Washington State Department of
Labor & Industries

State of Washington Industrial Insurance Fund Statutory Financial Information Report

For the Fiscal Years Ended June 30, 2018 and 2017

State of Washington Industrial Insurance Fund
Statutory Financial Information Report
For the Fiscal Years Ended June 30, 2018 and 2017

Prepared by:

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Washington State Office of Financial Management
Washington State Investment Board

Washington State Department of
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Keep Washington Safe and Working

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Introductory Section

Washington State Department of
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STATE OF WASHINGTON
DEPARTMENT OF LABOR AND INDUSTRIES
P.O. Box 44000 • Olympia Washington 98504-4000

November 27, 2018

The Honorable Jay Inslee, Governor
Honorable Members of the Legislature
Director of the Office of Financial Management
Washington State Citizens
Olympia, Washington

RE: Statutory Financial Information Report

The Revised Code of Washington 51.44.115 requires the Department of Labor and Industries (L&I) to publish a Statutory Financial Information Report for the Industrial Insurance Fund (State Fund) in conformity with statutory accounting practices and principles promulgated by the National Association of Insurance Commissioners and the practices permitted by the state of Washington within six months of the close of each fiscal year. This report is published to fulfill that requirement for the fiscal year ended June 30, 2018.

L&I is fully responsible for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal controls established for this purpose. Because the cost of internal controls should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

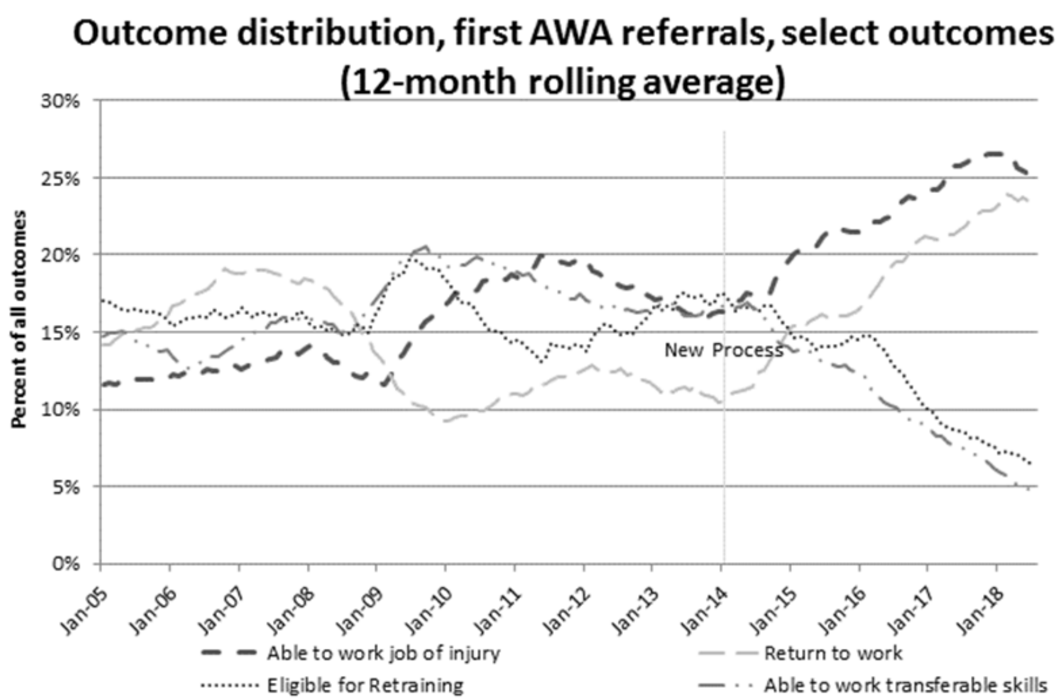
The independent certified public accounting firm, Eide Bailly, LLP, has issued an unmodified ("clean") opinion on the Regulatory Basis of Accounting utilized in the Statutory Financial Information Report for the fiscal years ended June 30, 2018 and 2017. The independent auditor's report is located at the front of the financial section of this report.

Management's Discussion and Analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the Consolidated Statutory Financial Statements. The MD&A complements the information provided in this letter of transmittal and should be read together with it.

MAJOR INITIATIVES

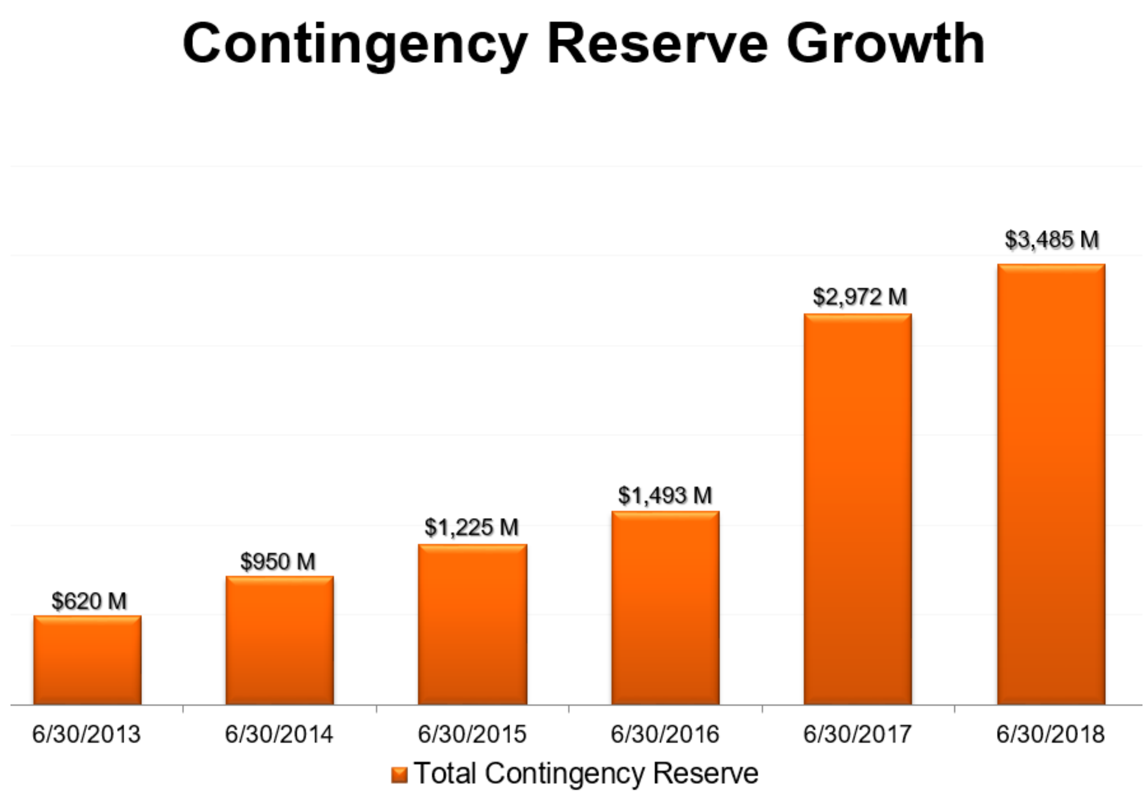
The Department of Labor & Industries has implemented many major initiatives during the last several years that have significantly improved the way we partner with employers and employees to help injured workers heal and return to work. Each of these changes have helped injured workers get better treatment and stay on the job – which reduces disability and has saved millions of dollars. Two changes that have had a major impact are highlighted below.

First, L&I uses vocational rehabilitation counselors (VRCs) to provide return-to-work services and employability assessments of injured workers to determine certain benefits and ultimately resolve claims. During fiscal year 2015, L&I began to make Able to Work Assessment (AWA) referrals to VRCs much earlier, hoping to reduce time-loss and associated costs, while maintaining or improving injured worker return-to-work outcomes. As AWA referrals to VRCs are made earlier, outcomes are improving. The percentage of workers returning to work increased dramatically (by more than 120 percent for all first referrals), as shown in the chart below. The chart also shows that, since the process change, the percentage of assessments ending with the worker being "able to work job of injury" has been increasing. At the same time, because more workers are returning to work or being found able to work at the job of injury, the shares ending in the outcomes of "able to work transferable skills" and "eligible for retraining" are declining. Our next improvement efforts will focus on interventions that shift these outcomes to "return to work". L&I is now focusing on evidence-based best practices for vocational providers in order to further increase return-to-work outcomes.



Second, our country's opioid epidemic is well documented. L&I has concentrated on reducing the percentage of claims with opioid use at six to twelve weeks from injury, because data shows these claimants are much more likely to become disabled long-term. In 2010, five percent of claims within six to twelve weeks of injury had opioid prescriptions. As of December 2017, only one percent of claims within six to twelve weeks of injury had opioid prescriptions, an 88 percent decrease from 2010. In addition, in 2018, about four percent of L&I's prescription drug costs were for opioids, down from 11-12 percent in 2016.

Two guidelines implemented by L&I since July 2013 give providers the tools they need to minimize the number of workers on long-term opioids. Early contact with VRCs, as well as reducing opioid use where appropriate, are just two of the many changes that have significantly helped injured workers heal and return to work. These changes have also reduced the costs to treat injured workers and contributed to the increase in the contingency reserve. The "contingency reserve" refers to any surplus remaining (similar to net position) on the statutory financial statements for the Industrial Insurance Fund, prepared in accordance with the National Association of Insurance Commissioners' statutory accounting principles. The contingency reserve is viewed as the financial resources available to ensure stable premium rates and absorb fluctuations in investment values.



To better anticipate and meet customer needs both now and in the future, L&I recently launched a Business Transformation initiative. Business Transformation works to align people, processes, and technology, with the goals of simplifying and standardizing processes and systems across the agency and providing employees the training and support they need to deliver the highest-quality service. Transformation will make it easier for customers to do business with L&I and easier for employees to do their jobs. Our entire transformation will take at least a decade and includes numerous projects.

Progress was made in the following areas during fiscal year 2018:

- Workers' Compensation System Review – A project to assess the current business processes and systems. This project also includes a feasibility study, which will review and recommend potential technology solutions.

- Credentialing Replacement – This partnership with the Health Care Authority (HCA) will replace L&I's existing medical provider credentialing and payment systems with the HCA's existing Provider One application.

- Enterprise Data Strategy – A holistic review of L&I's current data and record management. This project will recommend a future state that supports a large-scale system transformation, increases data consistency, and increases opportunities to link and use data across platforms.

- Technology Assessment & Readiness Plan – These assessments will review the current Information Technology (IT) services and provide recommendations for improvements to prepare for new technology solutions.

- Website Redesign – A project to assess, create, and launch a new Lni.wa.gov website. The project will create a modern website that is easy for customers to use and for L&I to manage.

PROFILE OF THE INDUSTRIAL INSURANCE FUND

The Industrial Insurance Fund is part of the Workers' Compensation Program and is made up of the Accident, Medical Aid, Pension Reserve, and the Industrial Insurance Rainy Day Fund Accounts. The activities within the Industrial Insurance Fund are financed and operated in a manner similar to private business entities. Premiums collected from employers and workers and investment earnings finance the cost of providing medical coverage, time-loss payments, disability benefits, Stay at Work reimbursements, and structured settlements. L&I prepares a Statutory Financial Information Report for the Washington State Industrial Insurance Fund of the Workers' Compensation Program annually, based on a fiscal year beginning July 1 and ending June 30.

L&I, an agency of Washington State, is responsible for managing the state's workers' compensation system; enforcing the Washington Industrial Safety and Health Act; providing safety and health consultations and information; enforcing wage and hour, child labor, and family leave requirements; managing the state's Crime Victims' Compensation Program; registering contractors and apprentices; inspecting electrical work, elevators, boilers, and factory-assembled structures; and issuing licenses for certain skilled trades.

L&I's headquarters is located at 7273 Linderson Way SW in Tumwater, Washington. In addition, there are 18 L&I field offices across Washington State that enable us to respond to specific needs in different localities.

The workers' compensation system has existed in Washington State for 107 years. Washington was one of the first states to enact workers' compensation laws. Our state's Workmen's Compensation Act, established on July 28, 1911, was designed to protect workers and employers from injustice and financial hardship arising from work-related injuries in extremely hazardous work. In 1923, Washington became one of only two states where workers pay a portion of the insurance premiums.

Washington's workers' compensation insurance was provided solely through the State Fund, managed by L&I, until 1971, when the Legislature created an option for qualified employers to self-insure and expanded the scope of coverage to virtually all workers. The Self-Insurance

Program allows employers with sufficient financial resources to pay the cost of claims for their injured workers from their own funds and assume significant responsibility for their own claims administration. The workers of self-insured employers are entitled to the same rights and benefits as those workers insured by the State Fund. There are currently 351 active employers who are self-insured, covering close to one-quarter of all workers in Washington.

The State Fund offers an optional financial incentive program, called Retrospective Rating, to help qualifying employers reduce their industrial insurance costs through safety and return-to-work efforts. Employers who join the Retrospective Rating Program receive partial refunds if their claim costs are lower than expected, but pay additional premiums if their claim costs are higher than expected.

The Industrial Insurance Fund covers approximately 179,000 employers and 2.99 million workers statewide. Total premiums assessed in the State Fund during fiscal year 2018, including both the employer and worker portions, were $2.29 billion. More than 95,000 claims were accepted in fiscal year 2018; about 84 percent of these claims were for medical treatment only and received no compensation for time off work or disability-related benefits. A monthly average of 36,488 claims were active during fiscal year 2018, and 15,036 of these claims were receiving time-loss benefits, many of which involve long-term disability and complex medical issues. In fiscal year 2018, vocational rehabilitation retraining plans were completed by 347 injured workers who would not otherwise have been able to return to any type of work after injury.

ACKNOWLEDGEMENTS

As in the work and service we provide every day, this Statutory Financial Information Report represents our commitment to maintain excellence in financial reporting, and the financial statements are in conformance with the highest standards of financial accountability.

The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of L&I, the Washington State Office of Financial Management, and the Washington State Investment Board.

Sincerely,

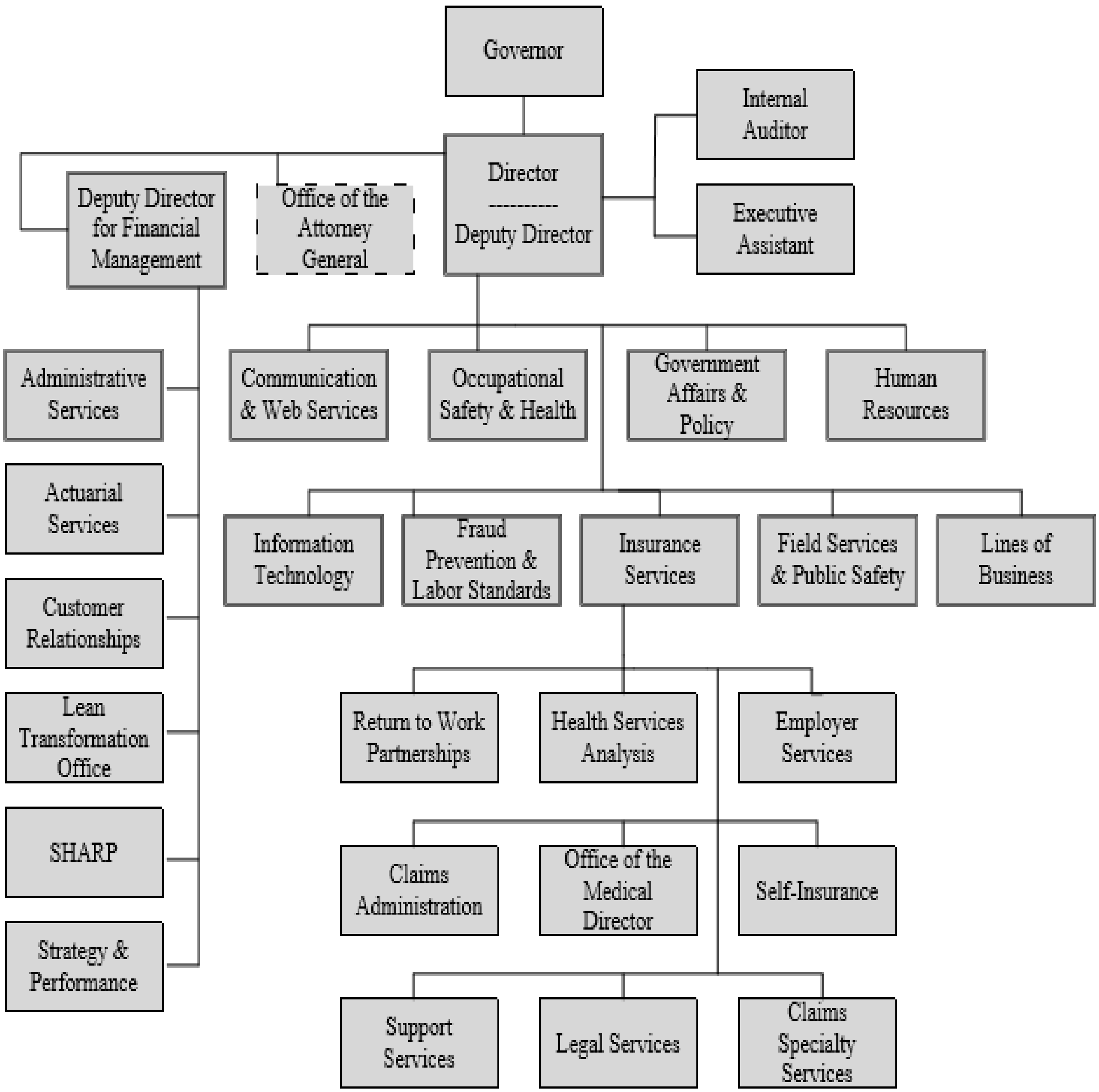
Joel Sacks
Director

Randi Warick
Deputy Director for
Financial Management

Victoria Kennedy
Assistant Director for
Insurance Services

Department of Labor & Industries

Organization Chart
June 30, 2018



Financial Section

Washington State Department of
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EideBailly
CPAs & BUSINESS ADVISORS

Independent Auditor's Report

Mr. Joel Sacks, Director
Washington State Department of Labor and Industries
Industrial Insurance Fund
Olympia, Washington

Report on the Financial Statements
We have audited the accompanying statutory financial statements (referred to as the financial statements) of Washington State Department of Labor and Industries Industrial Insurance Fund (Fund), which comprise the statutory statement of admitted assets, liabilities, and contingency reserve as of June 30, 2018 and 2017, and the related statutory statements of operations and changes in contingency reserve, and statutory cash flows for the years then ended, and the related notes to the statutory 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 the accounting practices prescribed or permitted by the Insurance Department of the State of Washington. 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 opinions.

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Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles
As described in Note 1 to the financial statements, the statutory financial statements are prepared using accounting practices prescribed or permitted by the Insurance Department of the State of Washington, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles
In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Fund as of June 30, 2018 and 2017, or the results of its operations or its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting
In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and contingency reserve of the Fund as of June 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Emphasis of Matter
As discussed in Note 14 and 16 to the financial statements, the Fund had a material subsequent event due to a reduction in the pension discount rate. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information
Our audits were conducted for the purpose of forming an opinion on the statutory-basis financial statements taken as a whole. The accompanying supplementary information included in the *Supplemental Schedule of Investment Risk Interrogatories* and the *Summary Investment Schedule* on pages 88 through 92 are required to be presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and are not a required part of the basic statutory financial statements. Such information included in the schedules referred to above is the responsibility of management, is presented for purposes of additional analysis and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Other Information
Our audit was conducted for the purpose of forming opinions on the financial statements. The *Introductory Section, Management's Discussion and Analysis, the Statement of Actuarial Opinion Section, and Schedule of Undiscounted Claims Development* are presented for purposes of additional analysis and are not a required part of the financial statements.

The *Schedule of Undiscounted Claims Development* is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

The information contained in the *Introductory Section, Management Discussion and Analysis and the Statement of Actuarial Opinion sections* have 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 them.

Eide Bailly LLP

Fargo, North Dakota
November 27, 2018

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Management's Discussion and Analysis

Our management's discussion and analysis of the state of Washington Industrial Insurance Fund's (State Fund) Statutory Financial Information Report provides an overview of the State Fund's financial performance for the fiscal years ended June 30, 2018 and 2017. The information included here should be considered along with the transmittal letter, which can be found on pages 3-7 of this report, and the accompanying Consolidated Statutory Financial Statements and Notes to the Consolidated Statutory Financial Statements, which follow this narrative.

History and Information that Make the State of Washington's Industrial Insurance Fund Unique

Washington was one of the first states to enact workers' compensation laws. The state of Washington's Workmen's Compensation Act established the industrial insurance system in 1911, covering only extremely hazardous work. Washington's workers' compensation insurance was provided solely through the State Fund until 1971, when the system underwent a major overhaul. It was then that the Legislature expanded the scope of coverage to virtually all workers and created an option for qualified employers to self-insure, thus paying the cost of claims for their injured workers from their own funds and also assuming responsibility for their own claims administration.

Washington State, through Title 51 of the Revised Code of Washington (RCW), requires all employers, unless exempted, to secure coverage for job-related injuries and illnesses, either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations. The state of Washington's Department of Labor and Industries (L&I) operates as an exclusive workers' compensation fund, one of only four remaining in the United States.

Washington employers and workers agreed in the 1930s to base premiums on the workers' exposure to risk (hours on the job). In addition, Washington requires both the employers and workers to contribute to the cost of Medical Aid premiums.

Under statute RCW 51.16.035, L&I is required to charge the lowest possible premium rates while maintaining solvency of the system. L&I is also required to limit rate fluctuations, follow recognized insurance principles, and stimulate and encourage accident prevention.

Size and Scope of Washington’s Industrial Insurance Fund

The following information provides some context on the size and scope of the Industrial Insurance Fund and how it changed between fiscal years 2017 and 2018. The Industrial Insurance Fund is the eighth largest workers’ compensation program in the nation, based on 2017 net premiums written, and the largest of the exclusive state funds.

Statistics at a Glance

	Fiscal Year 2018	Fiscal Year 2017
Employers insured*	179,000	176,000
Workers covered*	2,990,000	2,910,000
Hours reported**	3,927,000,000	3,824,000,000
Premiums assessed (employers' portion)**	$ 1,861,000,000	$ 1,825,000,000
Premiums assessed (workers' portion)**	$ 429,000,000	$ 423,000,000
Benefits incurred expense*	$ 1,989,530,000	$ 1,354,483,000
Number of claims filed	111,604	109,965
Total days paid for lost work	5,732,712	6,102,780

Note: The data above is a snapshot as of September following the fiscal year-end.
* Rounded to the nearest thousand
** Rounded to the nearest million

In fiscal year 2018, there were 111,604 claims filed and 95,213 claims accepted. Among the accepted claims, 79,888 of them were medical-only claims. There were 36 fatal pensions awarded in fiscal year 2018. Total premiums assessed from both employers and workers during the current fiscal year were approximately $2,290 million. The business or industry group that filed the greatest number of claims was restaurants and taverns. The most common injuries were traumatic injuries to back muscles, tendons, ligaments, and joints, including the spine and spinal cord.

Overview of the Financial Statements

The accompanying Consolidated Statutory Financial Statements report the financial position and results of operations for four of the seven Workers’ Compensation Program accounts: the Accident, Medical Aid, Pension Reserve, and Industrial Insurance Rainy Day Fund Accounts. In Fiscal Year 2016, the Industrial Insurance Rainy Day Fund Account did not have any transfers or restrictions, and in Fiscal Years 2017 and 2018, there were no transfers made, but funds were restricted. These four accounts represent the Workers’ Compensation Program Basic Plan, also known as the Industrial Insurance Fund.

This discussion and analysis serves as an introduction to the Industrial Insurance Fund’s financial statements, which consist of the following components:

The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve provides information about the Industrial Insurance Fund’s admitted assets and liabilities and reflects the contingency reserve as of June 30, 2018 and 2017. The Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve can be found on page 31 of this report.

The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve shows how the Industrial Insurance Fund's contingency reserve changed during the fiscal year. It presents revenues and expenses for fiscal years 2018 and 2017. The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve can be found on page 32 of this report.

The Consolidated Statutory Statement of Cash Flows reflects cash collections and cash payments to arrive at the net increase or decrease in cash and cash equivalents during fiscal years 2018 and 2017. The Consolidated Statutory Statement of Cash Flows can be found on page 33 of this report.

The Notes to the Consolidated Statutory Financial Statements are an integral part of the financial statements and are essential to a full understanding of the Industrial Insurance Fund's financial position and results of operations presented in the financial statements. The Notes to the Consolidated Statutory Financial Statements can be found on pages 37-84 of this report.

These financial statements have been prepared in conformity with the Statutory Accounting Principles (SAP), as promulgated by the National Association of Insurance Commissioners and the practices permitted by the state of Washington. The main purpose of SAP-based information is to determine solvency. *Solvency* is defined as "the availability of the Industrial Insurance Fund's admitted assets to satisfy its obligations to injured workers and beneficiaries." The Notes to the Consolidated Statutory Financial Statements provide additional information that is essential to a full understanding of the data provided in the Consolidated Statutory Financial Statements.

Elimination for Consolidated Financial Statements

It is important to the readers of the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve that we include details of each account, report the true contingency reserve balance, and show compliance with the statutory Pension Reserve Account transfer requirement. Each year, the Pension Reserve Account's assets and liabilities are evaluated, and transfers are made from the Accident and Second Injury Accounts, as required by law. Self-insured employers also pay their portion of deficiencies or receive their portion of the excess over the required reserve. In fiscal year 2018, the receivable and the accrued liability of $66,397 million resulting from the transfer from the Accident Account to the Pension Reserve Account was eliminated in order to arrive at an accurate consolidated Industrial Insurance Fund balance.

Financial Position

The Industrial Insurance Fund's financial position at June 30, 2018 and 2017 was as follows:

Summary of Financial Position
As of June 30, 2018 and 2017
(dollars in thousands)

	June 30, 2018	June 30, 2017	$ Change	% Change
Admitted Assets				
Fixed income investments	$ 14,267,240	$ 13,531,329	$ 735,911	5.4%
Equities investments	2,308,282	2,106,217	202,065	9.6%
Short-term investments	-	167,557	(167,557)	(100.0%)
Receivable for securities	152,644	10,894	141,750	1301.2%
Total Investments	16,728,166	15,815,997	912,169	5.8%
Securities lending collateral	98,853	84,144	14,709	17.5%
Interest receivable	106,982	106,285	697	0.7%
Cash and cash equivalents	117,069	10,173	106,896	1050.8%
Premiums receivable, net	606,175	606,234	(59)	(0.0%)
Other assets	66,282	64,883	1,399	2.2%
Total Admitted Assets	$ 17,723,527	$ 16,687,716	$ 1,035,811	6.2%
Liabilities and Contingency Reserve				
Benefit liabilities	$ 12,537,906	$ 12,726,732	$ (188,826)	(1.5%)
Discount rate reduction benefit liability	553,902	-	553,902	*
Claims administration liabilities	674,318	619,242	55,076	8.9%
Retrospective rating adjustments	188,664	169,517	19,147	11.3%
OPEB liabilities	129,271	63,456	65,815	103.7%
Other liabilities	55,649	52,861	2,788	5.3%
Collateral from securities lending activities	98,853	84,144	14,709	17.5%
Total Liabilities	14,238,563	13,715,952	522,611	3.8%
Restricted Contingency Reserve	1,600,754	111,021	1,489,733	1341.8%
Unrestricted Contingency Reserve	1,884,210	2,860,743	(976,533)	(34.1%)
Total Liabilities and Contingency Reserve	$ 17,723,527	$ 16,687,716	$ 1,035,811	6.2%

* Undefined

Total admitted assets of $17,724 million increased by $1,036 million, or 6.2 percent, as compared to the end of fiscal year 2017, primarily due to increases of $912 million in total investments, $107 million in cash and cash equivalents, and $15 million in securities lending collateral.

The most significant changes in the investment balances are from increases of $736 million in fixed income investments, $202 million in equities, and $142 million in receivable for securities, offset by a $168 million decrease in short-term investments.

- Cash collected from operations and net investment income received was reinvested within the fixed income portfolio.
- Equities increased due to a strong stock market during fiscal year 2018.

- Receivable for securities increased due to the sale of investments that occurred near the end of the fiscal year.

- Money market mutual funds were moved from short-term investments to cash and cash equivalents to comply with a change in Statement on Statutory Accounting Principle 2R (see Note 2).

Both assets and liabilities from securities lending activities increased by $15 million as compared to June 30, 2017, due to increased demand for borrowing securities. The June 30, 2018, balance of cash collateral held for securities lending transactions was $99 million. Additional information on securities lending collateral is included in Note 12 - Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities of this report.

Benefit liabilities and discount rate reduction benefit liability increased $365 million, or 1.5 percent, to $13,092 million during fiscal year 2018, as shown by the following table:

Benefit Liabilities
(in thousands)

	Fiscal Year 2018	Fiscal Year 2017
Benefit liabilities, beginning	$ 12,726,732	$ 12,978,157
New liabilities incurred, current year	1,622,862	1,616,132
Development on prior years		
Change in reserve discount	608,947	554,889
Other development on prior liabilities	(279,227)	(860,347)
Change in discount rate	36,948	43,811
Claim payments	(1,624,454)	(1,605,910)
Change in benefit liabilities	365,076	(251,425)
Benefit liabilities, ending*	$ 13,091,808	$ 12,726,732

* Includes discount rate reduction benefit liability

It is expected that benefit liabilities will change every year due to normal activities, such as adding the current accident year liabilities, discounting existing liabilities, and paying claims. In addition, benefit liabilities also changed due to favorable development on prior liabilities and the following managerial decision that had no direct relationship to claim operations: the Industrial Insurance Fund has developed a plan to reduce the pension discount rate from 6.5 to 4.5 percent by 2023. During fiscal year 2018, the pension discount rate was reduced from 6.2 to 6.1 percent for the State Fund and self-insurers, which increased liabilities by $37 million. In addition, with the passage of Senate Bill 6393, two different discount rates, one for self-insurers and one for the Industrial Insurance Fund, can now be used. As a result, the pension discount rate for the State Fund will be reduced from 6.1 percent to 4.5 percent during fiscal year 2019. Given our intention to adjust the discount rate, which is a material assumption in establishing the significant reserve estimate, SSAP No. 9 requires it to be treated as a material subsequent event that is recognized in the financial statements. The assumption change increased the liability recognized by $554 million as of June 30, 2018.

The net increase in benefit liabilities explained above was partially offset by favorable development of $947 million from new information on previously estimated liabilities. The Accident Account benefit liabilities were lower due to fewer active time-loss claims and fewer total permanent disability and partial permanent disability awards. The Medical Aid Account had lower-than-expected claim counts and lower-than-anticipated medical payments. Detailed changes in the benefit liabilities are explained in Note 16 - Changes in Benefit and Claims Administration Liabilities of this report.

Claims administration liabilities increased $55 million when compared to the prior year, mainly due to using a shorter-term average to estimate medical expenses in order to be more responsive to recent cost increases.

The Retrospective Rating Program is a voluntary financial incentive program offered by L&I to reduce workplace injuries and costs associated with workers' compensation claims. The program provides an economic incentive to employers that elect to have their premiums retrospectively rated, with an annual adjustment for actual benefits incurred. The Retrospective Rating Adjustments liability includes the estimated return of earned premiums, net of any additional premiums expected to be assessed through the final adjustment for all current participants. This liability increased $19 million, as compared to June 30, 2017. The increase was largely due to increases in reported hours and safer performance.

The contingency reserve increased by $513 million due to more premiums collected than current accident year benefits incurred, investment income, net gains on investments, and prior year development on benefit liabilities.

Results of Operations

The Industrial Insurance Fund operating results are presented in the following table:

Summary of Operations and Changes in Contingency Reserve
For the Fiscal Years Ended June 30, 2018 and 2017
(dollars in thousands)

	Fiscal Year 2018	Fiscal Year 2017	$ Change	% Change
Net premiums earned	$ 2,096,622	$ 2,080,809	$ 15,813	0.8%
Net investment income earned	481,047	478,130	2,917	0.6%
Net investment realized gains	1,092,446	102,540	989,906	965.4%
Self-insured reimbursements	102,768	99,254	3,514	3.5%
Other income	50,616	58,973	(8,357)	(14.2%)
Total Revenue Earned	3,823,499	2,819,706	1,003,793	35.6%
Net benefits (losses) incurred	1,989,530	1,354,483	635,047	46.9%
Claims administration expenses (LAE) incurred	236,282	165,397	70,885	42.9%
Premium administration expenses incurred	48,697	45,542	3,155	6.9%
Other administration expenses incurred	46,838	45,107	1,731	3.8%
Self-insured administration expenses incurred	30,825	29,549	1,276	4.3%
Non-insurance administration expenses incurred	73,426	57,830	15,596	27.0%
Total Administration Expenses Incurred	436,068	343,425	92,643	27.0%
Total Expenses Incurred	2,425,598	1,697,908	727,690	42.9%
Net Income	1,397,901	1,121,798	276,103	24.6%
Other changes in contingency reserve	(884,701)	357,044	(1,241,745)	(347.8%)
Changes in contingency reserve, net	513,200	1,478,842	(965,642)	(65.3%)
Beginning contingency reserve, July 1	2,971,764	1,492,922	1,478,842	99.1%
Ending Contingency Reserve, June 30	$ 3,484,964	$ 2,971,764	$ 513,200	17.3%

Net premiums earned for the current period is the sum of net premiums collected and the changes in premiums receivable and the retrospective rating adjustments liability between June 30, 2017, and June 30, 2018. Net premiums earned increased $16 million, mainly due to an increase in the number of hours reported by employers, offset by premium rate decreases in the Accident and Medical Aid Accounts effective January 1, 2018. In fiscal year 2018, employers reported 3,938 million actual hours worked, an increase of 111 million hours, or 2.9 percent more than the previous fiscal year. There has been steady growth of quarterly standard premiums for the 29 quarters since March 31, 2011.

Net realized capital gains of $1,092 million mainly resulted from the sale of equities to align the investment portfolio with the new asset allocation policy, rebalancing the investment portfolio in January 2018, and restructuring to a single global equity fund. In June 2017, the asset allocation policy was changed from a U.S./non-U.S. equity split of 60 percent/40 percent to a global structure, with the U.S./non-U.S. weightings being those of the MSCI ACWI IMI index, which was 52 percent U.S./48 percent non-U.S. as of June 30, 2017. In January 2018, the Washington State Investment Board (WSIB) sold $40 million in equities and purchased fixed income investments in order to rebalance the investment portfolio. In April 2018, the WSIB restructured the equity portfolio, transitioning the U.S. portfolio managed by BlackRock Institutional Trust Company (BTC) and the non-U.S. portfolio managed by State Street Global Advisors (SSGA), to a single global equity fund. As a result of this change, all equities were sold and repurchased in a global commingled fund under BTC.

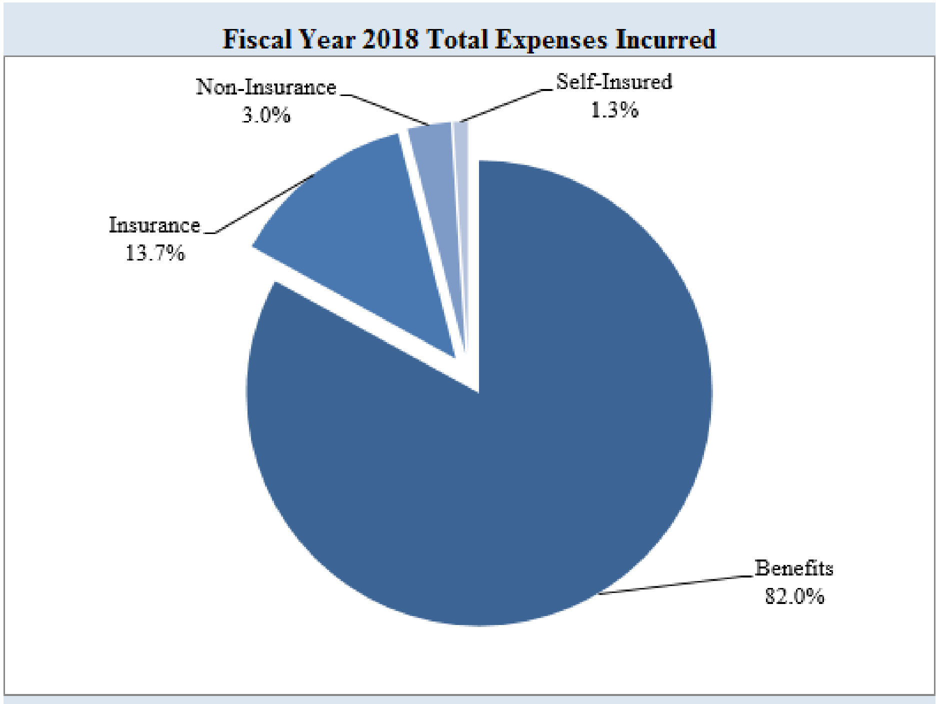
The decrease in other income is due primarily to a decrease in penalty and interest revenue. Previously, penalty and interest receivables waived as a result of negotiation or settlement were charged against bad debt expense. During fiscal year 2018, the Industrial Insurance Fund began reversing the revenues that were originally accrued when the receivables were recorded. This resulted in a decrease in penalty and interest revenues and a decrease in bad debt expense.

In fiscal year 2018, benefits incurred increased $635 million from the prior year to $1,990 million. Benefits incurred includes $1,624 million in benefits paid, a $189 million decrease in benefit liabilities due to favorable development and a $554 million increase for the discount rate reduction. The favorable development in benefit liabilities and the discount rate reduction is explained above, and benefits paid is explained in the cash flow section below.

Claim administration expenses incurred increased $71 million in fiscal year 2018 to $236 million. An increase in the actuaries' estimate of claims administration liabilities accounts for most of this change, as discussed above.

Claim administration expenses paid and non-insurance administration expenses paid also increased, as explained in the cash flow section below.

The following chart provides detail on total expenses incurred in fiscal year 2018:



Other changes in contingency reserve decreased $885 million, mainly due to unrealized losses on equities of $818 million and the change in OPEB liability of $58 million. Equities were sold as described in the realized gains section above, and as a result, the net unrealized gains reported in prior years were removed from unrealized gains and reported in realized gains. The increase in the OPEB liability is related to prior periods as a result of implementing Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (OPEB). GASB Statement 75 includes changes in methods and assumptions the actuary must use in determining the OPEB valuation. More information on the OPEB liability is included in Notes 1 and 2.

The following ratios, expressed as a percentage of total net premiums earned, are recognized industry measures used to compare one insurance company to another:

Key Financial Ratios

	Fiscal Year 2018	Fiscal Year 2017
Loss ratio	94.9%	65.1%
Loss adjustment expense (LAE) ratio	11.3%	7.9%
Loss and LAE Ratio	**106.2%**	**73.0%**
Underwriting and other expense ratio	4.6%	4.4%
Combined Ratio	**110.8%**	**77.4%**
Less: Net investment income ratio	22.9%	23.0%
Operating Ratio	**87.9%**	**54.4%**

The benefit (loss) and loss adjustment expense (LAE) ratios represent the total costs for processing claims and benefits as a percentage of total net premiums earned. There are many factors that impact loss and LAE ratios, including legislative decisions and claim frequency, severity, and exposure. The higher loss ratio in fiscal year 2018 resulted from increases to benefit liabilities from reducing the discount rate. The loss ratio of 65.1 percent for fiscal year 2017 resulted from favorable development similar to fiscal year 2018 and is the lowest the Industrial Insurance Fund has had since fiscal year 1998, when statutory financial statements were first produced. The LAE ratio of 11.3 percent is higher due to the increase in claim administration expenses previously discussed. The LAE ratio of 11.3 percent and the underwriting and other expense ratio of 4.6 percent are lower than the workers' compensation insurance industry of 13.6 and 26.0 percent, respectively.

The combined ratio expresses total insurance costs, including benefits and administration expenses incurred, as a percentage of total net premiums earned. When the total insurance costs exceed net premium revenues, the combined ratio is above 100 percent. The Industrial Insurance Fund's rates are set based on the anticipated breakeven rate. Income earned on investments supplements premium revenues to cover expenses so that the lowest possible rates can be set. As a result, it is normally expected that the Industrial Insurance Fund's combined ratio will exceed 100 percent, as it did this fiscal year. A combined ratio below 100 percent, as it was in fiscal year 2017, means that net premium revenues exceed insurance costs even without using investment income. The favorable development on prior year liabilities is the primary reason for the lower combined ratio in fiscal year 2017.

The operating ratio reflects the combined ratio, less the net investment income ratio, and is another industry measure of overall financial performance. Ratios above 100 percent indicate that expenses are greater than the sum of premiums and net investment income earned. The operating ratio does not include realized or unrealized investment gains. Insurance companies are motivated to make profits and, therefore, work toward an operating ratio below 100 percent. Unlike other insurance companies, the Industrial Insurance Fund is operated as a part of state government, and in most years, its goal is to break even rather than make a profit. An operating ratio less than 100 percent indicates that the Industrial Insurance Fund is building the contingency reserve. As reported hours have increased, a corresponding increase in claims is expected—this is called exposure. However, the overall industry and L&I have not experienced an equal increase in claims. This has had a major positive impact on the contingency reserve. In addition, positive investment results contributed to the growth in the contingency reserve. The operating ratio of 54.4 percent for fiscal year 2017 is the lowest the Industrial Insurance Fund has had since statutory financial statements were first produced in fiscal year 1998.

Cash Flows and Liquidity

Cash Flows – In fiscal years 2018 and 2017, the primary sources of cash were from premiums collected and investment income. The primary uses of cash were for benefit payments, administration expenses, and purchases of investments.

Cash flows of the Industrial Insurance Fund are summarized as follows:

Cash Flow Summary
For the Fiscal Years Ended June 30, 2018 and 2017
(dollars in thousands)

	Fiscal Year 2018	Fiscal Year 2017	$ Change	% Change
Operations				
Net premiums collected	$ 2,106,346	$ 2,038,351	$ 67,995	3.3%
Other reimbursements and income	140,743	144,629	(3,886)	(2.7%)
Net benefits paid	(1,624,454)	(1,605,910)	(18,544)	1.2%
Insurance administration expenses paid	(262,700)	(239,901)	(22,799)	9.5%
Self-insured administration expenses paid	(30,264)	(27,037)	(3,227)	11.9%
Non-insurance administration expenses	(70,497)	(54,579)	(15,918)	29.2%
Operating Cash Flow In (Out)	259,174	255,553	3,621	1.4%
Investment Activities				
Investment income	481,911	483,387	(1,476)	(0.3%)
Net realized gains	1,092,446	102,540	989,906	965.4%
Purchases, net	(1,825,861)	(839,054)	(986,807)	117.6%
Investment management expenses	(5,251)	(4,779)	(472)	9.9%
Investment Cash Flow In (Out)	(256,755)	(257,906)	1,151	(0.4%)
Net increase in cash (decrease)	$ 2,419	$ (2,353)	$ 4,772	(202.8%)

Net premiums collected increased by $68 million. This increase was mainly due to a higher number of hours reported by employers, offset by premium rate decreases in the Accident and Medical Aid Accounts effective in January 2018.

Net benefits paid increased $19 million when compared to the prior year, as explained below:

- The Accident Account’s $7 million decrease in net benefits paid is mainly due to a decline in current active time-loss claims and an increased use of Kept on Salary (KOS). Employers have the option to keep an injured worker on salary during time missed from work due to the injury or occupational disease. “KOS” means the employer continues to pay the usual wage or salary and benefits at the same level paid before the injury or occupational disease. Since the Industrial Insurance Fund does not pay time-loss for dates a worker is kept on salary, it reduces time-loss claims.

- The Medical Aid Account's $10 million increase in net benefits is mainly due to an increase in exposure and medical inflation.

- The Pension Account's net benefits paid increased $16 million, mainly because of higher numbers of pensioners receiving benefits, together with higher average monthly benefits.

Insurance administration expenses paid increased $23 million, mainly due to an increase in claims administration expenses. All state employees received a two percent pay increase effective July 1, 2017, and the employer portion of the retirement contribution increased 1.3 percent. Also, during the fiscal year, 91 employees were added to various programs including Claims Administration and Business Transformation.

Non-insurance expenses increased $16 million, mainly due to increases in salaries, benefits, and employees as discussed above. Approximately 15 Employment Standards and Workplace Rights employees were added to implement minimum wage Initiative 1433, and 16 Department of Safety and Health employees were added to provide training, consultation and ensure compliance.

There was $1,092 million in net realized gains in fiscal year 2018, an increase of $990 million from the previous year, as discussed in the Results of Operations section above.

Investment purchases exceeded sales by $1,826 million in fiscal year 2018, mainly due to reinvesting investment income and realized gain proceeds.

Liquidity - The Industrial Insurance Fund's operations require sufficient liquidity to meet both short-term and long-term requirements. Resources to ensure short-term liquidity come from two basic factors:

- L&I may increase rates in order to increase its contingency reserve, resulting in positive cash flow.

- Premiums are paid to L&I every three months.

The Industrial Insurance Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through reinvesting positive cash flow. The Industrial Insurance Fund is able to match projected cash inflows from premiums and investment income from its portfolio with projected cash outflows for payment of benefits.

Future Plan

The Industrial Insurance Fund has many computer systems used for paying benefits and collecting premiums. Many of the systems were built over thirty years ago, and the agency has made a goal to replace these systems before they turn 40 years old. A budget request has been submitted for funding to replace the aging computer systems that support Washington's Industrial Insurance Fund. The Industrial Insurance Fund has completed extensive research, developed cost and timeline estimates, and produced a business case that details the findings and proposed approach. The seven-year project will simplify the Workers' Compensation Program's technology architecture, replace manual and paperwork processes with electronic features, and free up staff time to focus on further improving services to injured workers and employers. The total estimated cost of this project is $299 million, with $82 million of that being requested for the next biennium.

In June 2017, the WSIB adopted a new asset allocation policy, and the decision was made to purchase real estate at a cost of up to five percent of total investments in the Accident, Medical Aid, and Pension Reserve Accounts. Real estate will be gradually purchased during the next seven years, with the plan to purchase several properties during fiscal year 2019.

Requests for Information

This report is designed to provide a general overview of the Industrial Insurance Fund and to illustrate its financial position and results of operations to interested parties. If you have any questions about this report or need additional financial information, please contact the Chief Accounting Officer at the Department of Labor & Industries, P.O. Box 44833, Olympia, Washington 98504-4833.

In accordance with the Revised Code of Washington (RCW) 51.44.115, L&I also publishes a Comprehensive Annual Financial Report (CAFR) for the Workers' Compensation Program. This report is prepared in compliance with Generally Accepted Accounting Principles (GAAP).

The Industrial Insurance Fund Statutory Financial Information Report and the Workers' Compensation Program CAFR are available at L&I's website at:
http://www.lni.wa.gov/ClaimsIns/Insurance/Learn/StateFund/Reports.

Washington State Department of
Labor & Industries

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Consolidated Statutory Financial Statements

Washington State Department of
Labor & Industries

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Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve

As of June 30, 2018 and 2017

(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Elimination for Consolidated Statements	Total June 30, 2018	Total June 30, 2017
Admitted Assets						
Cash and Investments						
Investments, net						
Fixed income	$ 5,546,921,000	$ 4,820,276,000	$ 3,900,043,000	$ -	$ 14,267,240,000	$ 13,531,329,000
Equities	748,892,000	1,013,259,000	546,131,000	-	2,308,282,000	2,106,217,000
Short-term	-	-	-	-	-	167,557,000
Receivable for securities	51,041,000	50,762,000	50,841,000	-	152,644,000	10,894,000
Total Investments	6,346,854,000	5,884,297,000	4,497,015,000	-	16,728,166,000	15,815,997,000
Securities lending collateral	2,015,000	40,981,000	55,857,000	-	98,853,000	84,144,000
Interest receivable	42,181,000	32,744,000	32,057,000	-	106,982,000	106,285,000
Cash and cash equivalents	45,780,000	30,854,000	40,435,000	-	117,069,000	10,173,000
Total Cash and Investments	6,436,830,000	5,988,876,000	4,625,364,000	-	17,051,070,000	16,016,599,000
Other Assets						
Premiums receivable, net, incl. earned but unbilled	380,032,000	226,143,000	-	-	606,175,000	606,234,000
Real estate and improvements						
(less $0 encumbrances)	17,215,000	17,215,000	-	-	34,430,000	35,804,000
Self-insurance receivables, net	3,547,000	3,479,000	6,126,000	-	13,152,000	14,683,000
Miscellaneous receivables, net	2,407,000	991,000	81,699,000	(66,397,000)	18,700,000	14,396,000
Total Other Assets	403,201,000	247,828,000	87,825,000	(66,397,000)	672,457,000	671,117,000
Total Admitted Assets	$ 6,840,031,000	$ 6,236,704,000	$ 4,713,189,000	$ (66,397,000)	$ 17,723,527,000	$ 16,687,716,000
Liabilities and Contingency Reserve						
Liabilities						
Benefits	$ 4,433,090,000	$ 3,451,623,000	$ 4,653,193,000	$ -	$ 12,537,906,000	$ 12,726,732,000
Discount rate reduction benefit liability	553,902,000				553,902,000	
Total Benefits	4,986,992,000	3,451,623,000	4,653,193,000	-	13,091,808,000	12,726,732,000
Other Liabilities						
Claims administration	215,294,000	459,024,000	-	-	674,318,000	619,242,000
Retrospective rating adjustments	188,664,000	-	-	-	188,664,000	169,517,000
Accrued liabilities						
OPEB claims administration	43,438,000	50,899,000	-	-	94,337,000	32,820,000
OPEB other administration	20,873,000	14,061,000	-	-	34,934,000	30,636,000
Other accrued liabilities	95,887,000	21,633,000	4,139,000	(66,397,000)	55,262,000	52,671,000
Deferred revenue	247,000	140,000	-	-	387,000	190,000
Collateral from securities lending activities	2,015,000	40,981,000	55,857,000	-	98,853,000	84,144,000
Total Other Liabilities	566,418,000	586,738,000	59,996,000	(66,397,000)	1,146,755,000	989,220,000
Total Liabilities	5,553,410,000	4,038,361,000	4,713,189,000	(66,397,000)	14,238,563,000	13,715,952,000
Restricted Contingency Reserve	388,606,000	1,212,148,000	-	-	1,600,754,000	111,021,000
Unrestricted Contingency Reserve	898,015,000	986,195,000	-	-	1,884,210,000	2,860,743,000
Total Contingency Reserve	1,286,621,000	2,198,343,000	-	-	3,484,964,000	2,971,764,000
Total Liabilities and Contingency Reserve	$ 6,840,031,000	$ 6,236,704,000	$ 4,713,189,000	$ (66,397,000)	$ 17,723,527,000	$ 16,687,716,000

The Notes to the Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System, with adjustments for statutory basis of accounting.

Consolidated Statutory Statement of Operations and Changes in Contingency Reserve

For the Fiscal Years Ended June 30, 2018 and 2017

(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total Fiscal Year 2018	Total Fiscal Year 2017
Revenues					
Net standard premiums earned	$ 1,420,463,000	$ 870,613,000	$ -	$ 2,291,076,000	$2,250,651,000
Less net retrospective rating adjustments	(194,454,000)	-	-	(194,454,000)	(169,842,000)
Net premiums earned	1,226,009,000	870,613,000	-	2,096,622,000	2,080,809,000
Net investment income earned	184,672,000	149,908,000	146,467,000	481,047,000	478,130,000
Net fixed income investment realized gains (losses)	8,772,000	308,000	24,247,000	33,327,000	101,535,000
Net equity investment realized gains	326,425,000	460,524,000	272,170,000	1,059,119,000	1,005,000
Self-insured administrative expense assessments	14,371,000	13,079,000	-	27,450,000	30,568,000
Self-insured second injury pension reserve assessments	-	-	51,673,000	51,673,000	50,562,000
Self-insured cash funded & bonded pension reimbursements	-	-	23,645,000	23,645,000	18,124,000
Fines, penalties, and interest	36,250,000	1,820,000	57,000	38,127,000	49,752,000
Other income	10,080,000	2,409,000	-	12,489,000	9,221,000
Total Revenues Earned	1,806,579,000	1,498,661,000	518,259,000	3,823,499,000	2,819,706,000
Expenses					
Benefits incurred	1,084,648,000	302,885,000	601,997,000	1,989,530,000	1,354,483,000
Administration expenses incurred					
Insurance expenses incurred					
Claims administration expenses incurred	70,434,000	165,848,000	-	236,282,000	165,397,000
Premium administration expenses incurred	24,125,000	24,572,000	-	48,697,000	45,542,000
General insurance administration expenses incurred	15,763,000	7,515,000	-	23,278,000	22,425,000
Other agencies insurance expenses incurred	11,747,000	11,813,000	-	23,560,000	22,682,000
Total insurance expenses incurred	122,069,000	209,748,000	-	331,817,000	256,046,000
Self-insured administration expenses incurred	16,045,000	14,780,000	-	30,825,000	29,549,000
Non-insurance administration expenses incurred	50,632,000	22,794,000	-	73,426,000	57,830,000
Total administration expenses incurred	188,746,000	247,322,000	-	436,068,000	343,425,000
Total Expenses Incurred	1,273,394,000	550,207,000	601,997,000	2,425,598,000	1,697,908,000
Net Income (Loss) Before Transfers	533,185,000	948,454,000	(83,738,000)	1,397,901,000	1,121,798,000
Transfers In (Out)					
Pension funding transfers	(294,408,000)	-	294,408,000	-	-
Net Transfers In (Out)	(294,408,000)	-	294,408,000	-	-
Net Income (Loss)	238,777,000	948,454,000	210,670,000	1,397,901,000	1,121,798,000
Other Changes in Contingency Reserve					
Fixed income unrealized gains (losses)	(462,000)	5,425,000	(29,000)	4,934,000	42,251,000
Equities unrealized gains (losses)	(250,061,000)	(357,244,000)	(210,571,000)	(817,876,000)	337,932,000
Previously unrecognized revenue	-	-	-	-	20,584,000
Change in OPEB liability (see Note 2)	(28,174,000)	(29,562,000)		(57,736,000)	
Change in nonadmitted assets	(12,630,000)	(1,323,000)	(70,000)	(14,023,000)	(43,723,000)
Change in Contingency Reserve, Net	(52,550,000)	565,750,000	-	513,200,000	1,478,842,000
Beginning contingency reserve, July 1	1,339,171,000	1,632,593,000	-	2,971,764,000	1,492,922,000
Ending Contingency Reserve, June 30	$ 1,286,621,000	$ 2,198,343,000	$ -	$ 3,484,964,000	$ 2,971,764,000

The Notes to the Statutory Financial Statements are an integral part of this statement.

The source of this financial information is the Washington State Agency Financial Reporting System, with adjustments for statutory basis of accounting.

Consolidated Statutory Statement of Cash Flows

For the Fiscal Years Ended June 30, 2018 and 2017

(rounded to the nearest thousand)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total Fiscal Year 2018	Total Fiscal Year 2017
Standard premiums collected	$ 1,422,387,000	$ 859,266,000	$ -	$ 2,281,653,000	$ 2,201,043,000
Less retrospective rating adjustments	(175,307,000)	-	-	(175,307,000)	(162,692,000)
Net premiums collected	1,247,080,000	859,266,000	-	2,106,346,000	2,038,351,000
Self-insured administration expense reimbursements	14,763,000	13,455,000	-	28,218,000	29,994,000
Self-insured second injury pension reserve reimbursements	-	-	47,831,000	47,831,000	67,459,000
Self-insured cash funded and bonded pension reimbursements	-	-	23,418,000	23,418,000	19,534,000
Fines, penalties, and interest	27,577,000	1,472,000	-	29,049,000	26,921,000
Other income (expenses)	9,850,000	2,423,000	(46,000)	12,227,000	721,000
Fund transfers in (out)	(267,199,000)	-	267,199,000	-	-
Operating Cash Flow In	1,032,071,000	876,616,000	338,402,000	2,247,089,000	2,182,980,000
Benefits paid	556,153,000	593,053,000	475,248,000	1,624,454,000	1,605,910,000
Administration expenses					
Insurance expenses					
Claims administration expenses	63,732,000	106,231,000	-	169,963,000	154,229,000
Premium administration expenses	23,203,000	23,565,000	-	46,768,000	42,286,000
General insurance administration expenses	15,669,000	7,325,000	-	22,994,000	21,239,000
Other agencies insurance expenses	11,450,000	11,525,000	-	22,975,000	22,147,000
Total insurance expenses	114,054,000	148,646,000	-	262,700,000	239,901,000
Self-insured administration expenses	15,799,000	14,465,000	-	30,264,000	27,037,000
Non-insurance administration expenses	48,675,000	21,822,000	-	70,497,000	54,579,000
Total Administration Expenses Paid	178,528,000	184,933,000	-	363,461,000	321,517,000
Operating Cash Flow Out	734,681,000	777,986,000	475,248,000	1,987,915,000	1,927,427,000
Net Operating Cash Flow In (Out)	297,390,000	98,630,000	(136,846,000)	259,174,000	255,553,000
Investment income - fixed income	183,711,000	149,394,000	146,950,000	480,055,000	482,470,000
Investment income - equities	629,000	787,000	440,000	1,856,000	917,000
Net realized gains on investments	335,197,000	460,832,000	296,417,000	1,092,446,000	102,540,000
Net (purchases) sales of investments	(814,132,000)	(706,804,000)	(304,925,000)	(1,825,861,000)	(839,054,000)
Investment expenses	(1,990,000)	(1,838,000)	(1,423,000)	(5,251,000)	(4,779,000)
Total Investment Cash Flow In (Out)	(296,585,000)	(97,629,000)	137,459,000	(256,755,000)	(257,906,000)
Net Cash Flow In (Out)	805,000	1,001,000	613,000	2,419,000	(2,353,000)
Beginning Cash and Cash Equivalents, July 1	7,359,000	1,741,000	1,073,000	10,173,000	12,526,000
Money Market Mutual Funds (See Note 2)	37,616,000	28,112,000	38,749,000	104,477,000	-
Ending Cash and Cash Equivalents	$ 45,780,000	$ 30,854,000	$ 40,435,000	$ 117,069,000	$ 10,173,000

The Notes to the Consolidated Statutory Financial Statements are an integral part of this statement.

The source of this financial information is Washington State's Agency Financial Reporting System (AFRS) with adjustments for statutory basis of accounting.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Notes to the Consolidated Statutory Financial Statements

For the Fiscal Years Ended June 30, 2018 and 2017

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Washington State Department of
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Keep Washington Safe and Working

Note 1 - Summary of Significant Accounting Policies

1.A. Nature of Operations

The state of Washington's Department of Labor & Industries (L&I) administers the state's Workers' Compensation Program. Through Title 51 of the Revised Code of Washington (RCW), Washington State requires all employers, unless excluded or exempt, to secure coverage for job-related injuries and illnesses, either by paying insurance premiums to the Industrial Insurance Fund or by self-insuring. L&I is the exclusive writer of workers' compensation insurance in the state of Washington for all businesses except the self-insured. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

Chapter 51.44 RCW provides six benefit accounts: the Accident, Medical Aid, Pension Reserve, Supplemental Pension, Second Injury, and the Self-Insured Employer Overpayment Reimbursement Accounts, primarily to make compensation payments to injured workers or to medical providers for rehabilitation services to injured workers. A seventh account, called the Industrial Insurance Rainy Day Fund Account, was created to receive transfers of funds from the Accident and Medical Aid Accounts when assets for those accounts combined are between 10 and 30 percent in excess of their funded liabilities. The funds are then set aside to reduce a future rate increase or aid businesses during or recovering from economic recessions. In fiscal years 2018 and 2017, the Industrial Insurance Rainy Day Fund Account did not have any transfers, but funds were restricted. These seven accounts are known collectively as the Workers' Compensation Program.

The Accident, Medical Aid, Pension Reserve, and Industrial Insurance Rainy Day Fund Accounts are referred to as the "Industrial Insurance Fund" and are the focus of this report. The Supplemental Pension, Second Injury, and Self-Insured Employer Overpayment Reimbursement Accounts are not part of the Industrial Insurance Fund and are not included in this report.

The Industrial Insurance Fund is self-sustaining through the ability to assess the appropriate rates of insurance premiums and prudent investment management. The Accident, Medical Aid, and Pension Reserve Accounts are maintained on an actuarially solvent basis, except that a cash-flow basis is used for the components of the Pension Reserve Account, in which self-insured employers guarantee related benefits with a surety bond. The accompanying consolidated statutory statements report on the financial position and results of operations of the Industrial Insurance Fund.

1.A.1. Description of the Industrial Insurance Fund

There are four accounts making up the Industrial Insurance Fund: the Accident, Medical Aid, Pension Reserve, and Industrial Insurance Rainy Day Fund Accounts.

The Accident Account was established on July 1, 1947, per RCW 51.44.010, and pays compensation directly to injured workers for lost wages for temporary disability and permanent partial disability awards. It also pays costs for vocational retraining and for structured settlements. Pursuant to RCW 51.44.070, funds from the Accident Account are to be transferred to the Pension Reserve Account for the present value of pensions awarded to survivors of fatally injured workers and to workers who have a total permanent disability.

Revenues for this account come from employer-paid premiums based on individual employers' reported payroll hours and are reported net of refunds. Employers may elect to have their premiums retrospectively rated with an annual adjustment for actual benefits incurred. The retrospective adjustment calculation considers both the Accident and Medical Aid Accounts' experience and premiums together and may result in either a refund of premiums paid or an assessment of additional premiums due. All retrospective premium adjustments are financed entirely through the Accident Account.

On behalf of injured workers, the Medical Aid Account, established on July 1, 1917, per RCW 51.44.020, pays for the cost of medical, vocational rehabilitation services, and Stay at Work reimbursements. Equal contributions from employers and employees fund this account. It is the employer's responsibility to collect the employee portion of the medical aid premium and submit the employee and employer contributions to L&I quarterly.

The Pension Reserve Account pays benefits to the surviving spouse or dependent(s) of fatally injured workers and to all permanently and totally disabled workers. This includes benefits for pensions awarded to employees of self-insured employers.

Funding for pension payments is generated by transfers from the Accident and Second Injury Accounts and cash-funded or bonded pension payments from self-insured employers. Funding required to cover the estimated present cash value of monthly pension payments is calculated on the basis of an annuity; such annuity values are based upon L&I's experience as to rates of mortality, disability, remarriage, and interest, according to RCW 51.44.070.

The Industrial Insurance Rainy Day Fund Account was established to help keep rates stable and meet the obligations of the industrial insurance statute, Title 51 RCW. RCW 51.44.023 was adopted during the 2011 Legislative Session, authorizing L&I to determine whether the assets of the Accident and Medical Aid Accounts combined are at least 10 percent but not more than 30 percent in excess of the funded liabilities and, if so, transfer any excess to the Industrial Insurance Rainy Day Fund Account. The funds set aside will be used to reduce a rate increase or aid businesses in recovering from or during economic recessions.

1.B. Accounting Practices and Basis of Presentation

The Industrial Insurance Fund follows the Statutory Accounting Principles (SAP), which include the Statements of Statutory Accounting Principles (SSAP), as promulgated by the National Association of Insurance Commissioners (NAIC), as directed by RCW 51.44.115. The SAP are very conservative in nature and designed to protect injured workers by ensuring that, in the event of liquidation, sufficient amounts have been set aside to provide for outstanding claims. This accounting basis is used to present solvency and the adequacy of premium rates.

The SAP are required to be used by property and casualty insurance enterprises in the United States (U.S.) when reporting their financial position to state insurance regulators, subject to any differences prescribed or permitted by each state's law. The NAIC defines prescribed accounting practices as "… those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. The NAIC Accounting Practices and Procedures Manual (AP&P) is not intended to preempt states' legislative and regulatory authority."[1] Washington's prescribed differences from the NAIC are addressed in RCW 48.13.071, which provides limits on investments. The NAIC defines permitted practices as "…practices specifically requested by an insurer that depart from NAIC SAP and state prescribed accounting practices, and have received approval from the insurer's domiciliary state regulatory authority."[2] Financial reporting, operating, and other guidance that is codified in statute related to a statutory reporting entity and departs from NAIC SAP is also generally accepted as prescribed practices.

In accordance with Title 51 RCW and Title 296 of the Washington Administrative Code (WAC), the Industrial Insurance Fund is administered by L&I. Pursuant to Title 48 RCW and Title 284 WAC, L&I is not required to file annual statements with the Washington State Office of the Insurance Commissioner (OIC). The Industrial Insurance Fund is not required to report to the OIC or complete an annual statement in accordance with the NAIC annual statement filing instructions.

Title 51 RCW directs the Industrial Insurance Fund to establish tabular reserving methodologies for pensions, considering rates of mortality, disability, remarriage and interest. Accordingly, the Fund established a practice of discounting on a tabular basis in a manner that complies with the guidance supplied in the Title. SSAP No. 65 allows discounting fixed and reasonably determinable payments on a tabular-only basis. Non-tabular discounting is only permitted in certain instances in which states have prescribed or permitted practices to allow it, which is the case for the Fund. (See Note 1.C.3 and Note 17.B for additional information on discounting methodology and non-tabular discounting.)

SSAP No. 53 states that 10 percent of earned but unbilled (EBUB) premium in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. Per SSAP 53, for workers' compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premiums are recorded on the basis of that frequency. Our quarterly billing process aligns with this guidance and, given that the receivables are not over 90 days old as of the reported date, they are 100 percent admitted. Subsequent to year-end, the majority of the balance recorded as of June 30 was received with only immaterial differences.

In addition, the Industrial Insurance Fund recognizes a liability for the net Other Postemployment Benefit (OPEB) obligation, which includes the unfunded actuarial accrued liability amortized over nine years. The Industrial Insurance Fund participates in a multiemployer OPEB plan. SSAP No. 92 states that employers with multiemployer plans are not required to recognize the unfunded status of the OPEB plan, but are only required to recognize the required contribution to the plan for the period reported. The Fund has elected to record this liability, given the basis for conservatism within statutory accounting principles and considering that the impact of this election does not have a material impact on the financial statements taken as a whole.

[1] NAIC AP&P Manual as of March 2018, Section: Preamble Questions and Answers, Question 2

[2] NAIC AP&P Manual as of March 2018, Section: Preamble Questions and Answers, Question 2

The following table reconciles the Industrial Insurance Fund's net income and contingency reserve as reported on the accompanying financial statements and what they would have been if they were recorded under NAIC SAP requirements:

Effect of Prescribed and Permitted Practices					
	SSAP #	F/S Page*	F/S Line	As of and For the Fiscal Year Ended June 30, 2018	As of and For the Fiscal Year Ended June 30, 2017
Net Income, WA Basis				**$ 1,397,901,000**	**$ 1,121,798,000**
Prescribed Non-tabular discounting	65	31	Benefits	164,430,000	116,238,000
Permitted OPEB administration liability	92	31	OPEB	8,079,000	10,378,000
Net Income, NAIC SAP Basis				**$ 1,570,410,000**	**$ 1,248,414,000**
Contingency Reserve, WA Basis				**$ 3,484,964,000**	**$ 2,971,764,000**
Prescribed Non-tabular discounting	65	31	Benefits	(1,520,585,000)	(1,685,015,000)
Permitted OPEB administration liability	92	31	OPEB	129,271,000	63,456,000
Contingency Reserve, NAIC SAP Basis				**$ 2,093,650,000**	**$ 1,350,205,000**

* F/S Page 31 means that Liabilities and the Contingency Reserve are primarily impacted

The financial statement layout and terminology were selected based on the terminology and formatting customary to governmental insurance funds. The Industrial Insurance Fund refers to losses as "benefits" and loss adjustment expenses as "claims administration expenses." Any surplus remaining in the Fund is referred to as "contingency reserve."

1.B.1. Use of Estimates

The preparation of financial information in conformity with SAP requires management to make estimates and assumptions that affect the reported amounts of admitted assets, liabilities, and contingency reserve at the date of the financial information and the reported amounts of revenues and expenses during the reporting period. Material estimates that are susceptible to significant changes include benefit and claims administration liabilities, premium receivables, self-insurance receivables, retrospective rating adjustment liabilities, and accrued liabilities for other postemployment benefits. Actual results could differ materially from those estimates.

Management's estimates are based on its knowledge of and experience with past and current events and circumstances and its assumptions about conditions it expects will exist in the future. The most significant estimates made in these statutory financial statements are the benefit and claims administration liabilities at the date of the financial information. Factors relevant to the estimation of these liabilities include the estimation of the ultimate frequency and severity of losses, the level of inflation of future medical costs over long periods of time, the future legal environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed after the fiscal year-end by a nationally recognized, qualified consulting actuarial firm. The independent actuarial firm's opinion is included at the end of this report.

1.B.2. Differences between SAP and GAAP

The SAP followed by the Industrial Insurance Fund vary in some respects from Generally Accepted Accounting Principles (GAAP) promulgated by the Governmental Accounting Standards Board (GASB). Some of the most significant differences between SAP and GAAP are as follows:

- Investments in bonds are reported for SAP at amortized cost or market value based on their NAIC designation; for GAAP, investments in bonds are reported at fair value.

- For SAP, all mortgage-backed and other loan-backed securities are adjusted for the effects of changes in prepayment assumptions using the retrospective method, which equates the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased. Under GAAP, all mortgage-backed and other loan-backed securities are reported at fair value.

- SAP assets designated as *nonadmitted assets* are defined as “assets having economic value other than those which can be used to fulfill policyholder obligations and assets unavailable due to encumbrances or third party interests” and are excluded from total admitted assets. These assets consist primarily of premium receivables in collection that have been outstanding for over 90 days, office furniture, equipment, internally developed software, and prepaid expenses. Nonadmitted assets are charged against the contingency reserve, unless otherwise specifically addressed within the NAIC’s AP&P Manual. Under GAAP, premium receivables are presented net of allowance for doubtful accounts; furniture, equipment, and internally developed software are presented net of accumulated depreciation; and prepaid expenses are presented at full cost.

- SAP limits the aggregate amount of admitted electronic data processing equipment and operating system software, net of accumulated depreciation, to three percent of the reporting entity’s capital and surplus. Under GAAP, computer equipment and software purchases meeting the state’s capitalization criteria are recorded as assets, net of accumulated depreciation, with no limitations.

- The focus of SAP accounting is solvency; therefore, it is concerned with assets that can be used immediately to cover benefit liabilities. GAAP accounting is focused on “going concern,” which assumes that an entity has the ability to survive, and therefore, assets and liabilities are presented in the order of liquidity and classified as current and non-current.

- The Consolidated Statutory Statement of Operations and Changes in Contingency Reserve presents premiums earned and investment income as the primary revenue sources, and expenses are presented as activities. GAAP presentations separate operating income from investment income, since investment activity is not normally a primary revenue source. GAAP also presents expenses by character rather than by the purpose of the item purchased or service obtained and the net effect of revenues and expenses as a change in net position.

- Both SAP and GAAP require the statement of cash flows to be prepared using the direct method. However, the statutory statement of cash flows differs in certain aspects from the presentation required by GAAP. On the SAP Consolidated Statement of Cash Flows, "Cash Flows In" includes operating transfers and other income, and "Cash Flows Out" is categorized by benefits paid and administration expenses. The GAAP statement of cash flows includes a reconciliation between operating income from the statement of operations and cash flows from operating activities.

1.C. Significant Accounting Policies

1.C.1. Recognition of Premiums

Workers' compensation insurance premiums are determined by individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past loss experience. In addition to its regular premium plans, the Industrial Insurance Fund offers a Retrospective Rating Plan, under which an employer's premiums are adjusted annually for up to three years following the plan year, based on the employer's actual loss experience during those years.

Premiums are due within 30 days following each calendar quarter in which payroll hours are reported. Net premiums receivable reported in the financial statements is an actuarial estimate of the amount that will ultimately be collected for the two most recent quarters' uncollected premium balances. These actuarial estimates are based on past collection statistics, growth projection, observed development of premiums reported, statistical analysis, and other factors. All premium receivables exceeding 90 days in age are adjusted as nonadmitted assets in the current period and are not included in the net premiums receivable amount; however, collection efforts are continued until the premiums are collected or all legal means are exhausted.

According to SSAP No. 53, a premium deficiency reserve is recognized "…when the anticipated losses, loss adjustment expenses, and maintenance costs exceed the recorded unearned premium reserve and any future installment premiums on existing policies." Because the Industrial Insurance Fund has sufficient anticipated investment income and no unearned premium reserves or installment premium contracts, no premium deficiency reserve is recorded.

1.C.2. Benefit and Claims Administration Liabilities

The Industrial Insurance Fund establishes benefit and claims administration liabilities arising from its workers' compensation coverage based on estimates of the ultimate cost of benefits that have been reported but not resolved and claims that have been incurred but not reported. The length of time for which such costs must be estimated varies, depending on the type of benefit involved. Since actual claim costs depend on complex factors, such as inflation, changes in doctrines of legal liabilities, claims adjudication, and judgments, the actual ultimate claim costs may differ from the estimates.

Benefit and claims administration liabilities are recomputed quarterly using a variety of actuarial and statistical techniques. These techniques are used to produce current estimates that reflect recent settlements, claim frequency, expected inflation, and other economic, legal, and social factors. A provision for inflation in the calculation of estimated future benefits is implicit in the calculation, because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Future premium income is not offset against benefit liabilities, because benefit liabilities come from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay benefit and claims administration liabilities is not contingent upon any future premiums for future coverage periods.

Adjustments to benefit and claims administration liabilities are charged or credited to benefit and claims administration expenses in the periods in which they are made. Unpaid benefits and claims administration expenses include amounts based on past experience for claims development on reported claims and benefits incurred but not reported. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in the period affected.

Statement on Statutory Accounting Principle 2015-21, effective August 25, 2016, now requires that third party administrative costs be deducted from third party recoveries before reducing loss estimates. This statutory accounting principle change resulted from an NAIC effort to standardize accounting for third party administration costs. After research, it was determined that the change to the Industrial Insurance Fund was minimal, that this change would be difficult to implement, and that comparability with other entities would not be impacted. Thus, SSAP 2015-21 was not implemented. If SSAP 2015-21 were implemented, we estimate that claims administration expenses would be $1,000,000 lower and loss liabilities would be $1,000,000 higher.

1.C.3. Discounting Methodology

The Industrial Insurance Fund discounts benefit and claims administration expenses reserves to reflect the time value of money using an average discount rate of 3.35 percent. The amount of discount is based on actuarially derived projected payment patterns and selected annual interest rates. The Industrial Insurance Fund uses both tabular and non-tabular discounting. Non-tabular discounting is an accounting practice that departs from SSAP No. 65, as disclosed in 1.B. of this note. The bullets below discuss the discount method and rate applied to each discounted liability category:

- The benefit liabilities in the Pension Reserve Account are discounted on a tabular basis at 6.1 percent.

- Liabilities in the Accident Account for pensions incurred but not-yet-awarded are discounted using a combination of discount rates on both a tabular and non-tabular basis. The future total permanent disability and fatal transfers, on a tabular basis, made to the Pension Account assume a discount rate of 6.1 percent through the first quarter of fiscal year 2019 and 4.5 percent beginning on April 1, 2019. The transfer payments and all other liabilities are discounted on a non-tabular basis at 1.5 percent.

- All other Accident and Medical Aid Account benefit and claims administration liabilities are discounted on a non-tabular basis at 1.5 percent.

Per L&I policy, the non-pension discount rate is equal to the benchmark rate less the risk adjustment, rounded to the nearest one-half percentage point. The benchmark rate is the five-year moving average of the U.S. 20-Year Treasury yield. The risk adjustment equals two percentage points until the benchmark rate reaches 4.0 percent. Below 4.0 percent, the risk adjustment is half the benchmark rate.

1.C.4. Cash and Cash Equivalents

Cash includes cash in banks, cash on deposit with the Office of the State Treasurer (OST), and cash on hand. It also consists of cash equivalents invested by the OST that are short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value due to interest rate fluctuations. Under RCW 43.08.015, the OST has the statutory responsibility to ensure the effective cash management of state public funds. RCW 43.84.080 authorizes the Treasurer to invest available cash and includes a list of eligible investments. Effective for this fiscal year, SSAP No. 2R reclassified money market mutual funds, managed by the Washington State Investment Board (WSIB), to cash equivalents, which may be valued at either fair value or net asset value as a practical expedient. The Industrial Insurance Fund has elected to use the net asset value method.

1.C.5. Investments

The Industrial Insurance Fund uses the following accounting policies to value investments:

- Investment grade bonds are stated at amortized cost using the scientific interest method. Non-investment grade bonds with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC.

- Short-term investments are stated at amortized cost using the scientific interest method. Per SSAP No. 2, accounting for short-term investments should follow guidance for similar long-term investments (see discussion above on investment grade bonds). Therefore, any short-term bond premiums and discounts are amortized using the scientific interest method.

- Common stocks are stated at fair value.

- Investment grade mortgage-backed and other loan-backed securities are stated at amortized cost. Non-investment grade mortgage-backed and other loan-backed securities with NAIC designations of 3-6 are stated at the lower of amortized cost or fair value. Fair values are reported using pricing sources approved by the NAIC. In compliance with SSAP No. 43R, changes in currently estimated cash flows are reviewed quarterly using the State Street

Corporation's investment valuation model for prepayment assumptions in valuing mortgage-backed and other loan-backed securities. These securities are revalued using the retrospective adjustment method. (See Note 3.H. for other-than-temporary impairment analysis of mortgage-backed and other loan-backed securities.)

- Securities Lending Collateral—Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the Industrial Insurance Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are also reported in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. Securities lending transactions collateralized by securities that the Industrial Insurance Fund does not have the ability to pledge or sell unless the borrower defaults are not reported as assets or liabilities.

1.C.6. Infrequently Occurring Items and Other Disclosures

The U.S. Department of Energy has contracted with L&I to pay benefits to the Industrial Insurance Fund for workers injured on the job at the Hanford nuclear production complex. The Industrial Insurance Fund has received amounts, including trust cash and trust investments, in advance from the U.S. Department of Energy to cover the pension liability for these injured workers. These amounts are not reported in the financial statements.

As of June 30, 2018, trust cash amounted to $370,920 and is available to reimburse the Industrial Insurance Fund for monthly pension payments. There were no trust investments in fiscal year 2018. At June 30, 2017, trust cash was $653,905, and there were no trust investments.

1.C.7. Capital Assets

Capital assets are tangible or intangible assets held and used in the Industrial Insurance Fund's operations that have a service life of more than one year and meet the state's capitalization policy. In accordance with the Washington State Office of Financial Management's (OFM) policy, it is the Industrial Insurance Fund's policy to capitalize:

- All land

- Buildings, building improvements, improvements other than buildings, and leasehold improvements with a cost of $100,000 or greater

- All capital assets with a unit cost (including ancillary costs) of $5,000 or greater, unless otherwise noted

- Infrastructure with a cost of $100,000 or greater

- Intangible assets, either purchased or internally developed, with a cost of $1,000,000 or greater, that are "identifiable" by meeting either of the following conditions:

  - The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged; or

  - The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable

- All capital assets acquired with a Certificate of Participation

Capital assets are recorded at cost. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use. Normal maintenance and repair costs that do not materially add to the value or extend the life of capital assets are not capitalized. The cost and related accumulated depreciation of capital assets that have been disposed of are removed from the accounting records.

The value of assets constructed for use in the Industrial Insurance Fund includes all direct construction costs and indirect costs that are related to the construction. Net interest costs incurred during the period of construction, if material, are capitalized.

Depreciation and amortization expenses are calculated using the straight-line method over the estimated useful lives of the assets. Total depreciation and amortization expense for capital assets was $8.5 million and $9.9 million at June 30, 2018 and 2017, respectively.

Generally, estimated useful lives are as follows:

• Buildings and building components	5 to 50 years
• Furnishings, equipment, and collections	3 to 50 years
• Other improvements	3 to 50 years
• Infrastructure	20 to 50 years
• Intangible assets with definite useful lives	3 to 50 years

In accordance with SAP, not all capitalized assets are admitted for reporting purposes. Common examples of nonadmitted capital assets are equipment, furniture, and internally developed software. These nonadmitted assets are adjusted from the respective account's contingency reserve, and current purchases are immediately expensed. SSAP No. 16 allows electronic data processing (EDP) equipment and operating system software to be admitted, up to three percent of the contingency reserve. However, the Industrial Insurance Fund takes a more conservative approach and does not admit any EDP equipment or operating system software.

1.C.8. Risk Management

The state of Washington operates a Self-Insurance Liability Program pursuant to RCW 4.92.130. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state's management believes it is more economical to manage its risks internally and set aside assets for claims settlement in the Risk Management Fund, an internal service fund. Coverage is provided up to $10 million for each claim with no deductible. Commercial insurance is purchased for various liabilities and to limit the exposure to catastrophic losses. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past 10 fiscal years. Otherwise, the Self-Insurance Liability Program services all claims against the state for injuries and property damage to third parties.

The Industrial Insurance Fund participates in the state's Self-Insurance Liability Program, in proportion to its anticipated exposure to liability losses, to manage its various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters.

1.C.9. Subrogation Recoverables

The Industrial Insurance Fund evaluates the value of potential subrogation recoverable in determining the reserve for unpaid loss and loss adjustment expenses. The nature of the recoverable is such that the length of collections, coverage of the injured worker, and other parties with a bona fide claim vary greatly from case to case. For this reason, the Industrial Insurance Fund feels that although collections are probable they are not reasonably estimated and are not accrued within the financial statements.

Note 2 - Accounting and Reporting Changes

Reporting Changes

Effective for fiscal year 2018 reporting, the Industrial Insurance Fund adopted the following new standard issued by the National Association of Insurance Commissioners.

Statement on Statutory Accounting Principle (SSAP) 2R. This statement now requires that money market mutual funds registered under the Investment Company Act of 1940 and regulated under Rule 2a-7 of the Act, shall be accounted for at fair value and reported as cash equivalents for statutory accounting. In previous years, the money market mutual funds impacted by this change were included in short-term investments on the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve.

In order to implement this accounting change, Cash and Cash Equivalents were increased by $104,477,000 on the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve, and Short-Term Investments were decreased by the same amount. In addition, the Consolidated Statutory Statement of Cash Flows was revised to include the $104,477,000 of money market mutual funds that are now included in Cash and Cash Equivalents. This change had no impact on net income, total admitted assets, or the contingency reserve.

Effective for fiscal year 2018 reporting, the Industrial Insurance Fund followed the established permitted practice of recording the Other Post Employment Benefit (OPEB) liability recognized in the financial statements, prepared in accordance with the accounting principles established by the Governmental Accounting Standards Board (GASB). Although the Industrial Insurance Fund's Statutory Financial Statements are not subject to GASB guidance, given the basis for conservatism within statutory accounting principles, the Fund has elected to record a liability for OPEB (see Note 1).

GASB Statement No. 75. *Accounting and Financial Reporting for Postemployment Benefit Other Than Pensions.* This statement establishes standards of accounting and financial reporting for defined benefit OPEB and defined contributions OPEB that are provided to the employees of state and local governmental employers. GASB 75 included changes in methods and assumptions that actuaries must use in determining the OPEB valuation.

Implementing this change in estimated valuation in the statutory financial statements resulted in an increase of the OPEB liability and a decrease of the contingency reserve by $57,736,000. The change in valuation of the net OPEB liability is primarily due to the reduction in the amortization period. Previously, liabilities were amortized over 30 years; for fiscal year 2018, liabilities are amortized over nine years.

Note 3 - Investments

3.A. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship over the Industrial Insurance Fund's investments is vested in the voting members of the Washington State Investment Board (WSIB). The legislature established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, chapter 42.52 RCW, as it makes investment decisions and seeks to meet its investment objectives.

In accordance with RCW 43.33A.110, Industrial Insurance Fund investments are to be managed to limit fluctuations in the industrial insurance premiums and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the investment objectives are to:

- Maintain the solvency of the accounts
- Maintain premium rate stability
- Ensure sufficient assets are available to fund the expected liability payments
- Subject to the objectives above, achieve a maximum return at a prudent level of risk

The investment performance objectives are intended to provide the WSIB and the Industrial Insurance Fund with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost, the performance of the investment portfolios shall be judged relative to the investment objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each account. The CMIs are developed and calculated with the goal to construct a hypothetical passive portfolio, with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each Industrial Insurance Fund account. The return for each account's portfolio should not be significantly different from that of its CMI over the long-term.

Eligible Investments - Eligible investments are securities and deposits that are in accordance with the Industrial Insurance Fund's investment policy and chapter 43.33A RCW. Eligible investments include:

- U.S. equities
- International equities
- U.S. Treasuries and government agencies
- Credit bonds
- Mortgage-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices
- Asset-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices
- Commercial mortgage-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices
- Investment grade non-U.S. dollar bonds
- Real estate

Investment Policies and Restrictions

To meet stated objectives, investments of the Industrial Insurance Fund are subject to the following constraints:

- All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk, in accordance with RCW 43.33A.110 and RCW 43.33A.140.
- No corporate fixed income issue cost shall exceed three percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed six percent of the Fund's fair value at any time.

- Asset allocations will be reviewed every four years or sooner if there are significant changes in funding levels or the liability durations. Asset allocations per the June 2017 L&I asset investment policy are:

Asset Allocation Target and Ranges			
Account	Fixed Income	Equity	Real Estate
Accident Account	80% ±6	15% ±4	5% ±2
Pension Reserve Account	85% ±5	10% ±3	5% ±2
Medical Aid Account	75% ±7	20% ±5	5% ±2

- Assets will be rebalanced across asset classes when the fair value of the assets falls outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

The WSIB has elected a gradual implementation plan to reach the strategic asset allocation. During this implementation period, if real estate is above or below its target due to timing or illiquidity, fixed income will be used to offset the balance.

Equity - The benchmark and structure for global equities will be the Morgan Stanley Capital International (MSCI) All Country World Investable Market Index net with USA gross. The global equity portfolio will be passively managed in commingled index funds. The commingled fund managers may use futures for hedging or establishing a long position.

Fixed Income – It is the goal of the fixed income portfolios to match the target durations. The fixed income portfolios' required duration targets are to be reviewed every three years or sooner if there are significant changes in the funding levels or the liability durations.

Sector allocation of fixed income investments must be managed within the following prescribed ranges:

- U.S. Treasuries and government agencies — 5 to 25 percent
- Credit bonds — 20 to 80 percent
- Asset-backed securities — 0 to 10 percent
- Commercial mortgage-backed securities — 0 to 10 percent
- Mortgage-backed securities — 0 to 25 percent

These targets are long-term in nature. Deviations may occur in the short term as a result of interim market conditions; however, if a range is exceeded, the portfolios must be rebalanced to the target allocations as soon as it is practicable.

Total market value of below-investment-grade credit bonds, as defined by Bloomberg Barclays Family of Fixed Income Indices, shall not exceed five percent of the total market value of the funds. Although below-investment-grade mortgage-backed, asset-backed, and commercial mortgage-backed securities may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held. Total market value of below-investment-grade mortgage-backed, asset-backed, and commercial-mortgage-backed securities shall not exceed five percent of total market value of the funds.

Real Estate - The objectives and characteristics of the real estate portfolio are as follows:

- Generate a six percent annual investment return over a rolling 10-year period.
- The return will be generated by current income, and the portfolio will be intentionally constructed to focus on yield rather than total return.
- The portfolio will be diversified across geography and property type.
- The benchmark for the portfolio is a total net return of six percent measured over a rolling 10-year period.
- No more than 15 percent of the real estate portfolio will be invested in a single property after the program's build-out period.

3.B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. The risk is managed within the portfolios using *effective duration*, which is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Increases in prevailing interest rates generally translate into decreases in fair values of fixed income investments. The Industrial Insurance Fund does not have a formal policy specifically for interest rate risk.

As of June 30, 2018, the Industrial Insurance Fund's portfolio was within the duration targets below:

- Accident Account – within plus or minus 20 percent of an effective duration target of six years
- Medical Aid Account – within plus or minus 20 percent of an effective duration target of five years
- Pension Reserve Account – within plus or minus 20 percent of an effective duration target of eight years

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time, those differences should not be material.

3.C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Industrial Insurance Fund's investment policies limit the fixed income securities to investment grade or higher at the time of purchase. Investment grade securities are those fixed income securities with a Moody's rating of Aaa to Baa or a Standard and Poor's rating of AAA to BBB. The rated debt investments of the Industrial Insurance Fund as of June 30, 2018, were rated by Moody's and/or an equivalent national rating organization.

Concentration of Credit Risk - *Concentration of credit risk* is the risk of loss attributed to the magnitude of an investment in a single issuer. The Industrial Insurance Fund's policy states that the corporate fixed income issues cost shall not exceed three percent of the Fund's fair value at the time of purchase, nor shall its fair value exceed six percent of the Fund's fair value at any time. There was no concentration of credit risk as of June 30, 2018.

Custodial Credit Risk - *Custodial credit risk* is the risk that in the event a depository institution or counterparty fails, the Industrial Insurance Fund would not be able to recover the value of its deposits, investments, or collateral securities. As of June 30, 2018, investment securities (excluding cash, cash equivalents, and repurchase agreements held as securities lending collateral) are registered and held in the name of the WSIB for the benefit of the Industrial Insurance Fund and are not exposed to custodial credit risk. There are no general policies relating to custodial credit risk.

3.D. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Industrial Insurance Fund does not have a formal policy to limit foreign currency risk. The Industrial Insurance Fund had $1,017.7 million and $785.2 million invested in an international commingled equity index fund at June 30, 2018 and 2017, respectively. As such, no currency denomination risk is present at June 30, 2018.

3.E. Derivatives

To manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns, the Industrial Insurance Fund is authorized to utilize various derivative financial instruments, including collateralized mortgage obligations, financial futures, forward contracts, interest rate and equity swaps, and options.

Derivative transactions involve, to varying degrees, market and credit risk. The Industrial Insurance Fund mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained in an amount equal to the securities positions outstanding and, thereby, prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable. The only derivative securities held directly by the Industrial Insurance Fund were collateralized mortgage obligations (CMOs) of $683.3 million and $746.6 million at June 30, 2018 and 2017, respectively.

3.F. Reverse Repurchase Agreements

State law permits the Industrial Insurance Fund to enter into reverse repurchase agreements, i.e., a sale of securities with a simultaneous agreement to repurchase them in the future at the same price, plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the state or provide securities or cash of equal value, the Industrial Insurance Fund would suffer an economic loss equal to the difference between the fair value, plus accrued interest, of the underlying securities and the agreement obligation, including accrued interest. There were no reverse repurchase agreements during fiscal year 2018 or 2017, and there were no liabilities outstanding as of June 30, 2018 or 2017.

3.G. Wash Sales Transactions

Wash sales are any transfers that occur when an asset is sold and the proceeds are reinvested within 30 days in the same, or substantially the same, security. These transactions involve unrated securities or those with NAIC designations of 3 or below. Cash equivalents, derivative instruments, as well as short-term investments with credit assessments equivalent to an NAIC 1-2 designation, are excluded. A wash sale is generally a tax strategy, and since the Industrial Insurance Fund and WSIB are tax exempt, this strategy is not used.

3.H. Bonds

At June 30, 2018 and 2017, bonds and assets receiving bond treatment were comprised of U.S. government, other government, corporate, mortgage-backed, and other loan-backed securities, with an aggregate book adjusted carrying value (BACV) of $14,267,240,000 and $13,531,329,000 and fair value of $14,240,301,000 and $14,016,855,000, respectively, as shown in the following tables:

Book Adjusted Carrying Values and Fair Values
June 30, 2018
(in thousands)

	Book Adjusted Carrying Value	Fair Value Excess over BACV	BACV Excess over Fair Value	Fair Value
U.S. government obligations - excluding mortgage-backed securities	$ 2,250,227	$ 2,179	$ (80,778)	$ 2,171,628
All other government obligations	1,469,579	15,579	(24,521)	1,460,637
Mortgage-backed and other loan-backed securities	1,222,759	38,031	(29,652)	1,231,138
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	9,240,896	235,977	(185,168)	9,291,705
Hybrid securities	83,779	1,414	-	85,193
Total	$ 14,267,240	$ 293,180	$ (320,119)	$ 14,240,301

Book Adjusted Carrying Values and Fair Values
June 30, 2017
(in thousands)

	Book Adjusted Carrying Value	Fair Value Excess over BACV	BACV Excess over Fair Value	Fair Value
U.S. government obligations - excluding mortgage-backed securities	$ 2,445,223	$ 6,605	$ (41,994)	$ 2,409,834
All other government obligations	1,329,037	37,442	(4,937)	1,361,542
Mortgage-backed and other loan-backed securities	1,203,553	65,922	(9,668)	1,259,807
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	8,449,498	461,901	(33,452)	8,877,947
Hybrid securities	104,018	3,707	-	107,725
Total	$ 13,531,329	$ 575,577	$ (90,051)	$ 14,016,855

In compliance with SSAP No. 26, the following tables present the Industrial Insurance Fund's bond investments by type and by stated contractual maturity in years, and provide the BACV and fair value of bonds and assets receiving bond treatment, as reported in the Annual Statement Schedule D-Bonds, as of June 30, 2018 and 2017. Expected maturities may differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Schedule of Maturities
June 30, 2018
(in thousands)

Investment Type	Fair Value	Book Adjusted Carrying Value	Maturity: 1 year or less	Over 1 year through 5 years	Over 5 years through 10 years	Over 10 years
U.S. government obligations - excluding mortgage-backed securities	$ 2,171,628	$ 2,250,227	$ 379,952	$ 694,644	$ 790,897	$ 384,733
All other government obligations	1,460,637	1,469,579	154,953	913,178	277,739	123,709
Mortgage-backed and other loan-backed securities	1,231,138	1,222,759	144,398	521,579	406,678	150,104
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	9,291,705	9,240,896	694,679	3,589,860	2,585,146	2,371,211
Hybrid securities	85,193	83,779	-	74,835	8,944	-
Total	$ 14,240,301	$ 14,267,240	$ 1,373,982	$ 5,794,096	$ 4,069,405	$ 3,029,757

Schedule of Maturities
June 30, 2017
(in thousands)

Investment Type	Fair Value	Book Adjusted Carrying Value	Maturity: 1 year or less	Over 1 year through 5 years	Over 5 years through 10 years	Over 10 years
U.S. government obligations - excluding mortgage-backed securities	$ 2,409,834	$ 2,445,223	$ 300,039	$ 884,146	$ 844,432	$ 416,606
All other government obligations	1,361,542	1,329,037	51,992	823,816	300,147	153,082
Mortgage-backed and other loan-backed securities	1,259,807	1,203,553	169	65,199	90,116	1,048,069
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	8,877,947	8,449,498	190,943	3,326,317	2,644,141	2,288,097
Hybrid securities	107,725	104,018	-	55,092	48,926	-
Total	$ 14,016,855	$ 13,531,329	$ 543,143	$ 5,154,570	$ 3,927,762	$ 3,905,854

The following additional tables are included to summarize the different classes of investments held by the Industrial Insurance Fund, as they are rated by the NAIC. There were no securities with an NAIC designation higher than 5 at the fiscal years ended June 30, 2018 or 2017.

Fair Value of Securities by NAIC Designation
June 30, 2018
(in thousands)

	NAIC Designation 1	2	3	4	5	Total
U.S. government obligations - excluding mortgage-backed securities	$ 2,171,628	$ -	$ -	$ -	$ -	$ 2,171,628
All other government obligations	1,271,030	173,865	15,742	-	-	1,460,637
Mortgage-backed and other loan-backed securities	1,231,138	-	-	-	-	1,231,138
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	6,261,677	2,860,047	142,196	14,178	13,607	9,291,705
Hybrid securities	-	9,099	-	76,094	-	85,193
Total	$ 10,935,473	$ 3,043,011	$ 157,938	$ 90,272	$ 13,607	$ 14,240,301

Fair Value of Securities by NAIC Designation
June 30, 2017
(in thousands)

	NAIC Designation 1	2	3	4	5	Total
U.S. government obligations - excluding mortgage-backed securities	$ 2,409,834	$ -	$ -	$ -	$ -	$ 2,409,834
All other government obligations	1,171,732	142,160	47,650	-	-	1,361,542
Mortgage-backed and other loan-backed securities	1,259,807	-	-	-	-	1,259,807
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	5,659,467	3,006,669	181,527	12,915	17,369	8,877,947
Hybrid securities	20,103	9,584	78,038	-	-	107,725
Total	$ 10,520,943	$ 3,158,413	$ 307,215	$ 12,915	$ 17,369	$ 14,016,855

Gross unrealized losses on bonds, the fair value of the related bonds aggregated by investment category, and the length of time that individual bonds have been in a continuous unrealized loss position at June 30, 2018 and 2017, were as follows:

Bonds with Unrealized Losses
June 30, 2018
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government obligations - excluding mortgage-backed securities	$ 693,817	$ (24,946)	$ 1,258,975	$ (55,866)	$ 1,952,792	$ (80,812)
All other government obligations	990,183	(18,866)	173,654	(8,849)	1,163,837	(27,715)
Mortgage-backed and other loan-backed securities	439,458	(10,438)	331,620	(19,214)	771,078	(29,652)
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	5,305,148	(143,772)	702,303	(75,970)	6,007,451	(219,742)
Hybrid securities	-	-	-	-	-	-
Total	$ 7,428,606	$ (198,022)	$ 2,466,552	$ (159,899)	$ 9,895,158	$ (357,921)

Bonds with Unrealized Losses
June 30, 2017
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. government obligations - excluding mortgage-backed securities	$ 2,033,959	$ (42,254)	$ -	$ -	$ 2,033,959	$ (42,254)
All other government obligations	343,885	(4,240)	80,142	(7,762)	424,027	(12,002)
Mortgage-backed and other loan-backed securities	350,694	(8,853)	33,788	(815)	384,482	(9,668)
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	1,480,107	(26,592)	308,173	(40,924)	1,788,280	(67,516)
Hybrid securities	-	-	-	-	-	-
Total	$ 4,208,645	$ (81,939)	$ 422,103	$ (49,501)	$ 4,630,748	$ (131,440)

In compliance with SSAP No. 26, management has looked at all bonds in an unrealized loss position and used several categories of information to determine whether any impairment is other-than-temporary. The information considered included general market conditions, industry or company financial prospects, an issuer's fundamental credit difficulties, and the length of time and the extent to which the fair value had been below cost. Management has no intention of selling these securities and does not believe these impairments are other-than-temporary.

Similarly, in compliance with SSAP No. 43R, management has looked at mortgage-backed and other loan-backed securities with unrealized losses and has used several categories of information to determine whether any impairment is other-than-temporary. State Street Corporation's investment valuation model for prepayment assumptions and determining currently estimated cash flows in valuing mortgage-backed and other loan-backed securities was used. The factors that are considered include discounted cash flow on an investment, the length of time and amount of impairment, forecasts, market data, and financial condition of the issuer(s). As of June 30, 2018, no mortgage-backed or other loan-backed securities have been determined to be other-than-temporarily impaired.

The following tables summarize realized gains or losses of bonds that were redeemed or sold during fiscal years 2018 and 2017:

Bonds Redeemed or Sold
Fiscal Year 2018
(in thousands)

	Sales Proceeds	**Realized Gains**	**Realized Losses**	**Net Realized Gains (Losses)**
U.S. government obligations - excluding mortgage-backed securities	$ 564,669	$ -	$ (9,112)	$ (9,112)
All other government obligations	101,962	2,127	(2,065)	62
Mortgage-backed and other loan-backed securities	142,161	-	-	-
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	860,903	45,577	(3,210)	42,367
Hybrid securities	20,000	10	-	10
Total	$ 1,689,695	$ 47,714	$ (14,387)	$ 33,327

Bonds Redeemed or Sold
Fiscal Year 2017
(in thousands)

	Sales Proceeds	Realized Gains	Realized Losses	Net Realized Gains (Losses)
U.S. government obligations - excluding mortgage-backed securities	$ 300,812	$ 3,899	$ (1,186)	$ 2,713
All other government obligations	279,508	3,673	-	3,673
Mortgage-backed and other loan-backed securities	164,034	-	-	-
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	2,295,433	103,912	(8,914)	94,998
Hybrid securities	10,077	151	-	151
Total	$ 3,049,864	$ 111,635	$ (10,100)	$ 101,535

In compliance with SSAP No. 26, paragraph 20.l, the following tables show the details of the structured notes held by the Industrial Insurance Fund at June 30, 2018 and 2017:

Structured Notes
June 30, 2018
(in thousands)

CUSIP* Identification	Actual Cost	Fair Value	Book/Adjusted Carry Value	Mortgage-Referenced Security (Y/N)
24023KAD0	$ 40,000	$ 40,060	$ 40,000	N
50048MCB4	50,439	50,313	50,281	N
Total	$ 90,439	$ 90,373	$ 90,281	

*CUSIP: Number identifying all stocks and registered bonds, using the Committee on Uniform Securities Identification Procedures (CUSIP). The CUSIP number will be listed on any trading confirmation ticket and is the basis for identification of holdings for custodial systems.

Structured Notes
June 30, 2017
(in thousands)

CUSIP* Identification	Actual Cost	Fair Value	Book/Adjusted Carrying Value	Mortgage-Referenced Security (Y/N)
24023KAD0	$ 40,000	$ 40,077	$ 40,000	N
50048MCB4	50,439	50,409	50,419	N
Total	$ 90,439	$ 90,486	$ 90,419	

*CUSIP: Number identifying all stocks and registered bonds, using the Committee on Uniform Securities Identification Procedures (CUSIP). The CUSIP number will be listed on any trading confirmation ticket and is the basis for identification of holdings for custodial systems.

In compliance with SSAP No. 26 and SSAP No. 43R, bonds, including loan-backed and structured securities, may provide for a prepayment penalty or acceleration fee in the event the security is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received. The following table represents bonds, including loan-backed and structured securities, sold, redeemed, or otherwise disposed of during fiscal year 2018, as a result of a callable feature (including make-whole call provisions).

L&I had 11 bonds called during the year, eight of which included a prepayment penalty totaling $6,248,000 as summarized in the following table:

Prepayment Penalties and Acceleration Fees Fiscal Year 2018 (in thousands)		
Category	**Number of CUSIPs**	**Aggregate Amount of Investment Income**
Bonds Called	11	$ 6,248,000

Prepayment Penalties and Acceleration Fees Fiscal Year 2017 (in thousands)		
Category	**Number of CUSIPs**	**Aggregate Amount of Investment Income**
Bonds Called	8	$ 1,935,100

3.I. Common Stocks

The gross unrealized losses on common stocks, fair value of the common stocks, and length of time that individual common stocks had been in a continuous unrealized loss position at June 30, 2018 and 2017, were as follows:

Common Stocks with Unrealized Losses As of and For the Fiscal Year Ended June 30, 2018 (in thousands)						
	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Commingled index funds	$ 2,308,282	$ (7,410)	$ -	$ -	$ 2,308,282	$ (7,410)
Total	$ 2,308,282	$ (7,410)	$ -	$ -	$ 2,308,282	$ (7,410)

Common Stocks with Unrealized Losses As of and For the Fiscal Year Ended June 30, 2017 (in thousands)						
	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Commingled index funds	$ 1,672	$ (1)	$ 67,953	$ (5,055)	$ 69,625	$ (5,056)
Total	$ 1,672	$ (1)	$ 67,953	$ (5,055)	$ 69,625	$ (5,056)

In compliance with SSAP No. 30, management has looked at all commingled index funds in an unrealized loss position and used several categories of information to determine whether any impairment is other-than-temporary. The information considered for broad equity funds included general market conditions and prospects for the economy as a whole in the short term. Management has no intention of selling these commingled index funds and does not believe these impairments are other-than-temporary.

3.J. Restricted Assets

The following tables summarize restricted assets at June 30, 2018 and 2017:

Restricted Assets
June 30, 2018
(dollars in thousands)

Restricted Asset Category	Total General Account (G/A) Restricted Assets	Restricted G/A Assets Supporting S/A Activity	Total Separate Account (S/A) Restricted Assets	Restricted S/A Assets Supporting G/A Activity	Total Restricted	Total Assets	% Restricted to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Collateral held under security lending agreements	$ 98,853	$ -	$ -	$ -	$ 98,853	$ 98,853	100.00%	$ 17,723,527	0.56%

Restricted Assets
June 30, 2017
(dollars in thousands)

Restricted Asset Category	Total General Account (G/A) Restricted Assets	Restricted G/A Assets Supporting S/A Activity	Total Separate Account (S/A) Restricted Assets	Restricted S/A Assets Supporting G/A Activity	Total Restricted	Total Assets	% Restricted to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Collateral held under security lending agreements	$ 84,144	$ -	$ -	$ -	$ 84,144	$ 84,144	100.00%	$ 16,687,716	0.50%

The following tables summarize collateral at June 30, 2018 and 2017:

Collateral
June 30, 2018
(dollars in thousands)

Restricted Asset Category	Total General Account Collateral	G/A Collateral Supporting S/A Activity	Total Separate Account Collateral	S/A Collateral Supporting G/A Activity	Total Collateral	% Collateral to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Assets received as collateral for security lending agreements	$ 98,853	$ -	$ -	$ -	$ 98,853	100.00%	$ 17,723,527	0.56%
Liability to return collateral from security lending agreements	$ 98,853	$ -	$ -	$ -	$ 98,853	100.00%	$ 17,723,527	0.56%

Collateral
June 30, 2017
(dollars in thousands)

Restricted Asset Category	Total General Account Collateral	G/A Collateral Supporting S/A Activity	Total Separate Account Collateral	S/A Collateral Supporting G/A Activity	Total Collateral	% Collateral to Total Assets	Total Admitted Assets	% Restricted to Total Admitted Assets
Assets received as collateral for security lending agreements	$ 84,144	$ -	$ -	$ -	$ 84,144	100.00%	$ 16,687,716	0.50%
Liability to return collateral from security lending agreements	$ 84,144	$ -	$ -	$ -	$ 84,144	100.00%	$ 16,687,716	0.50%

Note 4 - Real Estate and Improvements

At June 30, 2018 and 2017, the Accident and Medical Aid Accounts admitted only land, buildings, and improvements, net of accumulated depreciation and encumbrances.

SSAP No. 40R requires that buildings more than 50 percent occupied by the reporting entity be categorized as a real estate investment and that depreciation and interest expense be classified as investment expenses. The building occupied by the Industrial Insurance Fund's employees was financed through general obligation bonds of the state of Washington. The balance on the bonds was paid in full on October 1, 2015. Due to indirect ownership by Labor and Industries, the land, building, and improvements are not shown as a real estate investment of the Industrial Insurance Fund. The related depreciation and interest expenses are allocated between administrative and non-insurance expenses based on percentage of use by employees.

Real Estate and Improvements
(in thousands)

	June 30, 2018	June 30, 2017
Land	$ 3,204	$ 3,204
Building occupied by Industrial Insurance Fund	65,134	65,134
Improvements, other than buildings	1,021	1,020
Encumbrances	-	-
Accumulated depreciation - building	(34,409)	(33,055)
Accumulated depreciation - improvements	(520)	(499)
Total	$ 34,430	$ 35,804

Note 5 - Investment Income

The Industrial Insurance Fund does not admit investment income due and accrued if amounts are over 90 days past due. As of June 30, 2018 and 2017, all investment income due and accrued prior to the 90 day cut-off period is presented below by security type:

Interest Income Admitted Due and Accrued
(in thousands)

	June 30, 2018	June 30, 2017
U.S. government obligations - excluding mortgage-backed securities	$ 9,765	$ 8,982
All other government obligations	9,955	10,178
Mortgage-backed and other loan-backed securities	4,009	4,189
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities	81,501	81,179
Hybrid securities	1,390	1,582
Other interest	362	175
Total	$ 106,982	$ 106,285

The following table provides details for net investment income by security type for the fiscal years ended June 30, 2018 and 2017:

Net Investment Income Earned (in thousands)				
		Fiscal Year 2018		**Fiscal Year 2017**
U.S. government obligations - excluding mortgage-backed securities	$	41,029	$	40,740
All other government obligations		31,236		34,288
Mortgage-backed and other loan-backed securities		45,320		47,144
Industrial and miscellaneous - excluding mortgage-backed and other loan-backed securities		354,297		349,563
Hybrid securities		4,724		5,419
Total Bond Interest		476,606		477,154
Equities dividends		820		917
Net securities lending income		484		272
Other interest and litigation income		4,587		1,370
Amortization		3,727		3,231
Gross investment income		486,224		482,944
Investment expenses		(5,177)		(4,814)
Total Net Investment Income Earned	$	481,047	$	478,130

Note 6 - Income Taxes

The Industrial Insurance Fund is exempt from federal income tax under the Internal Revenue Service Code sections 115 and 501(c)(27).

Note 7 - Related Party Transactions

L&I administers the state's Workers' Compensation Program, including the Industrial Insurance Fund. It is an agency of the state of Washington; therefore, other Washington State agencies are related parties. Certain goods and services, such as attorney general legal services, information technology services, facilities management, building security, and cash and investment management services, are provided to L&I by other state agencies.

Total expenses incurred for goods and services provided by other Washington State agencies were $53,709,855 in fiscal year 2018 and $50,551,038 in fiscal year 2017. During fiscal years 2018 and 2017, 87.9 percent and 88.4 percent, respectively, of the total related party expenses were paid to the Attorney General's Office, the Department of Enterprise Services, and Consolidated Technology Services. Balances due to other Washington State agencies were $7,523,399 and $5,608,736 at June 30, 2018 and 2017, respectively.

The Washington State Legislature and the Governor provide appropriation authority from the Industrial Insurance Fund for use by the following Washington State agencies:

- **Board of Industrial Insurance Appeals** - hears appeals of decisions made by L&I
- **University of Washington -** promotes health and minimizes occupational disease or injury through teaching, research, and service
- **Department of Health** - completes surveys and on-site investigations of farm worker housing
- **Health Care Authority** - assists with reviews to develop preferred prescription drug lists

Total operating expenses incurred by these agencies in the Industrial Insurance Fund were $29,328,087 and $28,330,223 in fiscal years 2018 and 2017, respectively.

The Industrial Insurance Fund also transfers expenses and cash between the Accident, Medical Aid, and Pension Reserve Accounts, as well as the Supplemental Pension and Second Injury Accounts from the Workers' Compensation Program.

Note 8 - Retirement Plans, Compensated Absences, Deferred Compensation Plan, and Other Postemployment Benefits

8.A. Retirement Plans

The Industrial Insurance Fund is administered by L&I, an agency of the state of Washington and part of the primary government. Industrial Insurance Fund employees participate in the Washington State Public Employees' Retirement System (PERS) administered by the Washington State Department of Retirement Systems (DRS) and a Higher Education Defined Contribution Retirement Plan, which is privately administered.

The PERS is a multiemployer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans, and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977, and by February 28, 2002, are Plan 2 members, unless they exercised an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002, have the irrevocable option of choosing membership in either Plan 2 or Plan 3.

PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Under the PERS rules, the employee and employer each contribute a percentage of the employee's compensation.

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Contribution requirements are established and amended by state statute. All employers are required to contribute at the level established by the Legislature. The methods used to determine the contribution requirements are established under state statute, in accordance with chapters 41.40 and 41.45 RCW.

The employer contribution rates for the Industrial Insurance Fund at June 30, 2018 and 2017, for each of Plans 1, 2, and 3 were 12.70 and 11.18 percent of the employee's annual covered salary, respectively. The Industrial Insurance Fund contributed $22,159,302 and $17,932,362 to the PERS during the fiscal years ended June 30, 2018 and 2017, respectively. The Industrial Insurance Fund's contribution was 1.5 percent of total employer contributions to the plans in fiscal years ended June 30, 2018 and 2017. The employer contribution rate from July 1, 2017, through August 31, 2018, and September 1, 2018, through June 30, 2019, has already been established by the legislature to be 12.70 percent and 12.83 percent, respectively, for each of Plans 1, 2, and 3.

Employee contribution rates for Plan 1 are established by statute at six percent for state agency employees. Contributions for Plan 2 members are determined by the aggregate method and may vary over time. The contribution rate for Plan 2 state agency employees for fiscal years ended June 30, 2018 and 2017, were 7.38 and 6.12 percent of the employee's annual covered salary, respectively. Under Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Director of the DRS sets Plan 3 employee contribution rate options. Members can choose from six rate options ranging from 5 to 15 percent. Two of the options are graduated rates dependent on the employee's age.

Additional information regarding the PERS may be obtained from the stand-alone financial report prepared by the DRS. A copy of the report may be obtained by contacting the Washington State Department of Retirement Systems, P.O. Box 48380, Olympia, WA 98504-8380 or online at http://www.drs.wa.gov/administration/annual-report.

The Higher Education Retirement Plans are privately administered single-employer defined contribution plans with a supplemental defined benefit plan component which guarantees a minimum retirement benefit based upon a one-time calculation at each employee's retirement date. The supplemental component is financed on a pay-as-you-go basis. State institutions of higher education make direct payments to qualifying retirees when the retirement benefits provided by the fund sponsors do not meet the benefit goals. No assets are accumulated in trusts or equivalent arrangements. The University of Washington employees paid from the Industrial Insurance Fund accounts are members of Higher Education Retirement Plans. The University of Washington promotes health and minimizes occupational disease or injury through teaching, research, and service for the Industrial Insurance Fund.

The state and regional universities, the state college, the state community and technical colleges and the Student Achievement Council each participated in a separate plan. As authorized by chapter 28B.10 RCW, the plans cover faculty and other positions as designated by each participating employer.

RCW 28B.10.400, et. seq. assigns the authority to establish and amend benefit provisions to the board of regents of the state universities, the boards of trustees of the regional universities and the state college, the state board for community and technical colleges, and the Student Achievement Council.

The Higher Education Supplemental Retirement Plans provide retirement, disability, and death benefits to eligible members.

As of July 1, 2011, all Higher Educational Retirement Plans were closed to new entrants.

Members are eligible to receive benefits under this plan at age 62 with 10 years of credited service. The supplemental benefit is a lifetime benefit equal to the amount a member's goal income exceeds their assumed income. The monthly goal income is one-twelfth of two percent of the member's average annual salary multiplied by the number of years of service (such product not to exceed one-twelfth of 50 percent of the member's average annual salary). The member's assumed income is an annuity benefit the retired member would receive from their defined contribution Retirement Plan benefit in the first month of retirement had they invested all employer and member contributions equally between fixed income and variable income annuity investments. Plan members have the option to retire early with reduced benefits.

The Industrial Insurance Fund's proportionate share of the collective pension liability for fiscal year ended June 30, 2018, was $110,866,518 for the plans in which its employees participate. The proportion is based on the Industrial Insurance Fund's contributions relative to the contributions of all participating employers. In accordance with SSAP No. 102, the unfunded status of the pension plan is not required to be recognized because it is considered a multiemployer plan; therefore, it has not been accrued in the State Fund's financials.

8.B. Compensated Absences

Industrial Insurance Fund employees accrue vested annual leave at a variable rate based on years of service. In general, accrued annual leave cannot exceed 240 hours at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested; i.e., the Industrial Insurance Fund does not pay employees for unused sick leave upon termination except upon employee death or retirement, at which time the Industrial Insurance Fund is liable for 25 percent of the employee's accumulated sick leave. In addition, the Industrial Insurance Fund has a "sick leave buyout option" in which, each January, employees who have accumulated sick leave in excess of 480 hours may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the Industrial Insurance Fund's policy to liquidate unpaid compensated absence balances outstanding at June 30 with future resources, rather than advance funding it with currently available expendable financial resources.

The Industrial Insurance Fund recognizes the expense and accrues a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits as applicable, as the leave is earned. The annual leave and sick leave accrued liability was $15,923,961 and $14,314,231 at June 30, 2018 and 2017, respectively.

8.C. Deferred Compensation Plan

Industrial Insurance Fund employees have the option to participate in the state of Washington's Deferred Compensation Plan (DCP). There are no contributions made on behalf of employees to the DCP by the Industrial Insurance Fund. The DRS administers the DCP and contracts with a third party (currently Empower Retirement) for recordkeeping and other administrative services. The WSIB selects and monitors DCP's investment options based on advice and recommendations provided by the Employee Retirement Benefits Board.

8.D. Other Postemployment Benefits

Employees of the Industrial Insurance Fund are eligible to participate in the state of Washington's defined benefit Other Postemployment Benefit (OPEB) plan, a multiemployer plan, as administered by the state through the Washington State Health Care Authority (HCA).

Plan Description and Funding Policy

Per RCW 41.05.065, the Public Employees Benefits Board (PEBB), created within the HCA, is authorized to design benefits and determine the terms and conditions of active employee and retired employee participation and coverage, including establishment of eligibility criteria for both active and retired employees. PEBB programs include medical, dental, life, and long-term disability insurance.

The relationship between the PEBB OPEB plan and its member employers and their employees and retirees is not formalized in a contract or plan document. Rather, the benefits are provided in accordance with a substantive plan in effect at the time of each valuation. A substantive plan is one in which the plan terms are understood by the employers and plan members. This understanding is based on communications between the HCA, employers and plan members, and the historical pattern of practice with regard to the sharing of benefit costs.

The PEBB retiree OPEB plan is available to employees who elect to continue coverage and pay the administratively established premiums at the time they retire, under the provisions of the retirement system to which they belong. Retirees' access to PEBB plans depends on the retirement eligibility of their respective retirement system. PEBB members are covered in the following retirement systems: Public Employees' Retirement System, Public Safety Employees' Retirement System, Teachers' Retirement System, School Employees' Retirement System, Washington State Patrol Retirement System, Higher Education Retirement Plan, Judicial Retirement System, and the Law Enforcement Officers' and Fire Fighters' Retirement System.

Per RCW 41.05.022, retirees who are not yet eligible for Medicare benefits may continue participation in the state's non-Medicare community-rated health insurance risk pool on a self-pay basis. Retirees in the non-Medicare risk pool receive an implicit subsidy. The implicit subsidy exists because retired members pay a premium based on the claims experience for active employees and other non-Medicare retirees. The subsidy is valued using the difference between the age-based claim costs and the premium. In calendar year 2017, the average weighted implicit subsidy was valued at $328 per adult unit per month, and in calendar year 2018, the average weighted implicit subsidy is projected to be $348 per adult unit per month.

Retirees who are enrolled in both Parts A and B of Medicare may participate in the state's Medicare community-rated health insurance risk pool. Medicare retirees receive an explicit subsidy in the form of reduced premiums. Annually, the HCA administrator recommends an amount for the next calendar year's explicit subsidy for inclusion in the Governor's budget. In calendar year 2017, the explicit subsidy was up to $150 per member per month, and it remained at up to $150 per member per month in calendar year 2018. This will increase in calendar year 2019 up to $168 per member per month.

Administrative costs, as well as implicit and explicit subsidies, are funded by required contributions from participating employers. The subsidies provide monetary assistance for medical benefits. Contributions are set each biennium as part of the budget process. The benefits are funded on a pay-as-you-go basis.

The plan has no investments or other assets. Accordingly, the PEBB OPEB plan is not reported in the financial statements of the state, nor is a separate financial report publicly available.

The Industrial Insurance Fund's proportionate share of the collective OPEB liability for fiscal years ended June 30, 2018, and June 30, 2017 were $129,271,000 and $63,456,000, respectively. The proportion is based on the Industrial Insurance Fund's contributions relative to the contributions of all participating employers. The Industrial Insurance Fund had OPEB expenses of $8,079,000 and $10,378,000 at June 30, 2018 and 2017, respectively.

A complete description of the funded status and actuarial assumptions of the state of Washington's OPEB plan is included in the Comprehensive Annual Financial Report for the state of Washington. A copy of this report may be obtained by contacting the Accounting Division of the Office of Financial Management at P.O. Box 43127, Olympia, Washington 98504-3127, or online at http://www.ofm.wa.gov/cafr.

Note 9 - Capital and Contingency Reserve

9.A. Capital

The Industrial Insurance Fund has no shares of stock authorized or outstanding.

9.B. Contingency Reserve

The contingency reserve represents net admitted assets available for financing ongoing operations and uncertainties not otherwise reserved. Changes in the contingency reserve are comprised of investment and insurance operating results.

For fiscal years 2018 and 2017, changes in the contingency reserve resulted from the following:

Industrial Insurance Fund Operating and Investment Results
(in thousands)

	Fiscal Year 2018	Fiscal Year 2017
Contingency Reserve, July 1	$ 2,971,764	$ 1,492,922
Unexpected Investment Results		
Actual unrealized and realized gains (losses)		
Fixed income: unrealized gains	4,934	42,251
Equities: unrealized gains	(817,876)	337,932
Fixed income: realized gains	33,327	101,535
Equities: realized gains	1,059,119	1,005
Total actual unrealized and realized gains (losses)	279,504	482,723
Less expected gains	(80,700)	(72,200)
Total Unexpected Investment Results	198,804	410,523
Unexpected Insurance Operation Results		
Development of prior years' loss and CAE liability	(202,366)	(835,344)
Development of prior years' retro refund liability	(30,336)	(4,494)
Premium adequacy	561,121	1,951,880
Nonadmitted asset results	(14,023)	(43,723)
Total Unexpected Insurance Operation Results	314,396	1,068,319
Change in contingency reserve	513,200	1,478,842
Contingency Reserve, June 30	$ 3,484,964	$ 2,971,764

The contingency reserve balances by account for fiscal years 2018 and 2017 were:

Contingency Reserve Balances by Account
(in thousands)

	Accident Account	Medical Aid Account	Pension Reserve Account	Total
Contingency Reserve, June 30, 2018	$ 1,286,621	$ 2,198,343	$ -	$ 3,484,964
Contingency Reserve, June 30, 2017	$ 1,339,171	$ 1,632,593	$ -	$ 2,971,764

9.C. Restricted Contingency Reserve

The Industrial Insurance Rainy Day Fund Account was established to help keep rates stable and meet the obligations of the industrial insurance statute, Title 51 RCW. RCW 51.44.023 was adopted during the 2011 Legislative Session, authorizing L&I to determine whether the assets of the Accident and Medical Aid Accounts combined are at least 10 percent but not more than 30 percent in excess of the funded liabilities and, if so, transfer any excess to the Industrial Insurance Rainy Day Fund Account. The funds set aside will be used to reduce a rate increase or aid businesses in recovering from or during economic recessions.

Based on June 30, 2018, statutory financial information, the combined contingency reserve of $3,484,964,000 exceeded 10 percent of liabilities by $2,070,993,000. After removing the June 30, 2018, restricted contingency reserve balance of $1,600,754,000, an additional $470,239,000 may be restricted during fiscal year 2019. Based on the June 30, 2018, Statutory Financial Information Report for the Industrial Insurance Fund, the combined contingency reserve is 24.65 percent of total liabilities.

Note 10 - Commitments and Contingencies

10.A. Commitments

Effective July 1, 1992, the Washington State Legislature required the Industrial Insurance Fund, under RCW 48.22.070, to participate in an assigned risk pool providing workers' compensation coverage under the United States Longshoreman and Harbor Workers' Act. The Industrial Insurance Fund is obligated to participate 50 percent in the underwriting losses or surpluses of the assigned risk pool. This participation is scheduled to continue indefinitely, due to amending legislation passed in 1997. In the history of this program, no assessments or distributions have been declared since enactment of this indefinite commitment.

10.B. Contingencies

The Industrial Insurance Fund is party to numerous routine legal proceedings that normally occur in operations. At any given point, there may be numerous lawsuits that could financially impact the Fund. Although the outcome of these lawsuits is not currently determinable, the resolution of these matters is not likely to have a material impact on the Fund's financial position, revenues, or expenses.

10.C. Current Litigation

The Industrial Insurance Fund has received a demand for certain funds under its Retrospective Rating Program. The dispute is proceeding through the statutory appeals process at the Board of Industrial Insurance Appeals under Title 51 RCW. Management believes the claim is without merit and intends to vigorously defend its position. No amounts are reflected in the statutory financial statements, as the cost of defense or result of the dispute is not probable or reasonably determinable at this time.

10.D. Exposure

The lack of diversity of exposure by line of business and by state could be a risk factor for benefit liability and claims administration expenses (CAE) reserves. By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the

Fund's benefit liability and CAE reserves. Such trends would include legislative changes to benefit levels that may have an effect on all open workers' compensation claims.

Note 11 - Leases

The Industrial Insurance Fund leases office facilities, office and computer equipment, and other assets under a variety of operating lease agreements. Although lease terms vary, most leases are subject to appropriation from the State Legislature to continue the obligation. Since the possibility of not receiving funding from the Legislature is remote, leases are considered non-cancelable for financial reporting purposes. Certain operating leases are renewable for specified periods. Management expects the leases to be renewed or replaced by other leases.

The total operating lease expenses for fiscal years 2018 and 2017 were $12,294,955 and $10,965,191, respectively. There are no contingent rental payments or unusual renewal options, escalation clauses or restrictions. In addition, there was an increase of $3,170 in one month's lease payment due to the theft of two laptops. Certain rental commitments have renewal options extending through the year 2023. Some of these renewals are subject to adjustments in future periods.

The following table presents future minimum payments for operating leases as of June 30, 2018:

Future Minimum Payments for Operating Leases
June 30, 2018

Fiscal Year Ended June 30,	Accident Account	Medical Aid Account	Total
2019	$ 4,180,595	$ 3,931,034	$ 8,111,629
2020	3,118,783	3,077,637	6,196,420
2021	2,272,498	2,244,237	4,516,735
2022	1,143,393	1,126,009	2,269,402
2023	475,567	466,721	942,288
Total Future Minimum Lease Payments	$ 11,190,836	$ 10,845,638	$ 22,036,474

Note 12 - Sale, Transfer, and Servicing of Financial Assets and Extinguishments of Liabilities

Securities Lending

The Industrial Insurance Fund participates in securities lending programs with the Washington State Investment Board (WSIB) and the Office of the State Treasurer (OST) to increase investment income. At June 30, 2018, the Industrial Insurance Fund had $98,853,086 of cash collateral received through the WSIB in the Accident, Medical Aid, and Pension Reserve Accounts.

Securities Lending – Washington State Investment Board

Washington State law and WSIB policy permit the Industrial Insurance Fund to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation to act as agent for the WSIB in securities lending transactions. As State Street Corporation is the custodian bank for the WSIB, it is counterparty to securities lending transactions.

Debt securities were loaned and collateralized by the Industrial Insurance Fund's agent with cash and U.S. government or U.S. agency securities, including U.S. agency mortgage-backed securities (exclusive of letters of credit). When the loaned securities had collateral denominated in the same currency, the collateral requirement was 102 percent of the fair value, including accrued interest, of the securities loaned. All other securities were required to be collateralized at 105 percent of the fair value, including accrued interest of the loaned securities.

During fiscal years 2018 and 2017, securities lending transactions could be terminated on demand by either the Industrial Insurance Fund or the borrower. At June 30, 2018 and 2017, the cash collateral held had an average duration of 16.2 days and 19.1 days, and an average weighted final maturity of 79.0 days and 62.6 days, respectively. Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. To provide liquidity to manage those mismatches, State Street Corporation is required to reinvest no less than the targeted 20 percent of the cash collateral received in the overnight maturities to ensure sufficient liquidity available for the return of collateral to borrowers within the ordinary course of business. In the event that loans are returned beyond what is expected in the ordinary course of business, State Street Corporation would be allowed to sell investments at its discretion and in accordance with the investment guidelines of the cash collateral account.

No more than 20 percent of the total on-loan value can be held by a specific borrower. Collateral investment guidelines specifically prohibit European-domiciled holdings. There are no restrictions on the amount of securities that can be lent. Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. State Street Corporation indemnified the Industrial Insurance Fund by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. State Street Corporation's responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During fiscal years 2018 and 2017, there were no significant violations of legal or contractual provisions and no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Industrial Insurance Fund incurred no losses during fiscal years 2018 or 2017 resulting from a default by either the borrowers or the securities lending agents.

At June 30, 2018 and 2017, total collateral held was $353,065,205 and $501,578,993, and fair value of securities on loan were $347,051,376 and $490,824,972, respectively.

The market value of cash collateral assets at June 30, 2018 and 2017, was $98,853,086 and $84,009,486, respectively. The following tables provide information regarding cash collateral assets:

Cash Collateral Held Under Securities Lending
June 30, 2018
(in thousands)

	NAIC Designation	Book Adjusted Carrying Value	Level 2 Fair Value	Maturity Date: Under 30 days	30 - 59 days	60 - 89 days	90 - 119 days	120 - 179 days	180 days - less than 1 year	1 - 2 years
Cash and cash equivalents	1	$ 7,445	$ 7,445	$ 3,617	$ -	$ 1,196	$ -	$ 2,034	$ 598	$ -
Commercial paper	1	29,173	29,182	3,349	4,786	2,387	5,616	4,187	8,857	-
Repurchase Agreements	2	8,732	8,732	8,732	-	-	-	-	-	-
Repurchase Agreements	Not Rated	14,473	14,473	14,473	-	-	-	-	-	-
Yankee CDs	1	33,288	33,298	6,819	6,138	5,984	3,948	7,179	3,230	-
Corporate	1	1,196	1,196	-	-	-	1,196	-	-	-
Bank and promissory notes	1	4,527	4,527	1,555	-	-	1,196	341	1,435	-
Total Cash Collateral Held		$ 98,834	$ 98,853	$ 38,545	$ 10,924	$ 9,567	$ 11,956	$ 13,741	$ 14,120	$ -

Cash Collateral Held Under Securities Lending
June 30, 2017
(in thousands)

	NAIC Designation	Book Adjusted Carrying Value	Level 2 Fair Value	Maturity Date: Under 30 days	30 - 59 days	60 - 89 days	90 - 119 days	120 - 179 days	180 days - less than 1 year	1 - 2 years
Cash and cash equivalents	1	$ 9,023	$ 9,024	$ 2,585	$ 2,575	$ 921	$ 2,943	$ -	$ -	$ -
Commercial paper	1	18,752	18,759	6,893	2,297	1,379	460	-	7,730	-
Repurchase Agreements	2	13,333	13,333	13,333	-	-	-	-	-	-
Repurchase Agreements	Not Rated	23,458	23,458	23,458	-	-	-	-	-	-
Yankee CDs	1	15,291	15,297	2,299	4,139	1,840	920	2,760	1,841	1,498
Corporate	1	920	920	-	920	-	-	-	-	-
Bank and promissory notes	1	3,218	3,218	919	-	-	184	2,115	-	-
Total Cash Collateral Held		$ 83,995	$ 84,009	$ 49,487	$ 9,931	$ 4,140	$ 4,507	$ 4,875	$ 9,571	$ 1,498

Non-cash collateral cannot be pledged or sold absent borrower default. Accordingly, non-cash collateral held under securities lending contracts with a value of $254,212,119 at June 30, 2018, and $417,569,507 at June 30, 2017, has not been included in the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve. Net earnings received through the securities lending program were $483,835 for fiscal year 2018 and $272,313 for fiscal year 2017.

Securities Lending – Office of the State Treasurer

State statutes permit the OST to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The OST has contracted with Northern Trust Company as a lending agent and receives a share of income from this activity. The lending agent lends U.S. government and U.S. agency securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent.

Cash is invested by the lending agent in repurchase agreements, deposit accounts, or money market instruments, in accordance with investment guidelines approved by the OST. The securities held as collateral and the securities underlying the cash collateral are held by the custodian. One option available to the lending agent is to invest cash collateral into an OST account in the Local Government Investment Pool (LGIP). The LGIP portfolio is invested in a manner that meets the requirements set forth by the Governmental Accounting Standards Board for the external investment pools that wish to measure all of its investments at amortized costs. The funds are limited to high quality obligations with regulated maximum average maturities, the effect of which is to minimize both market and credit risk. The LGIP transacts with its participants at a stable net asset value per share of one dollar, which results in the amortized cost reported equaling the number of shares in the LGIP. During fiscal year 2018, cash received as collateral was invested in the LGIP money market fund, which allow withdrawals each business day to cover maturing loans. There was no cash collateral from securities lending as of June 30, 2018. At June 30, 2017, the Industrial Insurance Fund's cash collateral totaled $134,750, all of which was invested in the LGIP.

Contracts require the lending agent to indemnify the OST if the borrowers fail to return securities and if the collateral is inadequate to replace the securities lent, or if the borrower fails to pay the OST for income distribution by the securities' issuers while the securities are on loan. The OST cannot pledge or sell collateral securities received unless the borrower defaults. At June 30, 2018, the fair value of securities on loan for the Industrial Insurance Fund totaled $314,571. At June 30, 2017, the fair value of securities on loan was $131,479.

The OST investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the OST. During fiscal years 2018 and 2017, the OST had no credit risk exposure to borrowers, because the amounts owed to the borrowers exceeded the amounts the borrowers owed to the OST.

There were no violations of legal or contractual provisions or any losses resulting from a default of a borrower or lending agent during the fiscal year.

Note 13 - Fair Value Measures

The Industrial Insurance Fund has categorized its investments that are reported on the Consolidated Statutory Statement of Admitted Assets, Liabilities, and Contingency Reserve at fair value into a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value per SSAP No. 100—Fair Value Measurements. The three-level hierarchy is based on the degree of subjectivity inherent in the valuation method by which fair value was determined. The three levels are defined as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities

- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities

- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value:

- Industrial and miscellaneous bonds - value is based on market values approved by the NAIC

- Equities – value is based on the underlying equity

- Other invested assets – value is based on the underlying equity

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of the future fair values. The Industrial Insurance Fund has determined that its valuation methods are appropriate and consistent with other market participants; however, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following tables present the financial instruments related to the Industrial Insurance Fund's assets carried at fair value as of June 30, 2018 and 2017, by the SSAP No. 100 valuation hierarchy. Because net asset value (NAV) is more readily available, The Industrial Insurance Fund elects to use NAV for all of its money market mutual funds.

Investment Assets Carried at Fair Value
June 30, 2018
(in thousands)

	Level 1	Level 2	Level 3	Total	Net Asset Value (NAV) included in Level 2
Fixed income	$ -	$ 154,455	$ -	$ 154,455	$ -
Equities	-	2,308,282	-	2,308,282	-
Money Market Mutual Funds	-	104,477	-	104,477	104,477
Total	$ -	$ 2,567,214	$ -	$ 2,567,214	$ 104,477

Investment Assets Carried at Fair Value
June 30, 2017
(in thousands)

	Level 1	Level 2	Level 3	Total
Fixed income	$ -	$ 332,564	$ -	$ 332,564
Equities	-	2,106,217	-	2,106,217
Total	$ -	$ 2,438,781	$ -	$ 2,438,781

Only bonds with an NAIC designation of 3-6 and a fair value lower than the book adjusted value are carried at fair value on the financial statements. On June 30, 2018, there were 11 bonds in this category, with fair values totaling $154,455,000. On June 30, 2017, there were 18 bonds in this category, with fair values totaling $332,564,000.

At the end of each reporting period, the Industrial Insurance Fund evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. This policy also applies to transfers into or out of Level 3. During the current year, no transfers between Levels 1, 2, or 3 were required.

The fair values of bonds categorized as Level 2 were valued using a market approach. These valuations were determined to be Level 2 valuations, as quoted markets prices for similar instruments in an active market were utilized. This was accomplished by the use of matrix pricing. Matrix pricing takes quoted prices of bonds with similar features and applies analytic methods to determine the fair value of bonds held.

The following tables reflect the fair values and admitted values of all admitted assets and liabilities. The fair values are also categorized into the three-level fair value hierarchy, as described above. Because NAV is more readily available, the Industrial Insurance Fund elects to use NAV for all of its money market mutual funds.

Investment Assets at Fair Value
June 30, 2018
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total	Net Asset Value (NAV) Included in Level 2
Fixed income	$ 14,240,301	$ 14,267,240	$ -	$ 14,240,301	$ -	$ 14,240,301	$ -
Equities	2,308,282	2,308,282	-	2,308,282	-	2,308,282	-
Cash, cash equivalents and short-term invesments	117,069	117,069	12,592	104,477	-	117,069	104,477
Total	$ 16,665,652	$ 16,692,591	$ 12,592	$ 16,653,060	$ -	$ 16,665,652	$ 104,477

Investment Assets at Fair Value
June 30, 2017
(in thousands)

	Fair Value	Admitted Value	Level 1	Level 2	Level 3	Total
Fixed income	$ 14,016,855	$ 13,531,329	$ -	$ 14,016,855	$ -	$ 14,016,855
Equities	2,106,217	2,106,217	-	2,106,217	-	2,106,217
Short-term investments	167,557	167,557	-	167,557	-	167,557
Total	$ 16,290,629	$ 15,805,103	$ -	$ 16,290,629	$ -	$ 16,290,629

Note 14 - Subsequent Events

For the annual Statutory Financial Information Report as of June 30, 2018, an analysis of subsequent events has been evaluated through the report issuance date of November 27, 2018. The events described below existed after June 30, 2018.

14.A. Discount Rate Change

Due to its materiality, a liability for the reduction in the State Fund pension discount rate from 6.1 to 4.5 percent, occurring in fiscal year 2019, was incorporated in the financials presented as of June 30, 2018. The pension discount rate reduction increased the Pension Reserve liability estimate by $553.9 million for fiscal year 2018 (see note 16).

14.B. Proposed Rate Announcement

Each year, the Director of L&I adopts new workers' compensation insurance premium rates for the next calendar year. On September 19, 2018, the Director announced a proposed five percent decrease in the average premium rate for 2019. This rate decrease will reduce the overall hourly rate from $0.675 to $0.641, or $0.034 per hour, which equates to an average cost reduction of $64.50 per year per employee. Decreases in work-related injuries, along with agency initiatives to improve outcomes for injured workers and reduce costs, have made the system healthier and are contributing to the proposed decrease.

The final rates will be adopted in early December 2018 and go into effect on January 1, 2019.

14.C. Restricted Contingency Reserve in the Medical Aid Account

RCW 51.44.023 was enacted during the 2011 Legislative session, creating an Industrial Insurance Rainy Day Fund Account to hold transfers from the Accident and Medical Aid Accounts when assets for those accounts combined are between 10 and 30 percent of total liabilities for the Industrial Insurance Fund. Money from the Industrial Insurance Rainy Day Fund Account should be applied to reduce a future rate increase or aid businesses in recovering from or during economic recessions. Based on the June 30, 2018, Statutory Financial Information Report for the Industrial Insurance Fund, the combined contingency reserve is 24.65 percent of total liabilities. As a part of the 2019 rate-making process, the Director will determine the timing and additional amount to be restricted in the contingency reserve balance.

Note 15 - Retrospectively-Rated Contracts and Contracts Subject to Redetermination

15.A. Method Used to Estimate

The Industrial Insurance Fund estimates accrued retrospective premium annual adjustments for unadjusted enrollment periods by reviewing historical participation and return patterns. The historical averages are used to arrive at an estimate of net retrospective return premiums for unadjusted periods. Cumulative return premiums for periods from the first annual adjustment through the third annual adjustment are system-generated, and the accruals are the difference between the cumulative returns and the amount already returned. The third annual retrospective adjustment is final.

15.B. Method Used to Record

Retrospective return premiums due to employers are netted with additional premiums due from employers and recorded as a liability.

15.C. Amount and Percent of Net Retrospective Premiums

Net premiums for the fiscal year ended June 30, 2018, on retrospectively rated workers' compensation policies were $1,044.2 million, which were 46 percent of total workers' compensation net standard premiums earned. The net premiums for fiscal year ended June 30, 2017, on retrospectively rated workers' compensation policies were $918.0 million, which were 40 percent of total workers' compensation net standard premiums earned for that year.

15.D. Calculation of Nonadmitted Retrospective Premiums

Retrospective additional premiums 90 days past due after the third annual retrospective adjustment are nonadmitted.

Note 16 - Changes in Benefit and Claims Administration Liabilities

The following schedule presents the changes in benefit and claims administration liabilities for the fiscal years ended June 30, 2018 and 2017, for the Industrial Insurance Fund:

Changes in Benefit and Claims Administration Liabilities (in thousands)	Fiscal Year 2018	Fiscal Year 2017
Unpaid benefit and claims administration liabilities, July 1	$ 13,345,974	$ 13,600,704
Incurred benefit and claims administration liabilities		
Provision for insured events of the current year	1,799,568	1,777,313
Increase in provision for insured events of prior years	415,001	(271,904)
Total incurred benefit and claims administration liabilities	2,214,569	1,505,409
Less payments		
Benefit and claims administration liabilities attributable to		
Insured events of the current year	(325,934)	(309,490)
Insured events of prior years	(1,468,483)	(1,450,649)
Total payments	(1,794,417)	(1,760,139)
Unpaid benefit and claims administration liabilities, June 30	$ 13,766,126	$ 13,345,974
Current portion	$ 1,640,003	$ 1,492,438
Long-term portion	$ 12,126,123	$ 11,853,536

It is expected that benefit and claims administration liabilities will change every year due to normal activities, such as adding the insured events of the current year, discounting existing liabilities, and paying claims. Benefit and claims administration liabilities also changed due to increases of $415.0 million in provisions for insured events of prior years, mostly due to increases of $617.4 million in the mixed discount accretion and $36.9 million for the change in discount rate, offset by $239.3 million of net favorable development on prior years. The main reasons for the net favorable development are a reduction in the number of active time-loss claims, reductions in permanent partial disability awards, and lower-than-anticipated medical payments.

The significant methodologies and assumptions used in calculating the liability for unpaid claims and claims administration expenses include decreasing the pension discount rate, which resulted in a net increase of prior year liabilities. Management is moving to align the current discount rate with the expected market portfolio. Per statute, the discount rate is established at the discretion of the Director, and the industry standard is to align the applied discount rate with the expected return on investments. The targeted rate of 4.5 percent, for the State Fund, is to be adopted during the 2019 fiscal year. Management analyzes portfolio performance and deems the currently established discount rate to be reasonable.

During fiscal year 2018, the pension discount rate was reduced from 6.2 to 6.1 percent for the State Fund and Self-Insurance Program. Additional liability has also been accrued to reduce the pension discount rate from 6.1 to 4.5 percent in fiscal year 2019 for the State Fund. These pension discount rate reductions increased the Pension Reserve liability estimate by $645.9 million for fiscal year 2018.

The following table shows the significant changes to methodologies and assumptions used in calculating the liability for unpaid claims and claim administration expense:

Estimated Benefit and Claims Administration Liability
Methodology Change
Fiscal Year 2018
(in thousands)

Change	**Impact to Benefit Liabilities and CAE**
Pension discount rate change from 6.2% to 6.1%	$ 28,532
Pension discount rate change from 6.1% to 4.5%	
On pensions not yet granted	63,554
On pensions already granted	553,902
Total Impact	$ 645,988

At June 30, 2018 and 2017, $21,199 million and $21,222 million of unpaid benefit and claims administration liabilities are shown at their net present and settlement value of $13,766 million and $13,346 million, respectively. In the Accident Account, liabilities for pensions incurred but not-yet-awarded are discounted on both a tabular and non-tabular basis. For each future pension award, the estimated future pension payments are discounted from the anticipated payment dates back to the anticipated date of the pension award on a tabular basis from 4.5 to 6.1 percent. The payments are then discounted from the anticipated date of the pension award back to the evaluation date, on a non-tabular basis, at 1.5 percent. For more information on discounting, see Note 1.C.3.

All other Accident and Medical Aid Account benefits and claims administration liabilities are discounted at 1.5 percent. The benefit liabilities in the Pension Reserve Account are discounted at 6.1 percent. The difference between the Pension Account benefit liabilities for State Fund claims discounted at 6.1% and those liabilities discounted at 4.5% is carried as an additional benefit liability in the Accident Account, anticipating the future change to the State Fund pension discount rate to 4.5% in April 2019 for pensions already granted.

Benefit Liability Development by Program
June 30, 2018
(dollars in thousands)

Program/Category	**Undiscounted Liabilities**	**Discount Rate**	**Benefit Liabilities**
Accident	$ 7,265,999	1.5%, 4.5%-6.1%	$ 4,433,090
Medical Aid	4,560,082	1.5%	3,451,623
Pensions	8,626,283	6.1%	5,207,095
Total Benefit Liability	20,452,364		13,091,808
Claim Administration Expense (CAE)	746,227	1.5%	674,318
Total Benefit and CAE Liabilities	$ 21,198,591		$ 13,766,126

Benefit Liability Development by Program June 30, 2017 (dollars in thousands)			
Program/Category	**Undiscounted Liabilities**	**Discount Rate**	**Benefit Liabilities**
Accident	$ 7,022,225	1.5%, 4.5%-6.2%	$ 4,458,296
Medical Aid	5,005,931	1.5%	3,741,791
Pensions	8,506,791	6.2%	4,526,645
Total Benefit Liability	20,534,947		12,726,732
Claim Administration Expense (CAE)	687,214	1.5%	619,242
Total Benefit and CAE Liabilities	$ 21,222,161		$ 13,345,974

Note 17 - Discounting of Liabilities for Unpaid Benefits or Unpaid Claims Administration Expenses

The case reserves shown in this exhibit are the reserves for pensions awarded through June 30, 2018, only. The Industrial Insurance Fund estimates case reserves on certain other individual claims solely for the purpose of classification rating, retrospective rating, and experience rating. Such case reserves are not maintained on claims that do not enter the rating calculations, so they are not meaningful for claims less than approximately 18 months old or more than approximately seven years old.

17.A. Tabular Discounts

The mortality tables are based on a 2014 study of Industrial Insurance Fund claimant data and the 2000 U.S. Census data. The liabilities for pensions already granted are discounted at 6.1 percent per annum. The liabilities for pensions incurred but not yet granted are discounted at rates of 4.5 percent and 6.1 percent, reflecting the pension discount rates anticipated to be in effect when the pensions are granted. The June 30, 2018, liabilities include $7,758,176,000 of such reserves, net of tabular discounts. The amount of the tabular discount for case reserves (i.e., pensions already granted) is $3,419,188,000 and is $2,492,692,000 for incurred but not reported (IBNR) reserves at June 30, 2018.

At June 30, 2017, the liabilities, net of tabular discounts, amounted to $7,070,549,000. The amount of the tabular discount for case reserves was $3,980,146,000 and was $2,211,026,000 for IBNR reserves. Tabular discount accretion increased the fiscal year 2018 benefits incurred by $11,785,000.

Liabilities Discounted on a Tabular Basis*
June 30, 2018
(in thousands)

Fiscal Accident Year	Undiscounted Benefit Liabilities Gross of Tabular Discounts	Tabular Discounts** Case	Tabular Discounts** IBNR	Benefit Liabilities Net of Tabular Discounts
2008 & Prior	$ 7,464,662	$ 2,556,621	$ 430,553	$ 4,477,488
2009	681,143	193,402	118,348	369,393
2010	605,887	167,248	116,414	322,225
2011	578,576	139,408	133,794	305,374
2012	542,593	116,115	141,543	284,935
2013	568,475	83,397	187,412	297,666
2014	610,010	71,350	222,595	316,065
2015	565,165	42,028	233,667	289,470
2016	611,092	22,965	272,367	315,760
2017	696,324	15,094	306,051	375,179
2018	746,129	11,560	329,948	404,621
Total	$ 13,670,056	$ 3,419,188	$ 2,492,692	$ 7,758,176

*Includes liabilities for pensions already granted and pensions incurred but not yet granted.

**The amount of interest accretion from tabular discounts included in benefits incurred and claims administration expense incurred in the Consolidated Statutory Statement of Operations and Changes in Contingency Reserve was $281,366,000 and $0, respectively.

Liabilities Discounted on a Tabular Basis*
June 30, 2017
(in thousands)

Fiscal Accident Year	Undiscounted Benefit Liabilities Gross of Tabular Discounts	Tabular Discounts** Case	Tabular Discounts** IBNR	Benefit Liabilities Net of Tabular Discounts
2007 & Prior	$ 7,080,455	$ 2,879,744	$ 368,465	$ 3,832,246
2008	765,520	256,218	129,551	379,751
2009	687,437	214,100	133,411	339,926
2010	611,456	184,301	127,663	299,492
2011	573,526	144,254	145,395	283,877
2012	539,985	114,826	155,186	269,973
2013	581,366	77,680	206,376	297,310
2014	584,966	52,959	227,952	304,055
2015	583,009	29,101	237,619	316,289
2016	614,449	16,248	240,700	357,501
2017	639,552	10,715	238,708	390,129
Total	$ 13,261,721	$ 3,980,146	$ 2,211,026	$ 7,070,549

*Includes liabilities for pensions already granted and pensions incurred but not yet granted.

**The amount of interest accretion from tabular discounts included in benefits incurred and claims administration expense incurred in the Consolidated Statutory Statement of Operations and Changes in Contingency Reserve was $269,581,000 and $0, respectively.

The Industrial Insurance Fund anticipates moving to a tabular discount rate of 4.5 percent by the end of fiscal year 2019. This change in discount rate is anticipated to lower the tabular discounts for pensions already granted in the Pension Reserve Account by approximately $553,902,000, and increasing the discounted pension reserves by the same amount. As of June 30, 2018, the Fund has set up an accrual of this amount for the anticipated discount rate change. The accrual is included in the table above, and has decreased the Tabular Case discounts by $553,902,000 and increased the benefit liabilities net of tabular discount by the same amount.

17.B. Non-Tabular Discounts

The non-tabular discount rate is made up of a benchmark rate less a risk adjustment rate, rounded to the nearest one-half percentage point. The benchmark rate is the five-year moving average of the U.S. 20-Year Treasury yield. The risk adjustment equals two percentage points until the benchmark rate reaches 4.0 percent. Below 4.0 percent, the risk adjustment is one-half the benchmark rate rounded to the nearest one-half percent. As of June 30, 2018, the benchmark rate was 2.74 percent, and the indicated non-tabular discount rate was 1.5 percent. The non-tabular discount is calculated using the selected non-tabular discount rate and the anticipated payout of the liabilities.

The June 30, 2018, liabilities included $7,884,713,000 of reserves for benefits and $674,318,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $1,448,676,000; the amount for defense and cost containment (DCC) expense reserves was $48,909,000; and the amount for adjusting and other (AO) expense reserves was $23,000,000.

The June 30, 2017, liabilities included $8,200,087,000 of reserves for benefits and $619,242,000 of reserves for claims administration expenses, net of tabular and non-tabular discounts. The amount of the non-tabular discounts for IBNR reserves was $1,617,043,000; the amount of non-tabular discount for DCC expense reserves was $46,476,000; and the non-tabular discount for AO expense reserves was $21,496,000. Non-tabular discount accretion decreased for fiscal year 2018 benefits incurred by $6,066,000, and claim adjustment expenses incurred by $307,000.

Liabilities Discounted on a Non-Tabular Basis*
June 30, 2018
(in thousands)

Fiscal Accident Year	Benefit & CAE Liabilities Net of Tabular and Gross of Non-Tabular Discount	Non-Tabular Discounts** Case	IBNR	DCC	AO	Benefit & CAE Liabilities Net of Tabular and Non-Tabular Discount
2008 & Prior	$ 2,783,299	$ -	$ 546,353	$ 17,415	$ 3,414	$ 2,216,117
2009	378,313		62,940	1,945	781	312,647
2010	349,262		55,233	1,722	775	291,532
2011	390,308		58,465	1,838	930	329,075
2012	414,676		59,699	1,904	1,032	352,041
2013	546,553		73,657	2,384	1,452	469,060
2014	679,286		90,614	2,952	1,821	583,899
2015	763,350		98,464	3,275	2,095	659,516
2016	934,208		111,708	3,876	2,668	815,956
2017	1,207,375		132,329	4,886	3,557	1,066,603
2018	1,632,986		159,214	6,712	4,475	1,462,585
Total	$ 10,079,616	$ -	$ 1,448,676	$ 48,909	$ 23,000	$ 8,559,031

*Excludes liabilities for pensions already granted, but includes liabilities for pensions incurred but not yet granted.

**The amount of interest accretion from non-tabular discounts included in benefits incurred and claims administration expense incurred in the Consolidated Statutory Statement of Operations and Changes in Contingency Reserve was $114,793,000 and $8,243,000, respectively.

Liabilities Discounted on a Non-Tabular Basis*
June 30, 2017
(in thousands)

Fiscal Accident Year	Benefit & CAE Liabilities Net of Tabular and Gross of Non-Tabular Discounts	Non-Tabular Discounts** Case	IBNR	DCC	AO	Benefit & CAE Liabilities Net of Tabular and Non-Tabular Discounts
2007 & Prior	$ 2,833,986	$ -	$ 577,797	$ 15,604	$ 2,868	$ 2,237,717
2008	432,689		73,966	1,978	849	355,896
2009	449,211		75,409	2,016	900	370,886
2010	412,814		67,009	1,811	869	343,125
2011	466,122		71,438	1,951	1,060	391,673
2012	514,474		75,315	2,100	1,229	435,830
2013	685,180		96,207	2,717	1,720	584,536
2014	839,105		118,217	3,376	2,086	715,426
2015	987,383		129,989	3,858	2,564	850,972
2016	1,234,142		151,295	4,760	3,254	1,074,833
2017	1,649,238		180,401	6,305	4,097	1,458,435
Total	$ 10,504,344	$ -	$1,617,043	$ 46,476	$ 21,496	$ 8,819,329

*Excludes liabilities for pensions already granted, but includes liabilities for pensions incurred but not yet granted.

**The amount of interest accretion from non-tabular discounts included in benefits incurred and claims administration expense incurred in the Consolidated Statutory Statement of Operations and Changes in Contingency Reserve was $120,859,000 and $8,550,000, respectively.

Note 18 - Asbestos and Environmental Reserves

Claims related to asbestos and hazardous chemicals or waste arise mainly as a result of the claimants' exposure at work and are covered by the Industrial Insurance Fund. There is not a large exposure, and it is not fundamentally different from any other injury due to exposure to hazardous materials in normal industrial activity. Case and incurred but not reported (IBNR) reserves related to asbestos or environmental exposure claims are not specifically reserved. IBNR and claim administrative expenses (CAE) reserves related to asbestos claims are included as part of benefit and CAE liabilities.

The table below shows a gross basis for the case reserves related to asbestos. L&I does not currently hold any reinsurance agreements.

Workers' Compensation
Asbestos Claims

	Fiscal Year 2018	Fiscal Year 2017
Beginning case reserve related to asbestos	$ 46,514,356	$ 45,699,380
Benefits incurred	(450,723)	8,303,903
Payments made	(6,188,641)	(7,488,927)
Ending case reserve related to asbestos	$ 39,874,992	$ 46,514,356

Note: Amounts are case reserves and do not include IBNR or CAE reserves.

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Supplementary Information

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

State of Washington Industrial Insurance Fund
Schedule of Undiscounted Claims Development Information
Fiscal Years 2009 through 2018
(dollars in millions)

The table below illustrates how the Industrial Insurance Fund's earned revenues (net of reinsurance) and investment revenues compared to the related costs of losses (net of loss assumed by reinsurers) and other expenses assumed by the program as of the end of each of the last ten fiscal years. The Industrial Insurance Fund has not purchased reinsurance since September 30, 2002, and has never had a qualifying event that generated a recovery.

The columns of the table show data for successive fiscal years.

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net earned required contribution and investment revenues	$ 1,692	$ 2,797	$ 2,525	$ 2,581	$ 1,928	$ 2,888	$ 2,113	$ 2,931	$ 2,770	$ 2,448
Estimated incurred claims and expenses, end of fiscal accident year	2,363	2,312	2,254	2,086	2,105	2,061	2,304	2,205	2,218	2,311
Paid (cumulative) as of										
End of fiscal accident year	322	298	289	284	296	297	301	304	309	326
One year later	667	604	584	580	593	613	605	614	627	
Two years later	863	773	747	734	755	778	766	771		
Three years later	1,000	890	857	840	866	888	874			
Four years later	1,107	981	940	918	949	973				
Five years later	1,192	1,054	1,006	978	1,016					
Six years later	1,262	1,114	1,060	1,029						
Seven years later	1,323	1,162	1,106							
Eight years later	1,376	1,206								
Nine years later	1,425									
Re-estimated incurred claims and expenses *										
End of fiscal accident year	2,363	2,312	2,254	2,086	2,105	2,061	2,304	2,205	2,218	2,311
One year later	2,535	2,271	2,139	2,026	2,001	2,175	2,124	2,119	2,173	
Two years later	2,538	2,261	2,066	1,967	2,036	2,097	2,045	2,032		
Three years later	2,485	2,137	2,012	1,878	2,025	2,061	1,963			
Four years later	2,411	2,147	1,986	1,960	1,995	2,040				
Five years later	2,439	2,137	2,060	1,874	1,948					
Six years later	2,439	2,151	1,956	1,855						
Seven years later	2,461	2,068	1,953							
Eight years later	2,387	2,059								
Nine years later	2,380									
Increase (decrease) in estimated incurred claims and expenses from end of policy year **	17	(253)	(301)	(231)	(157)	(21)	(341)	(173)	(45)	
Percentage change in estimated incurred claims and expenses	0.7%	(10.9%)	(13.4%)	(11.1%)	(7.5%)	(1.0%)	(14.8%)	(7.8%)	(2.0%)	

Source: Washington State Department of Labor & Industries Actuarial Services

* Re-estimated claims and expenses result from new information received on known claims, re-evaluation of existing information on known claims, and emergence of new claims not previously known.

** This line compares the latest re-estimated incurred claims amount to the amount originally established and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and re-estimates is commonly used to evaluate the accuracy of incurred claims currently recognized in more recent fiscal accident years.

Supplemental Investment Risk Interrogatories
June 30, 2018

1. The Industrial Insurance Fund's total admitted assets as reported on page 31 of this annual Statutory Financial Information Report were $17,723,527,000 at June 30, 2018.

2. The following are the Industrial Insurance Fund's ten largest exposures to a single issuer/borrower/investment by investment category, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed as exempt in the Appendix to the SVO's *Practices and Procedures Manual*, (ii) property occupied by the Industrial Insurance Fund, and (iii) policy loans:

	Amount	Percentage of Total Admitted Assets
Bonds - FHLMC Gold	$ 187,778,000	1.06%
Bonds - Ontario Province of	118,859,000	0.67%
Bonds - Novartis Capital Corp	118,836,000	0.67%
Bonds - Asian Development Bank	118,718,000	0.67%
Bonds - Apple Inc	114,798,000	0.65%
Bonds - Microsoft Corp	108,873,000	0.61%
Bonds - Canada Government	99,877,000	0.56%
Bonds - Union Pacific Corp	89,573,000	0.51%
Bonds - Freddie Mac	88,824,000	0.50%
Bonds - JPMorgan Chase & Co	84,987,000	0.48%

3. The Industrial Insurance Fund's total admitted assets held in bonds and preferred stocks, by NAIC designation, including bonds classified as short-term investments at June 30, 2018, were:

	Amount	Percentage of Total Admitted Assets
Bonds with an NAIC rating of 1	$ 10,977,655,000	61.94%
Bonds with an NAIC rating of 2	3,029,411,000	17.09%
Bonds with an NAIC rating of 3	157,555,000	0.89%
Bonds with an NAIC rating of 4	89,013,000	0.50%
Bonds with an NAIC rating of 5	13,607,000	0.08%

4. Assets held in foreign investments:

   Assets held in foreign investments exceeded 2.5 percent of the Industrial Insurance Fund's total admitted assets.

Supplemental Investment Risk Interrogatories
June 30, 2018

Total admitted assets held in foreign investments at June 30, 2018:

Asset Type	Amount	Percentage of Total Admitted Assets
Bonds	$ 3,758,381,000	21.21%
Equities	1,017,667,000	5.74%

Total admitted assets held in foreign investments in bonds by NAIC rating at June 30, 2018:

NAIC Designation	Amount	Percentage of Total Admitted Assets
Countries rated NAIC – 1	$ 2,764,559,000	15.60%
Countries rated NAIC – 2	463,076,000	2.61%
Countries rated NAIC – 3	530,746,000	3.00%

The two countries with the largest foreign investment exposure in each NAIC designation at June 30, 2018:

Issuer	NAIC Designation	Amount	Percentage of Total Admitted Assets
United Kingdom	1	$ 549,521,000	3.10%
Australia	1	435,962,000	2.46%
Indonesia	2	135,075,000	0.76%
Mexico	2	107,711,000	0.61%
SupraNational	3 or below	268,470,000	1.51%
Brazil	3 or below	208,195,000	1.17%

Supplemental Investment Risk Interrogatories
June 30, 2018

Ten largest non-sovereign (i.e., non-governmental) investments held in foreign issues at June 30, 2018:

Issuer	NAIC Designation	Amount	Percentage of Total Admitted Assets
BNZ Intl Funding London	1	$ 74,925,000	0.42%
Westpac Banking Corp	1	64,981,000	0.37%
Commonwealth Bank Aust	1	64,954,000	0.37%
Alibaba Group Holding LTD	1	64,843,000	0.37%
Vale Overseas Limited	2	63,471,000	0.36%
Mizuho Financial Group	1	60,000,000	0.34%
Aust & NZ Banking Group	1	54,941,000	0.31%
Barclays PLC	2	54,926,000	0.31%
National Australia BK LT	1	54,849,000	0.31%
State Grid Overseas Inv	1	54,414,000	0.31%

		Amount	Percentage of Total Admitted Assets
5.	Total admitted assets held in Canadian investments	$1,315,524,000	7.42%

6. The Industrial Insurance Fund had no investments with *contractual sales restrictions*, which are defined as “investments having restrictions that prevent investments from being sold within 90 days.”

7. The Industrial Insurance Fund’s admitted assets held in equity interests, including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities (including Schedule BA equity interests), and excluding money market and bond mutual funds listed in the Appendix to the SVO’s *Practices and Procedures Manual*, as exempt, or Class 1, were:

Fund	Amount	Percentage of Total Admitted Assets
MSCI ACWI IMI INDEX FUND B2	$ 2,308,282,000	13.02%

Assets held in equity interest exceeded 2.5 percent of the Industrial Insurance Fund’s total admitted assets.

Supplemental Investment Risk Interrogatories
June 30, 2018

8. The Industrial Insurance Fund did not hold any non-affiliated, privately-placed equities under Securities Exchange Commission (SEC) Rule 144a or SEC Rule 144 without volume restrictions.

9. The Industrial Insurance Fund did not hold general partnership interests.

10. The Industrial Insurance Fund did not own any mortgage loans.

11. The Industrial Insurance Fund did not have any individual parcels or groups of contiguous parcels of real estate.

12. The Industrial Insurance Fund held no investments in mezzanine real estate loans.

13. The Industrial Insurance Fund did not have admitted assets subject to repurchase agreements, reverse repurchase agreements, dollar repurchase agreements, or dollar reverse repurchase agreements at June 30, 2018.

14. The Industrial Insurance Fund did not own any warrants not attached to other financial instruments, options, caps, or floors at June 30, 2018.

15. The Industrial Insurance Fund did not have any exposure for collars, swaps, or forwards during fiscal year 2018.

16. The Industrial Insurance Fund did not have any potential exposure for futures contracts during fiscal year 2018.

Summary Investment Schedule
June 30, 2018

The Industrial Insurance Fund held cash and invested assets as of June 30, 2018, consisting of the following:

	Gross investment holding		Admitted assets as reported in the annual statement			
	Amount	Percentage	Amount	Securities Lending Reinvested Collateral Amount	Total Amount	Percentage
Bonds						
U.S. Treasury securities	$ 2,250,227,000	13.20%	$ 2,250,227,000	$ -	$ 2,250,227,000	13.20%
U.S. Government agency and corporate obligations (excluding mortgage-backed securities)	-	0.00%	-		-	0.00%
Foreign government (including Canada, excluding mortgage-backed securities)	1,469,579,000	8.62%	1,469,579,000	-	1,469,579,000	8.62%
Mortgage-backed securities (includes residential and commercial mortgage-backed securities)						
Issued or guaranteed by GNMA	42,000	0.00%	42,000	-	42,000	0.00%
Issued or guaranteed by FNMA, FHLMC	892,194,000	5.23%	892,194,000	-	892,194,000	5.23%
Issued or guaranteed by all other	262,185,000	1.54%	262,185,000	-	262,185,000	1.54%
Other fixed income securities (excluding short-term)						
Unaffiliated domestic securities	5,788,687,000	33.94%	5,788,687,000	-	5,788,687,000	33.95%
Unaffiliated foreign securities	3,604,326,000	21.14%	3,604,326,000	-	3,604,326,000	21.14%
Equity interests						
Commingled index funds - international	2,308,282,000	13.54%	2,308,282,000	-	2,308,282,000	13.54%
Real estate investments						
Property occupied by company	-	0.00%	-	-	-	0.00%
Property held for production of income	-	0.00%	-	-	-	0.00%
Receivables for securities and interest	259,626,000	1.52%	259,626,000	-	259,626,000	1.52%
Cash and cash equivalents	117,069,000	0.69%	117,069,000	59,036,000	176,105,000	1.03%
Securities lending collateral	98,853,000	0.58%	98,853,000	xxx	xxx	xxx
Short-term investments	-	0.00%	-	39,817,000	39,817,000	0.23%
Total	$ 17,051,070,000	100.00%	$ 17,051,070,000	$ 98,853,000	$ 17,051,070,000	100.00%

Independent Actuarial Opinion

Washington State Department of
Labor & Industries

Keep Washington Safe and Working

Deloitte.

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October 10, 2018

Statement of Actuarial Opinion

State of Washington – Industrial Insurance Fund

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am a Member of the American Academy of Actuaries and meet its qualification standards for issuing Statements of Actuarial Opinion. I am a Fellow of the Casualty Actuarial Society. I was appointed by the Washington State Auditors' Office to provide a Statement of Actuarial Opinion regarding the reasonableness of the State of Washington Industrial Insurance Fund's ("the Fund") carried loss and loss adjustment expense reserves as of June 30, 2018.

The Fund is comprised of three Workers' Compensation Program Accounts: the Accident Account, the Medical Aid Account, and the Pension Reserve Account. The Fund is currently administered by the State of Washington Department of Labor & Industries ("the Department").

Scope

I have examined the reserves listed in Exhibit A, as shown in the Fund's Statutory Financial Information Report, as of June 30, 2018. The loss and loss adjustment expense reserves ("reserves") specified in Exhibit A, where applicable, include provisions for Disclosure items (disclosures 8 thru 11) in Exhibit B. I have reviewed the June 30, 2018 loss and loss adjustment expense recorded under U.S. Statutory Accounting Principles. My review considered information provided to me through the date of this opinion.

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data provided by Mr. William Vasek, the Department's Chief Actuary, his actuarial staff, and Sharon Elias, the Department's Financial Services Program Manager. I evaluated that data for reasonableness and consistency. In other respects, my examination included the use of such actuarial assumptions and methods and such tests of the calculations as I considered necessary.

My review was limited to items listed in Exhibit A, and did not include an analysis of any other balance sheet items. I have not examined the Fund's assets and I have formed no opinion as to the validity or value of these assets.

Opinion

In my opinion, the amounts carried in Exhibit A on account of the items identified:

(A) meet the requirements of the insurance laws of the State of Washington;

(B) are consistent with reserves computed in accordance with accepted actuarial standards and principles;

(C) make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Fund under the terms of its contracts and agreements.

Relevant Comments

A. Company-Specific Risk Factors

Actuarial Estimates of property and casualty loss and loss adjustment expense reserves are inherently uncertain because they are dependent on future contingent events. Also, these unpaid claim liability estimates are generally derived from analyses of historical data, and future events or conditions may differ from the past. The actual amount necessary to settle the unpaid claims may therefore be significantly different from the reserve amounts listed in Exhibit A.

The major factors and/or particular conditions underlying the risk and uncertainties that I consider relevant to the Company's estimates of unpaid losses and loss adjustment expenses of June 30, 2018 are described in the sections below. These include but are not necessarily limited to the following items.

By statute, the Fund's direct exposure is limited to one line of business (workers' compensation) in one state (Washington). Therefore, any adverse trends affecting this line of business and/or state could have a material effect on the Fund's loss and loss adjustment expense reserves. Such trends would include legislative benefit level changes and adverse decisions or interpretations of law that may have an effect on all open workers' compensation claims.

A major assumption in the analysis of the medical component of the workers' compensation reserves is the selection of a long-term medical trend factor to apply to future calendar year medical payments. Estimating medical trend is difficult because it is highly variable. In my opinion, there is a higher than normal degree of variability associated with the Fund's medical loss reserves due to the uncertainty surrounding future medical trends and the expected length of medical payments.

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money using an average annual interest rate of 3.35%. Changes to the interest rate used for discounting could result in material changes to the reserves. We note that the current risk free interest rate matching the duration of these liabilities (approximately 15.6 years) was 2.88% as of June 30, 2018.

The Fund defines its "Contingency Reserve" as the difference between its assets and liabilities. Other insurance companies typically refer to this Contingency Reserve as Statutory Surplus. Due to the size of the Fund's Contingency Reserve, $3.48 billion, relative to the size of its loss and loss adjustment expense reserve, $13.77 billion, any small changes in reserves will have a material impact on the Contingency Reserve. The current reserve leverage ratio (reserve / contingency reserve) is significantly higher than the majority of workers' compensation carriers in the industry and workers' compensation funds in other states, although the Fund's leverage ratio has been declining in recent years.

An implicit assumption in the Department's actuarial review is that the State of Washington cost of living adjustments will be similar to cost of living adjustments approved by the Federal Government for Social Security retirement benefits. Future State of Washington cost of living adjustments that vary significantly from those approved by the Federal Government for Social Security retirement benefits could result in a material change in future costs and the adequacy of the reserves, especially for the Pension Reserve Account.

B. Risk of Material Adverse Deviation

With respect to this Statement of Actuarial Opinion, the amount of adverse deviation that I consider to be material is $697.0 million. My basis for determining this amount is 20% of the Contingency Reserve. This amount represents a reasonable upward fluctuation in reserves from those carried by the Fund that would be material to the Contingency Reserve. My materiality standard was selected based on the context in which this opinion letter will be used. It is prepared solely to assess the reasonableness of the Fund's loss and loss adjustment expense reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

I believe there are significant risks and uncertainties with the Fund's net loss and loss adjustment expenses that could result in material adverse deviation. I have identified those risk factors as the lack of diversity of exposure by line of business and by state, future medical trend, the discounting of the reserves, reserve leverage, and future cost of living adjustments. These risk factors are described in greater detail in the preceding paragraph and in the report supporting this opinion. The absence of other risk factors from this commentary is not meant to imply that additional factors cannot be identified in the future as having had a significant influence on the Fund's reserves.

C. Other Disclosures in Exhibit B

Discounting

The Department discounts the loss and loss adjustment expense reserves to reflect the time value of money. The amount of discount is based on an actuarially derived projected payment pattern and selected annual interest rates as follows.

- For the Medical Aid Account, the Department's selected interest rate is 1.5%.
- For the Pension Reserve Account, the Department's selected interest rate is 6.1%.
- For the Accident Account, combinations of interest rates are used to discount the reserves. The future total permanent disability and fatal transfers made to the Pension Reserve Account assume interest discounts based on an annual rate of 6.1% through the 1st quarter of 2019. This rate is then reduced to 4.5% for all future quarters. The actual transfer payments and all other payments are discounted using a Department selected rate of 1.5%.
- We note that although the Pension Reserve Account is currently discounted using an annual interest rate of 6.1%, the intention is to reduce the interest rate down to 4.5% for the State Fund pensions next fiscal year. Therefore, the Department has recorded a liability this year in the Accident Account for the difference between an interest rate of 6.1% and 4.5% for the State Fund pensions in the Pension Reserve Account. The amount of this liability totals $553.902 million.

The average combined interest rate for the Program is approximately 3.35% with a total discount amount of $7.4 billion. The interest rates were selected by the Department, and I make no opinion regarding the appropriateness of the selected rates. We note that the current risk free interest rate matching the duration of these liabilities was 2.88% as of June 30, 2018.

The interest rate used to discount the Pension Reserve Account changed from 6.2% last year to 6.1% this year. The effect of reducing these interest rate assumptions this year was an increase in the discounted unpaid claim liability of $36.948 million on the Pension Reserve Account reserve.

The interest rate used to discount the Accident Account future total permanent disability and fatal transfers made to the Pension Reserve Account continued to gradually decrease to 4.5% this year. Although, we note that the rate at which the interest rates gradually decreased to 4.5% changed this year, causing the discounted unpaid claim liability to increase $55.138 million. The interest rate used for all other future payments remained the same this year at 1.5%.

The combined effect of all the interest rate assumption changes combined this year (including the $553.902 million to account for the reduction of the interest rate of State Fund pensions in the Pension Reserve Account from 6.1% to 4.5% recorded in the Accident Account) was an increase in the discounted unpaid claim liability of $645.988 million including the current fiscal accident year.

Underwriting Pools or Associations

The Fund participates in the Washington United States Longshore and Harbor Workers' Compensation Act Assigned Risk Plan ("WARP") which was established to provide USL&H workers' compensation insurance coverage for employers unable to purchase it through the normal private insurance market. The Fund pays assessments to WARP and participates in any underwriting losses or surpluses incurred by WARP. Based on discussions with the Department, we understand that WARP is not currently in a deficit position. Therefore, the Fund has not booked a reserve to account for any unpaid claim liability related to WARP.

We understand that the Fund does not participate in any other voluntary or involuntary pools.

Asbestos Exposures and Environmental Exposures

I have reviewed the Fund's exposure to asbestos and environmental claims. In my opinion, the chance of material liability related to asbestos and environmental claims is remote. The Fund has not provided coverage that could reasonably be expected to produce material levels of asbestos and/or environmental liability claims activity.

Disclosure of Unearned Premium Reserves for Long Duration Contracts

The Fund does not write single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase.

Reinsurance

The Fund has no ceded or assumed reinsurance. Based on discussions with the Department's management and their description of the Fund's ceded (and/or assumed) reinsurance, I am not aware of any reinsurance contract that either has been or should have been accounted for as retroactive reinsurance or financial reinsurance.

D. Methods and Assumptions

Over the past few years the claim count persistency rates (i.e. number of active time-loss claims) have continued to decline dramatically. The Department's actuarial methodologies for certain types of claim categories (i.e. medical, time-loss, and total permanent disability) are highly dependent on a future estimate of the persistency rates. The future persistency rate assumptions selected over the past year by the Department have dropped significantly to reflect the actual recent changes or declines in the persistency rates. This drop in assumption has caused a significant decrease in the unpaid claim liability estimates even more than what would be indicated in the favorable paid amounts over the past year.

E. General Uncertainty

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss adjustment expense, it is necessary to project future loss and loss adjustment expense payments. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. No warranty is expressed or implied that such variance will not occur. Further, my projections make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Fund's historical data base or which are not yet quantifiable.

Actuarial Report

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the Department to be retained for a period of seven years in its administrative offices and available for regulatory examination.

This Statement of Opinion is solely for the use of assessing the reasonableness of the loss and loss adjustment expense reserves and is only to be relied upon by the Fund and the State.

Rod Morris

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October 8, 2018

Statement of Actuarial Opinion – Year Ended June 30, 2018

State of Washington Industrial Insurance Fund

Exhibit A: SCOPE

Loss Reserves:	**Amount**
1. Reserve for Unpaid Losses	$13,091,808,000
2. Reserve for Unpaid Loss Adjustment Expenses	$ 674,318,000
Total Net Loss and Loss Adjustment Expense Reserves	$13,766,126,000
3. Reserve for Unpaid Loss – Direct and Assumed	$13,091,808,000
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed	$ 674,318,000
Total Direct and Assumed Loss and Loss Adjustment Expense Reserves	$13,766,126,000
5. Retroactive Reinsurance Reserve Assumed	$0
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion	$0
Premium Reserves:	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	$0
8. Reserve for Net Unearned Premiums for Long Duration Contracts	$0
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion	$0

Statement of Actuarial Opinion – Year Ended June 30, 2018

State of Washington Industrial Insurance Fund

Exhibit B: DISCLOSURES

Item:	Column 1	Column 2	Column 3	Column 4
1. 1. **Name of Appointed Actuary**		**Last** Morris	**First** Rodney	**Middle** Scott
2. **The Appointed Actuary's Relationship to the Company.** Enter E or C based upon the following: E if an Employee, C if a Consultant			**C**	
3. **The Appointed Actuary is a Qualified Actuary based upon what qualification?** Enter F, A, M, or O based upon the following: **F** if a Fellow of the Casualty Actuarial Society (FCAS) **A** if an Associate of the Casualty Actuarial Society (ACAS) **M** if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries approved by the Casualty Practice Council, as documented with the attached approval letter. **O** for Other			**F**	
4. **Type of Opinion, as identified in the OPINION** paragraph. Enter R, I, E, Q, or N based upon the following: **R** if Reasonable **I** if Inadequate or Deficient Provision **E** if Excessive or Redundant Provision **Q** if Qualified. Use Q when part of the OPINION is Qualified. **N** if No Opinion			**R**	
5. **Materiality Standard expressed in $US** (Used to answer Question #6.)	$696,992,800			
6. **Are there a Significant Risk of Material Adverse Deviation?** YES, NO**,** or Not Applicable (N/A)				YES [X] NO [ ] N/A [ ]
7. **Statutory Surplus (Contingency Reserve)**	$3,484,964,000			

Exhibit B: DISCLOSURES

Item:	**Column 1**	**Column 2**	**Column 3**	**Column 4**
8. Discount included as a reduction to loss reserves and loss expense reserves				
8.1 Non-tabular Discount	$1,520,585,000			
8.2 Tabular Discount	$5,911,880,000			
9. The net reserves for losses and expenses for the Company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.	n/a			
10. The total claims made extended loss and expense reserve				
10.1 Amount reported as loss reserves	n/a			
10.2 Amount reported as unearned premium reserves	n/a			
11. Other items on which the Appointed Actuary is providing Relevant Comments	n/a			

State of Washington Industrial Insurance Fund
Statutory Financial Information Report

Upon request, foreign language support and formats for persons with disabilities are available. Call 1-800-547-8367. TDD users, call 360-902-5797. L&I is an equal opportunity employer.

FY19-276 [12-2018]