0.01%
Mortgage Backed Securities	153	Aa1	0.01%
Mortgage Backed Securities	200,068	Aaa	14.17%
Mortgage Backed Securities	129	B1	0.01%
Mortgage Backed Securities	751	Ba1	0.05%
Mortgage Backed Securities	239	Ba2	0.02%
Mortgage Backed Securities	793	Baa1	0.06%
Mortgage Backed Securities	590	Baa2	0.04%
Mortgage Backed Securities	1,608	Baa3	0.11%
Mortgage Backed Securities	13	Caa1	0.00%
Mortgage Backed Securities	102	WR	0.01%
Mortgage Backed Securities	11,791	NR	0.83%
<b>Total Mortgage Backed Securities</b>	<b>\$ 219,203</b>		
Asset Backed Securities	627	A1	0.04%
Asset Backed Securities	1,219	A2	0.09%
Asset Backed Securities	2,963	A3	0.21%
Asset Backed Securities	848	Aa1	0.06%
Asset Backed Securities	1,914	Aa2	0.13%
Asset Backed Securities	2,445	Aa3	0.17%
Asset Backed Securities	34,433	Aaa	2.44%
Asset Backed Securities	232	B3	0.01%
Asset Backed Securities	292	Ba1	0.02%
Asset Backed Securities	394	Ba2	0.03%
Asset Backed Securities	1,601	Baa1	0.11%
Asset Backed Securities	790	Baa2	0.06%
Asset Backed Securities	355	Baa3	0.03%
Asset Backed Securities	17,159	NR	1.22%
<b>Total Asset Backed Securities</b>	<b>\$ 65,272</b>		

**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Corporate Obligations	61,234	A1	4.34%
Corporate Obligations	57,994	A2	4.11%
Corporate Obligations	131,692	A3	9.33%
Corporate Obligations	9,336	Aa1	0.66%
Corporate Obligations	29,333	Aa2	2.08%
Corporate Obligations	18,558	Aa3	1.31%
Corporate Obligations	10,060	Aaa	0.71%
Corporate Obligations	2,683	B1	0.19%
Corporate Obligations	821	B2	0.06%
Corporate Obligations	20,881	Ba1	1.48%
Corporate Obligations	6,889	Ba2	0.49%
Corporate Obligations	4,890	Ba3	0.35%
Corporate Obligations	105,806	Baa1	7.49%
Corporate Obligations	72,096	Baa2	5.11%
Corporate Obligations	58,042	Baa3	4.11%
Corporate Obligations	103	Caa1	0.01%
Corporate Obligations	9,787	NR	0.69%
Corporate Obligations	827	WR	0.06%
<b>Total Corporate Obligations</b>	<b>\$ 601,032</b>		
<b>Treasury Investment Program</b>	<b>\$ 45,350</b>	NR	3.21%
<b>Total Fixed Income Securities</b>	<b>\$ 1,276,676</b>		
<b>Equity Securities</b>	<b>\$ 134,882</b>	NR	9.55%
<b>Preferred Securities</b>	<b>\$ 470</b>	NR	0.03%
<b>Total Portfolio at December 31, 2016</b>	<b>\$ 1,412,028</b>		<b>100.00%</b>

**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

**December 31, 2015**

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
US Agency	\$ 407	A1	0.03%
US Agency	9,972	A2	0.70%
US Agency	794	A3	0.06%
US Agency	3,824	Aa1	0.27%
US Agency	3,325	Aa2	0.24%
US Agency	4,372	Aa3	0.31%
US Agency	31,410	Aaa	2.21%
US Agency	138	Baa1	0.01%
US Agency	295	Baa2	0.02%
US Agency	532	WR	0.04%
US Agency	8,700	NR	0.61%
<b>Total US Agency Securities</b>	<b><u>\$ 63,769</u></b>		
US Government	294,457	Aaa	20.69%
<b>Total US Government Securities</b>	<b><u>\$ 294,457</u></b>		
Mortgage Backed Securities	1,032	A1	0.07%
Mortgage Backed Securities	1,016	A2	0.07%
Mortgage Backed Securities	1,142	A3	0.08%
Mortgage Backed Securities	1,865	Aa1	0.13%
Mortgage Backed Securities	1,234	Aa2	0.09%
Mortgage Backed Securities	208,129	Aaa	14.63%
Mortgage Backed Securities	541	Ba1	0.04%
Mortgage Backed Securities	769	Ba2	0.05%
Mortgage Backed Securities	1,171	Baa1	0.08%
Mortgage Backed Securities	1,540	Baa2	0.11%
Mortgage Backed Securities	2,578	Baa3	0.18%
Mortgage Backed Securities	17	Caa1	0.00%
Mortgage Backed Securities	13,748	NR	0.97%
<b>Total Mortgage Backed Securities</b>	<b><u>\$ 234,782</u></b>		

**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Asset Backed Securities	1,050	A1	0.07%
Asset Backed Securities	37,347	Aaa	2.63%
Asset Backed Securities	280	B3	0.02%
Asset Backed Securities	233	Ba1	0.02%
Asset Backed Securities	384	Ba3	0.03%
Asset Backed Securities	1,017	Baa2	0.07%
Asset Backed Securities	9,879	NR	0.69%
<b>Total Asset Backed Securities</b>	<b>\$ 50,190</b>		
Corporate Obligations	68,184	A1	4.79%
Corporate Obligations	71,737	A2	5.04%
Corporate Obligations	123,848	A3	8.70%
Corporate Obligations	10,160	Aa1	0.71%
Corporate Obligations	24,919	Aa2	1.75%
Corporate Obligations	21,692	Aa3	1.53%
Corporate Obligations	7,297	Aaa	0.51%
Corporate Obligations	3,406	B1	0.24%
Corporate Obligations	327	B2	0.02%
Corporate Obligations	275	B3	0.02%
Corporate Obligations	15,012	Ba1	1.05%
Corporate Obligations	8,579	Ba2	0.60%
Corporate Obligations	6,964	Ba3	0.49%
Corporate Obligations	108,315	Baa1	7.61%
Corporate Obligations	71,913	Baa2	5.05%
Corporate Obligations	46,077	Baa3	3.24%
Corporate Obligations	17,361	NR	1.22%
Corporate Obligations	2,628	WR	0.18%
<b>Total Corporate Obligations</b>	<b>\$ 608,694</b>		
<b>Treasury Investment Program</b>	<b>\$ 48,283</b>	NR	3.39%
<b>Total Fixed Income Securities</b>	<b>\$ 1,300,175</b>		

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**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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**NOTE B – INVESTMENTS (Continued)**

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<u>Investment Type</u>	<u>Amount</u>	<u>Moody's Rating</u>	<u>% Portfolio</u>
Equity Securities	\$ 121,654	NR	8.55%
Preferred Securities	<u>\$ 1,210</u>	NR	<u>0.09%</u>
<b>Total Portfolio at December 31, 2015</b>	<u><b>\$ 1,423,039</b></u>		<u><b>100.00%</b></u>

**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**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, 2016 and 2015, SWIF's fixed income portfolio had the following option-adjusted durations by fixed income sector:

<u>December 31, 2016</u> <u>Investment Type</u>	<u>Amount</u>	<u>Duration</u> <u>(in years)</u>
US Agency Securities	\$ 67,362	5.99
US Government Securities	278,457	9.47
Mortgage Backed Securities	219,203	3.12
Asset Backed Securities	65,272	2.53
Corporate Obligations	601,032	6.88
Treasury Investment Program	45,350	N/A
<b>Total Fixed Income Securities</b>	<b>\$ 1,276,676</b>	
Equity Securities	134,882	N/A
Preferred Securities	470	N/A
<b>Total Portfolio Securities</b>	<b>\$ 1,412,028</b>	

**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

<u>December 31, 2015</u> <u>Investment Type</u>	<u>Amount</u>	<u>Duration</u> <u>(in years)</u>
US Agency Securities	\$ 63,769	6.71
US Government Securities	294,457	9.72
Mortgage Backed Securities	234,782	2.75
Asset Backed Securities	50,190	2.15
Corporate Obligations	608,694	6.76
Treasury Investment Program	48,283	N/A
<b>Total Fixed Income Securities</b>	<b><u>\$ 1,300,175</u></b>	
Equity Securities	121,654	N/A
Preferred Securities	1,210	N/A
<b>Total Portfolio Securities</b>	<b><u>\$ 1,423,039</u></b>	

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

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**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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**NOTE B – INVESTMENTS (Continued)**

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of credit, United States Treasury, corporate, and/or foreign debt obligations. Collateral is priced to market daily. 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 agent 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, 2016, 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 the loans that could be made.

At December 31, 2016 and 2015 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 \$52,031 and \$59,150, respectively.



**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

**NOTE B – INVESTMENTS (Continued)**

SWIF's investment securities owned at December 31, 2016 and 2015, were as follows (amounts in thousands):

<b><u>December 31, 2016</u></b>		
	<b><u>Book/Adjusted Carrying Value</u></b>	<b><u>Market Value</u></b>
<b><u>Bonds</u></b>		
Government	\$ 343,766	\$ 339,150
States, Territories, and Possessions	17,915	18,782
Political Subdivisions of States, Territories, and Possessions	7,406	8,119
Revenue and Special Obligations	29,038	29,676
Residential Mortgage Backed Securities	172,216	166,022
Industrial and Miscellaneous	650,266	654,360
<b><u>Total Bonds</u></b>	<b><u>\$ 1,220,607</u></b>	<b><u>\$ 1,216,109</u></b>
<b><u>Common Stocks</u></b>	<b><u>\$ 134,882</u></b>	<b><u>\$ 134,882</u></b>
<b><u>Preferred Stocks</u></b>	<b><u>\$ 478</u></b>	<b><u>\$ 470</u></b>
<b><u>Short-Term Investments</u></b>	<b><u>\$ 60,567</u></b>	<b><u>\$ 60,567</u></b>
<b><u>December 31, 2015</u></b>		
	<b><u>Book/Adjusted Carrying Value</u></b>	<b><u>Market Value</u></b>
<b><u>Bonds</u></b>		
Government	\$ 366,974	\$ 368,583
States, Territories, and Possessions	17,964	18,605
Political Subdivisions of States, Territories, and Possessions	8,621	9,261
Revenue and Special Obligations	31,285	32,098
Residential Mortgage Backed Securities	167,562	165,367
Industrial and Miscellaneous	647,968	646,184
<b><u>Total Bonds</u></b>	<b><u>\$ 1,240,374</u></b>	<b><u>\$ 1,240,098</u></b>
<b><u>Common Stocks</u></b>	<b><u>\$ 121,654</u></b>	<b><u>\$ 121,654</u></b>
<b><u>Preferred Stocks</u></b>	<b><u>\$ 1,145</u></b>	<b><u>\$ 1,210</u></b>
<b><u>Short-Term Investments</u></b>	<b><u>\$ 60,077</u></b>	<b><u>\$ 60,077</u></b>

**STATE WORKERS' INSURANCE FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 and 2015**

**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, 2016 and 2015. Pertaining to marketable equity securities, both December 31, 2016 and December 31, 2015 showed net unrealized capital gains (in thousands) of \$14,270 and \$6,708, respectively.

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

	<b>December 31, 2016</b>		
	<b>(Amounts in Thousands)</b>		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<b><u>Loss Reserves</u></b>			
Indemnity	\$ 18,035	\$ 356,954	\$ 374,989
Medical	3,271	117,428	120,699
Bulk	14,812	1,021,661	1,036,473
<b>Total Loss Reserves</b>	<u>\$ 36,118</u>	<u>\$ 1,496,043</u>	<u>\$ 1,532,161</u>
<b><u>IBNR Loss Reserves</u></b>	<u>\$ 1,445</u>	<u>\$ 65,579</u>	<u>\$ 67,024</u>
<b><u>Net Losses</u></b>			\$ 1,599,185
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			1,486
Less:			
Discount of Reserves			(289,752)
Recoverable Reinsurance (Including IBNR)			(1,025)
Reinsurance Ceded			(684)
<b><u>Net Unpaid Losses</u></b>			<u>\$ 1,309,210</u>

**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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

	December 31, 2015 (Amounts in Thousands)		
	<u>Coal</u>	<u>Commercial</u>	<u>Total</u>
<b><u>Loss Reserves</u></b>			
Indemnity	\$ 20,203	\$ 413,464	\$ 433,667
Medical	3,384	135,908	139,292
Bulk	13,839	966,738	980,577
<b>Total Loss Reserves</b>	<u>\$ 37,426</u>	<u>\$ 1,516,110</u>	<u>\$ 1,553,536</u>
<b><u>IBNR Loss Reserves</u></b>	<u>\$ 1,247</u>	<u>\$ 98,381</u>	<u>\$ 99,628</u>
<b><u>Net Losses</u></b>			\$ 1,653,164
Add:			
Assumed Outstanding Loss Reserves (Including IBNR)			1,509
Less:			
Discount of Reserves			(296,983)
Recoverable Reinsurance (Including IBNR)			<u>(1,621)</u>
<b><u>Net Unpaid Losses</u></b>			<u>\$ 1,356,069</u>

**NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS**

**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. The plan, covering substantially all Commonwealth employees, is a contributory defined benefit pension plan as established by Commonwealth laws.

**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 or, if under age 60, with 35 years of service 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.

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**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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**NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)**

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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.

**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](http://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

**Funding Policy:** 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.

**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

**NOTE D - PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)**

During each of the three years ended December 31, the annual required employer contribution and the related percentage of that amount actually contributed are as follows:

<u>Year Ended December 31</u>	<u>Annual Required Contribution (ARC) (in thousands)</u>	<u>Percentage of ARC Contributed</u>
2016	\$1,613,626	100.0%
2015	\$1,469,116	92.5%
2014	\$1,407,361	76.9%

The SWIF's contributions (in thousands) for the fiscal years ended December 31, 2016 and 2015 were \$3,830 and \$3,148, respectively.

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 Comprehensive Annual Financial Report.

***Postemployment Health Care Benefits:*** 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 OPEB plan and benefit provisions have been established under pertinent statutory authority. The OPEB plan does not issue a stand-alone financial report, nor is it included in the financial statements of a public employee retirement system.

REHP contribution requirements are established by the Office of Administration and the Governor's Budget Office. During the period January 1, 2016 to June 30, 2016, SWIF contributed \$418 for each active employee paid and reported as part of biweekly payroll expenses for its employees. During the period July 1, 2016 to December 31, 2016, SWIF contributed \$362 for each active employee paid and reported as part of biweekly payroll expenses for its employees. SWIF recognizes the cost of providing these benefits, which for the fiscal years ended December 31, 2016 and 2015 totaled \$2,902 and \$2,844, respectively, as paid (in thousands).

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

**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

**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, 2016 and December 31, 2015. There is uncertainty as to whether the reported liability will be supported by future claim 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.

For the two calendar years ended December 31, 2016 and 2015, 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	
2016	\$1,604,104	\$174,305	14,797	\$34,338	\$195,971	\$1,562,897
2015	\$1,593,984	\$276,464	(\$14,287)	\$48,555	\$203,502	\$1,604,104

**NOTE F – SURPLUS AS REGARDS POLICYHOLDERS**

By statute, the State Workers' Insurance Board (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.

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**STATE WORKERS' INSURANCE FUND  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2016 and 2015**

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**NOTE G – SUBSEQUENT EVENT**

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On June 20, 2017, the Pennsylvania Supreme Court issued its decision in *Protz v. WCAB*, ruling that Section 306(a.2) of the Workers' Compensation Act (77 P.S. § 511.2), pertaining to the method of conducting impairment rating examinations based on American Medical Association guidelines, is an unconstitutional delegation of legislative authority which effectively ends partial disability determinations and eliminates the five hundred week cap on partial disability indemnity payments. In response, the Pennsylvania Compensation Rating Bureau submitted a filing to the Pennsylvania Insurance Department which proposed a 6.06 percent increase in loss costs with a proposed effective date of November 1, 2017. The filing remains under review. The effect on SWIF's insurance loss liability has not yet been determined but is expected to result in a future increase to the liability.



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EUGENE A. DePASQUALE  
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***

Independent Auditor's Report

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, 2016, and December 31, 2015, and the related notes to the financial statements and have issued our report thereon dated December 1, 2017.

**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) to determine the 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.

### **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 determination of financial statement amounts. 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.



Eugene A. DePasquale  
Auditor General

December 1, 2017

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**STATE WORKERS' INSURANCE FUND  
OBSERVATION  
DECEMBER 31, 2016 and 2015**

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**Observation – Password Requirements for the Iworks Application Do Not Fully Comply With Commonwealth Information Technology Policy (ITP) – SEC007**

Password requirements for Iworks (investment portfolio software) do not fully comply with ITP-SEC007, “Minimum Standards for IDs, Passwords, and Multi-Factor Authentication”, specifically regarding inadequate settings for password expiration and user lockout after multiple failed login attempts. The lack of compliance is due to Iworks software limitations; however, management has not applied for a waiver to the ITP.

ITP-SEC007 establishes standards regarding settings for minimum length, password complexity, password expiration, and user lockout after multiple failed login attempts.

**Recommendation**

We recommend that management request a waiver to ITP-SEC007 for the Iworks application via the Commonwealth of Pennsylvania Policy and Procurement Action Request (COPPAR) process as defined in the policy.

**COMMONWEALTH OF PENNSYLVANIA  
DEPARTMENT OF LABOR AND INDUSTRY  
STATE WORKERS' INSURANCE FUND DISTRIBUTION LIST  
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