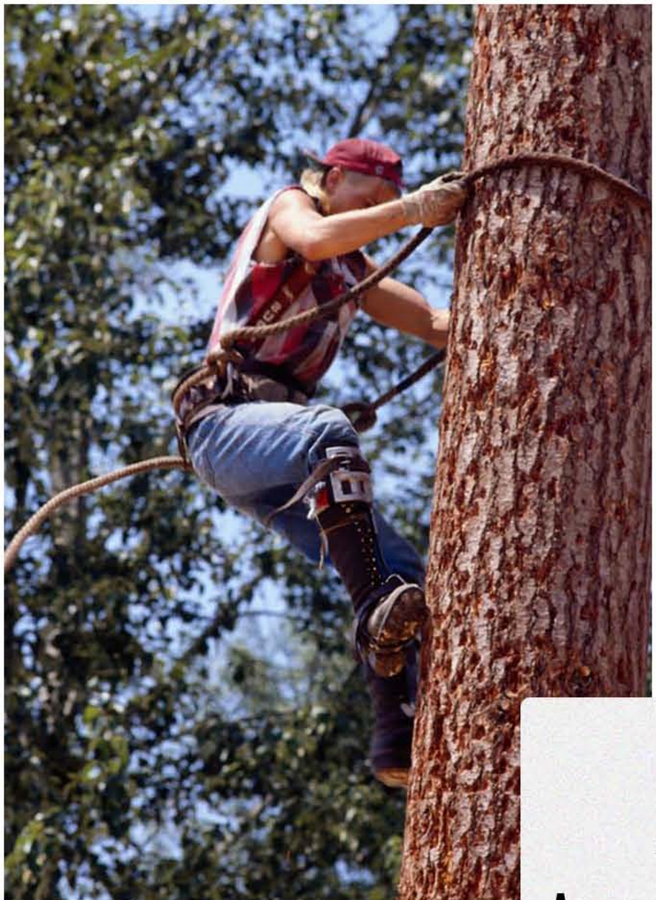


2005 Annual Report

WCRA®

TO OUR MEMBERS:

Our annual report to you customarily focuses on our financial accomplishments for the preceding year, and we are very pleased to report that we ended 2005 with a surplus of $10 million, completing a three-year recovery from the $105 million deficit we reported at the end of 2002.

This year, however, we would like to focus on our primary business purpose: providing you, our members, with prompt, reliable claims reimbursements and highly professional advisory services on the management of catastrophic injuries. These services are the central tenets of the WCRA's mission and vision.

> ***Mission***
>
> ***The WCRA ensures the availability of long-term reinsurance protection for serious Minnesota workers' compensation claims. Our staff of innovative professionals is dedicated to achieving the highest standard of excellence through stable and reasonable rates, expert claims administration, and informational services.***

We have built a culture of service with our staff and strive every day to provide informed responses to inquiries from members and timely reimbursement of claims payments to which you are entitled.

How are we doing? The results of periodic member surveys have generally supported our belief that we have been providing "reinsurance services that are considered superior" by our members. In 2005, we sought to obtain a thorough, objective assessment of our claims services by retaining the Hayes Companies to perform an independent claims review and performance audit by benchmarking our services against the best practices in the reinsurance industry.

> ***Vision***
>
> ***The WCRA will provide reinsurance services that are considered superior by its members and other participants in the workers' compensation system.***

We were very pleased with the results of this review. While Hayes made a number of recommendations for improving our claims services, the report characterizes them as "minor in nature." The following quotations summarize the overall conclusions:

"We found that the WCRA Claims Department is a well-run, efficient organization with management and staff who constantly revisit their roles and procedures for processing excess workers' compensation claims for member organizations."

"Compared with other excess and reinsurance carriers, WCRA has significant advantages for ease of use, functionality and claims interaction over all other carriers."

"With the limited line of coverage and single jurisdiction, WCRA has taken full advantage to leverage their knowledge and has successfully created a breadth and depth of tools unparalleled in the industry."

"On the whole, we did not find any deficiencies in the Claims Department operational procedures . . . Unlike most of our operational audits, there are no significant gaps or areas in which we believe WCRA is substantially lacking."

Our services to you. The findings of the claims operation audit validate the work we have done over the past ten years to improve both the quality of service and the efficiency of our claims operation. In 1995, a ten-person claims staff processed 1,652 reimbursement checks in an average turnaround time of four days. In 2005, five claims staff members processed 2,764 reimbursements with an average turnaround time of one day.

While we have streamlined our internal claims operations, much of the dramatic increase in efficiency is the result of online calculators developed by our claims and information services staff. These ten calculators have become the standard in the Minnesota workers' compensation system, and enable our staff, as well as everyone else involved in the determination of workers' compensation benefits, to quickly calculate indemnity benefits on Minnesota claims, the ultimate and present values of claims, subrogation recovery distributions, and other complex benefit determinations.

These calculators have dramatically reduced the amount of time it takes our staff, our members, third-party administrators, attorneys, and others to do their work. In addition, our online eMember service allows registered members to quickly file reimbursements electronically and to access information about their WCRA claims and premiums.

We have developed lists of preferred providers that we believe are the most experienced at treatment and rehabilitation of serious burns, traumatic brain injuries, and spinal cord injuries, which we share with our members. In addition, we have produced four comprehensive catastrophic injury packets on outcome-based rehabilitation of serious burns, amputations, traumatic brain injuries, and spinal cord injuries for the use of our members.

Our financial status. Our positive financial results for the year are documented in the Management's Summary Analysis of 2005 Financial Results and the financial statements that accompany this report. We again received an unqualified opinion from our independent auditors, PricewaterhouseCoopers, LLP. In addition, we continued our focus on internal controls and enhancement of our communications with the Audit and Financial Compliance Committee.

Further, in 2005 our Board of Directors was successful in adopting reinsurance rates for 2006 that resulted in an overall rate reduction of 2 percent. This rate reduction was accomplished in spite of the fact that rapidly rising medical costs continue to be a significant driver of overall workers' compensation claims expenses. The medical cost spiral has had a particularly dramatic effect on the catastrophic claims exceeding WCRA retention limits. Our actuaries have calculated that in 1990, WCRA claims payments were composed of 62 percent indemnity benefits and 38 percent medical costs. For claims occurring in 2005, the actuaries project that indemnity benefits will constitute only 12 percent and medical costs 88 percent of our claims reimbursements. We are examining a variety of ways in which we can assist our members to try to better manage these dramatic medical cost increases.

In closing, we would like to recognize and thank Jerry Werner, our assistant vice president–rehabilitation, who retired last year after 25 years of service with the WCRA. We wish Jerry well!

President and CEO
Carl W. Cummins III
WCRA

Board Chair
David R. Young
Wausau Insurance Companies

WCRA Board of Directors

Sitting: Kathryn Lovaas (The Hartford Financial Services Group); Wayne Simoneau (Public Representative); Gary Swoverland (Land O'Lakes); David Young (Wausau Insurance Companies); Patricia Johnson (State Fund Mutual)

Standing: David Hennes (The Toro Company); Peter Sausen (Deptartment of Finance); Howard Bicker (State Board of Investment); Donald Gerdesmeier (MN D.R.I.V.E.); Hugh Fendry II (JNR Corporation); Raymond Waldron (AFL-CIO); Mark Tansey (Berkley Risk Administrators)

Not pictured: Robert Ditmore (St. Paul Travelers)

WCRA Management

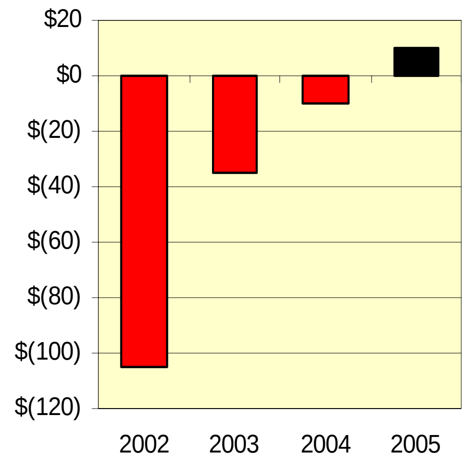
Carl "Buzz" Cummins (President and CEO); Elisabeth Skoglund, (Vice President, Claims and IS); Donald Swanson (Vice President, Finance and Investments); Cynthia Smith (Vice President, Administration); Randall Holmberg (Vice President and Actuary)

MANAGEMENT'S SUMMARY ANALYSIS OF 2005 FINANCIAL RESULTS

Overview

The WCRA experienced its third consecutive year of financial improvement in 2005. The Association recorded comprehensive income of $20 million and swung from a deficit to a balance sheet surplus. At December 31, 2005, the balance sheet surplus was $10 million, an improvement of $20 million from the December 31, 2004 deficit of $10 million. This continued financial improvement was primarily due to a reduction in prior year loss reserves and solid investment returns. The investment portfolio returned 8 percent in 2005, 1 percent above the 7 percent investment return assumed in loss reserving.

Surplus (Deficit)
(in millions)



The Board of Directors has a policy of maintaining a surplus band between +30 percent and -10 percent of the discounted funded loss reserve liability. The December 31, 2005 surplus of $10 million represented 1 percent of funded reserves, an improvement from the -1 percent position at December 31, 2004, and a significant improvement from the -10 percent position at December 31, 2002.

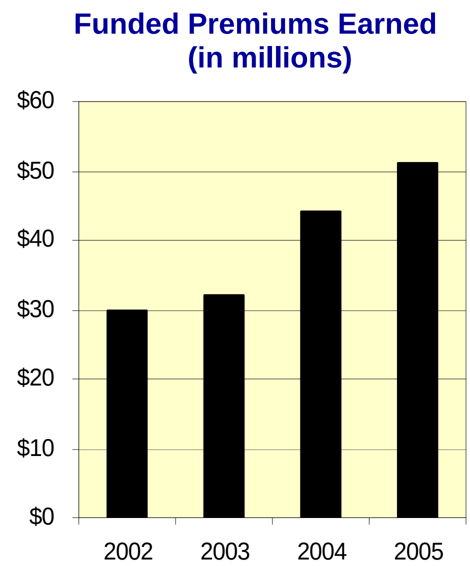
During 2005, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. For 2005, premiums collected, interest and dividends from investments, losses and loss expenses paid, and operating expenses were all in line with management's expectations.

Financial Highlights

($ in millions)	2005	2004
Funded earned premiums	**$51**	**$ 44**
Comprehensive income	**$20**	**$ 25**
Accumulated surplus (deficit)	**$10**	**$(10)**
Investment return	**8%**	**10%**
Assumed investment return	**7%**	**7%**

Operating Results and Comprehensive Income

Premiums and Losses



The WCRA earned $51 million in funded premiums in 2005, up significantly from $44 million in 2004. This increase was the result of a combination of factors including an increase in premiums resulting from prior year adjustments, an increase in the premium exposure base, and a 2 percent increase in the 2005 reinsurance rates.

The components of funded losses and loss expenses are shown below. Funded losses and loss expenses incurred for 2005 were $115 million, a modest decrease from $117 million in the prior year. This decrease was the result of a $12 million reduction in prior accident year loss reserves. This prior year impact was due primarily to actuarial adjustments of loss development estimates for the effect of past strengthening of medical case reserves. There were no actuarial adjustments to prior year loss reserves in 2004.

The components of discounted funded losses and loss expenses are shown below.

Funded Losses and Loss Expenses Incurred (Discounted)

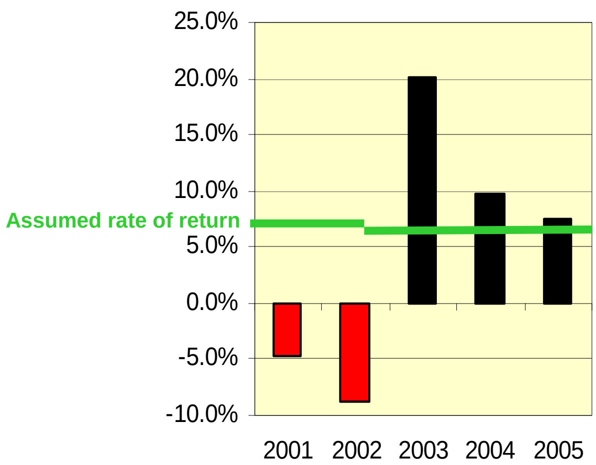
(in millions)	**2005**	**2004**
Prior accident years:		
Present value update	$ 79	$ 75
Actuarial adjustments	(12)	—
Total prior accident years	67	75
Current accident year	48	42
Total funded losses and loss expenses incurred	$ 115	$ 117

Investment Performance

The investment portfolio had a total rate of return of 8 percent in 2005, down from a return of 10 percent in 2004. The 2005 return was driven by strong returns in the domestic and international stock markets. Domestic equities returned 10 percent and international equities returned 12 percent. The components of investment results are shown below.

(in millions)	**2005**	**2004**
Investment income, net of related expenses	$ 28	$ 25
Net realized investment gain (loss)	67	48
Change in unrealized gain (loss) on securities	(10)	30
Total investment results	$ 85	$ 103

Annual Investment Returns



The *WCRA Investment Policy* includes asset allocation targets of 50 percent for domestic equities, 10 percent for international equities, and 40 percent for fixed income investments.

Comprehensive Income

The WCRA recorded comprehensive income of $20 million in 2005, a decline from the $25 million recorded in 2004. Comprehensive income (loss) consists of net income (loss) and the change in unrealized gains (losses) on investments. For 2005, comprehensive income was due primarily to two factors: a reduction in prior year loss reserves, and an 8 percent investment return, which exceeded the 7 percent investment return assumed in loss reserving. In 2004, comprehensive income was primarily due to the strong investment performance. The actual 2004 investment return of 10 percent exceeded the investment return assumed in loss reserving by 3 percent.

Balance Sheet

Assets and Liabilities

Total assets were $1,409 million at December 31, 2005 compared with $1,600 million at the end of the previous year. The decrease in total assets was primarily due to a decrease in securities lending collateral. At December 31, 2005, the WCRA temporarily did not have any securities on loan or securities lending collateral due to the year-end implementation of a new collateral investment trust. Normal securities lending activity resumed after January 1, 2006. At December 31, 2004, securities lending collateral totaled $284 million.

Total liabilities were $1,399 million at December 31, 2005 compared with liabilities of $1,610 million at December 31, 2004. The decrease in liabilities corresponded to the decrease in assets, and was the result of a $284 million decrease in collateral payable under the securities loan agreement.

The WCRA's largest liability is the reserve for funded losses and loss expenses. This liability totaled $1,216 million at December 31, 2005 compared with $1,159 million at December 31, 2004. This liability represents the present value, discounted at 7 percent, of the total estimated obligation for losses and loss expenses for unpaid amounts up to the prefunded limit. Because this liability involves claims that will be paid out over a period of many years, judgments as to the ultimate exposure are an important component of the loss reserving process. Reserves are reviewed on a regular basis using a variety of actuarial techniques. They are adjusted based on loss experience and as new information becomes available. Changes in the discounted liability for funded losses and loss expenses are shown below.

(in millions)	**2005**	**2004**
Funded reserves as of January 1	$ 1,159	$ 1,091
Losses and loss expenses incurred:		
Prior accident years	67	75
Current accident year	48	42
Total incurred	115	117
Losses and loss expenses paid	(58)	(49)
Funded reserves as of December 31	$ 1,216	$ 1,159

The components of prior accident year incurred losses and loss expenses are discussed under Operating Results and Comprehensive Income.

The liability for unfunded losses and loss expenses totaled $155 million at December 31, 2005 compared with $161 million at December 31, 2004. This liability represents the present value, discounted at 7 percent, of the total estimated obligation for losses and loss expenses for unpaid amounts in excess of the prefunded limit. The $6 million decrease in this liability during 2005 was due to a $24 million reduction in prior accident year loss reserves. This prior year impact was the result of actuarial adjustments of loss development estimates for the effect of past strengthening of medical case reserves. The negative $6 million of incurred losses and loss expenses was the net result of the prior year actuarial adjustments of $24 million, offset by reserves for the current accident year of $7 million, and the present value update of $11 million. Unfunded deferred premium revenue of a negative $6 million was recognized in 2005 concurrent with the negative incurred unfunded losses and loss expenses. Loss payments in excess of prefunded limits totaled $429,000 and $649,000 in 2005 and 2004, respectively.

Surplus

At year-end 2005, the WCRA had an accumulated surplus of $10 million compared with a deficit of $10 million at the end of 2004. This $20 million improvement was primarily due to a reduction in prior year loss reserves and an investment return of 8 percent, 1 percent above the 7 percent investment return assumed in loss reserving. The Board of Directors has a policy objective of maintaining a surplus band between +30 percent and -10 percent of the discounted funded loss reserve liability. The December 31, 2005 surplus represented 1 percent of funded reserves, an improvement from the -1 percent position at December 31, 2004.

Cash Flow

During 2005, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. Cash flow from operating activities was $20 million in 2005, compared with $16 million in 2004. This $4 million increase in operating cash flow was the net result of an increase in premiums collected and an increase in interest and dividends received, partially offset by an increase in losses and loss expenses paid. Net realized gains on the sale of investments are not reported as part of net cash provided by operating activities. However, net realized investment gains provide an additional planned source of cash flow to fund the operations of the Association. Net realized investment gains were $67 million in 2005, up significantly from $48 million in 2004.

PricewaterhouseCoopers LLP
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225 South Sixth Street
Minneapolis MN 55402
Telephone (612) 596 6000
Facsimile (612) 373 7160

Report of Independent Auditors

To the Board of Directors and Members of
Workers' Compensation Reinsurance Association

In our opinion, the accompanying balance sheets and the related statements of operations, comprehensive income and accumulated surplus and cash flows present fairly, in all material respects, the financial position of the Workers' Compensation Reinsurance Association (the "Association") at December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 21, 2006

Workers' Compensation Reinsurance Association
Balance Sheets
December 31, 2005 and 2004

(in thousands of dollars)	**2005**	**2004**
Assets		
Investments, at market value		
Cash and cash equivalents (including securities lending collateral of $0 and $284,364 at December 31, 2005 and 2004, respectively)	$ 50,545	$ 325,181
Short-term	887	1,785
Common and preferred stock	744,591	700,768
Bonds	440,963	402,203
Total investments	1,236,986	1,429,937
Uncollected reinsurance premiums		
Current premiums due	126	78
Deferred funded premiums	2,632	2,531
Reinsurance premium receivable	2,109	-
Deferred for unfunded losses	154,567	161,059
Total uncollected reinsurance premiums	159,434	163,668
Accrued investment income	4,017	4,113
Due from securities brokers	8,881	1,764
Prepaid reinsurance	-	703
Prepaid expenses and other assets	130	98
Property and equipment, less accumulated depreciation of $704 and $676 at December 31, 2005 and 2004, respectively	97	150
Total assets	$ 1,409,545	$ 1,600,433
Liabilities and Accumulated Surplus		
Liabilities		
Losses and loss expenses		
Funded	$ 1,216,346	$ 1,159,143
Unfunded	154,502	160,824
Total losses and loss expenses	1,370,848	1,319,967
Payable under securities loan agreement	-	284,364
Due to securities brokers	27,890	5,559
Accounts payable and accrued expenses	336	234
Total liabilities	1,399,074	1,610,124
Accumulated deficit from operations	(129,456)	(159,414)
Accumulated other comprehensive income	139,927	149,723
Designated accumulated surplus (deficit) (Note 2)	10,471	(9,691)
Total liabilities and accumulated surplus	$ 1,409,545	$ 1,600,433

The accompanying notes are an integral part of these financial statements.

Workers' Compensation Reinsurance Association
Statements of Operations, Comprehensive Income and Accumulated Surplus
Years Ended December 31, 2005 and 2004

(in thousands of dollars)	2005	2004
Revenues		
Reinsurance premiums		
Funded earned	$ 51,409	$ 44,230
Unfunded deferred	(5,893)	35,936
Ceded reinsurance	(703)	(2,812)
Investment income, net of related expenses	28,425	24,998
Net realized investment gain	67,253	47,888
Total revenues	140,491	150,240
Expenses		
Losses and loss expenses		
Funded	114,834	117,413
Unfunded	(5,893)	35,936
Losses and loss expenses incurred	108,941	153,349
Operating and administrative expenses	1,592	1,609
Total expenses	110,533	154,958
Net income (loss)	29,958	(4,718)
Other comprehensive income		
Change in net unrealized gains on securities and foreign currency translation adjustment (Note 3)	(9,796)	29,814
Comprehensive income	20,162	25,096
Accumulated deficit, beginning of year	(9,691)	(34,787)
Accumulated surplus (deficit), end of year	$ 10,471	$ (9,691)

The accompanying notes are an integral part of these financial statements.

Workers' Compensation Reinsurance Association
Statements of Cash Flows
Years Ended December 31, 2005 and 2004

(in thousands of dollars)	**2005**	**2004**
Cash flows from operating activities		
Net premiums collected	$ 49,749	$ 41,929
Interest and dividends received, net of related expenses	29,360	24,799
Losses and loss expenses paid	(58,060)	(49,889)
Operating and administrative expenses paid	(1,439)	(1,334)
Net cash provided by operating activities	19,610	15,505
Cash flows from investing activities		
Sale of investments		
Short-term, net	898	60,622
Common and preferred stocks	524,151	457,053
Bonds	439,425	349,955
Purchase of investments		
Common and preferred stocks	(506,746)	(427,644)
Bonds	(467,580)	(471,986)
Purchase of equipment	(30)	(28)
Net cash used in investing activities	(9,882)	(32,028)
Cash flows from financing activities		
Collateral for securities on loan	(284,364)	8,152
Net cash (used in) provided by financing activities	(284,364)	8,152
Net decrease in cash and cash equivalents	(274,636)	(8,371)
Cash and cash equivalents		
Beginning of year	325,181	333,552
End of year	$ 50,545	$ 325,181

The accompanying notes are an integral part of these financial statements.

1. General Information

Description of Association

In 1979, the Minnesota Legislature created the Workers' Compensation Reinsurance Association (the "Association"), a nonprofit, unincorporated association, to provide reinsurance protection for serious workers' compensation losses to all primary workers' compensation insurance providers and self-insured employers in the state of Minnesota. The Association provides full indemnification to its members for workers' compensation losses paid in accordance with Minnesota Statutes Chapter 176 that exceed a member's retention limit.

Operating procedures are prescribed by Minnesota Statutes Section 79.34-79.40, as amended (the "Enabling Act"), and the Association's Plan of Operation (the "Plan"). Amendments to the Plan must be approved by the Board of Directors of the Association (the "Board") and the Minnesota Commissioner of Labor and Industry.

Membership

All insurance carriers authorized to underwrite workers' compensation risks in Minnesota and all employers, including political sub-divisions, authorized to self-insure their workers' compensation liabilities in Minnesota are required to be members of the Association.

Retention Limits

For 2005, members selected one of three maximum per-loss occurrence retention limits, which were $380,000, $760,000 or $1,520,000. For 2004, members selected one of three maximum per-loss occurrence retention limits, which were $360,000, $720,000 or $1,440,000. Retention limits are determined annually based on a formula prescribed in the Enabling Act. Minnesota workers' compensation losses incurred by members in excess of the retention limit selected are reinsured by the Association.

Premiums

The estimated aggregate annual reinsurance premium billed by the Association to members in each calendar year is calculated to cover the following estimated costs:

- The present value of the estimated ultimate liability for members' incurred losses above the selected retention limit up to and including the prefunded limit of $7.6 million and $7.2 million per occurrence for 2005 and 2004, respectively, for funded losses reinsured by the Association.

- Loss payments expected to be made to members for claim amounts in excess of prefunded limits (unfunded losses).

- Operating and administrative expenses of the Association, and loss expenses incurred by the Association. (Loss expenses incurred by members on reinsured claims are not recoverable from the Association.)

- Charges for the current year or a prior year, as determined by the Board, for any reinsurance coverage purchased by the Association.

- Adjustments due to excess or deficient funded premiums, if any, for prior years as determined by the Board.

Estimated reinsurance premiums for each year are billed to the individual members based on: (1) the funded rate for the member's selected retention limit; (2) the rate for expected unfunded payments; and (3) the member's most recent actual exposure base available at the beginning of the annual billing cycle, adjusted for a factor which represents the estimated difference between the member's most recent actual exposure base and the actuarially projected exposure base. In the following year, reinsurance premium adjustments to bring the estimated premiums to actual are calculated and billed or credited to members. In addition, members may be charged for reinsurance purchased by the Association based on: (1) the rate for the reinsurance protection, and (2) the member's estimated or actual exposure base for the coverage year of the reinsurance protection.

For insurer members, the exposure base is the earned premium at the designated statistical reporting level reported in the Annual Financial Call for Experience to the Minnesota Workers' Compensation Insurers Association ("MWCIA") multiplied by 1.20. Experience rating modifications of the insurers' individual insureds are reflected in the Annual Call data.

For self-insurer members, the exposure base is calculated from Minnesota's covered payroll, multiplied by pure premium base rates as published by the MWCIA, multiplied by 1.20, multiplied by an experience rating modification factor.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Risks and Uncertainties

The Association invests in stocks and bonds of U.S. and foreign companies, U.S. government securities, and mortgage-backed securities. The investment viability and return of funds is dependent on, among other factors, the financial results of the underlying issuers. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values will occur in the near term and that such changes could materially affect the financial statements.

The process of estimating the liability for losses and loss expenses, by its very nature, involves substantial uncertainty. The level of uncertainty is influenced by factors such as the economic assumptions associated with workers' compensation reinsurance. Ultimate actual payments for losses and loss expenses could be significantly different from the estimates.

Comprehensive Income

The Association follows the reporting concept of "Comprehensive Income" which requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. Comprehensive income for the Association includes net income, unrealized gains and losses (other comprehensive income) on available-for-sale securities, and the impact of foreign currency translation adjustments on securities denominated in a currency other than U.S. dollars.

Cash Equivalents

Cash on deposit, shares in money market funds, and short-term debt securities with original maturities of three months or less are classified as cash equivalents.

Short-Term

Debt securities with original maturities greater than three months and less than one year are classified as short term. Amortized cost approximates market value.

Investments

The Association has classified its investments as "available-for-sale" and carries such securities at fair market value based on quoted market prices. Accordingly, the net unrealized gains or losses are included in other comprehensive income as a separate component of surplus. In determining the realized gain or loss on sales of investments, cost is based on the average cost method. Interest income is recognized when earned. Dividend income is recognized on the ex-dividend date.

Purchased premiums and discounts are amortized or accreted using the straight-line method over the terms of the respective issues. The straight-line method approximates the interest method accounting.

When a decline in value of an investment is determined to be other than temporary, the specific investment is carried at estimated realizable value, and its original book value is reduced to reflect this impairment. Such reductions in book value are recognized as realized investment losses in the period in which they were written down.

The Association has entered into interest-rate future, stock index future and interest-rate option contracts. Hedge accounting is not used for these contracts. The contracts are valued at market value and account for less than 1% of total investments.

Property and Equipment

Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Upon sale or retirement of property and equipment, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to operations.

Determination of Surplus

After the close of each fiscal year or at such other times that it deems appropriate, the Board reports whether a surplus or deficit exists based on the annual audited year-end financial statements. In determining whether or not to declare an excess surplus distribution or a deficiency assessment, the Board evaluates surplus or deficit relative to the reserves for discounted funded loss and loss expenses. The Board has determined that up to 30% of funded losses should be retained and reflected on the balance sheet as designated surplus. Designated surplus is needed to maintain sufficient assets to provide for variations between expected and actual investment returns, variations between expected and actual claims experience, and other unexpected financial developments.

The Board may declare an excess surplus distribution or a deficiency assessment if no such distribution or assessment has been declared in the preceding four years, provided that distributions or assessments may be declared more or less frequently than every five years if the Board, at its sole discretion, determines that it is necessary and prudent to do so. Excess surplus distributions or deficiency assessments may be declared by the Board and distributed to or collected from self-insurer members or policyholders pursuant to the provisions of The Enabling Act and applicable provisions of the Plan.

Reinsurance Premiums

Funded earned reinsurance premiums are for the calendar year coverage period for funded losses (losses up to and including the prefunded limit). These premiums are billed in the current period. The reinsurance premiums for the calendar year may also include a credit or charge to equitably distribute excess or deficient premiums for previous periods, including any excess or deficient premiums resulting from a retroactive change in the prefunded limit. No excess or deficient premiums were distributed or collected in 2005 or 2004.

Effective January 1, 2003, the Association purchased a three-year terrorism reinsurance policy that provides coverage of $50 million excess of a $10 million retention for certain domestic and international terrorist events. This protection was intended to minimize the impact of potential assessments or additional premium charges to Association members by covering terrorism losses not covered by the federal Terrorism Risk Insurance Act of 2002. The annual ceded reinsurance premium for this terrorism reinsurance policy was approximately $2.8 million. This terrorism reinsurance policy expired on December 31, 2005, and was not renewed. Based on favorable loss experience through December 31, 2005, and as provided for under the terms of the reinsurance agreement, an expected premium refund of $2.1 million was recorded as a receivable with a corresponding reduction in ceded reinsurance premium.

In 2004 and 2005, the Association charged annual amounts for the terrorism reinsurance coverage and will continue to do so in calendar year 2006. However, the charge relates to each member's exposure for the previous year, thereby matching the period covered by the terrorism reinsurance contract. Therefore, members will be billed for 2005 terrorism coverage during 2006, using their 2005 estimated exposure base. Based on exposure, amounts of $2.6 million and $2.5 million are reflected as earned premium and as deferred funded premium receivable in 2005 and 2004, respectively.

Unfunded deferred reinsurance premiums are to be billed in future years for unfunded losses (loss amounts in excess of the prefunded limit) incurred during the calendar year coverage period and are recognized as earned revenue concurrent with the related unfunded losses and loss expenses. Reinsurance premiums for unfunded losses are billed to the members of the Association in the calendar year when payments in excess of prefunded limits are expected to be reimbursed by the Association. The Association began billing for losses in the unfunded layer in 2003. Premiums of $598,000 and $525,000 were billed in 2005 and 2004, respectively.

Losses and Loss Expenses

The liability for funded losses and loss expenses represents the present value, discounted using 7%, of the estimated liability for losses and loss expenses of the Association for unpaid amounts up to and including the prefunded limit, as determined by actuarial projections using historical pricing model simulations and the payment and case reserve experience of the Association.

The liability for unfunded losses and loss expenses represents the present value, discounted using 7%, of the estimated liability for losses and loss expenses of the Association for unpaid amounts in excess of the prefunded limit, as determined by actuarial projections of the Association.

Reclassifications

Certain items in prior periods have been reclassified to conform to current presentation. Such reclassifications did not affect net income or comprehensive income as previously recorded.

3. Investments

The cost of common and preferred stocks, amortized cost of bonds, and estimated fair values at December 31, 2005 and 2004, are as follows:

	2005			
(in thousands of dollars)	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 602,358	$ 152,230	$ (12,440)	$ 742,148
Preferred stocks	2,309	134	-	2,443
Total stocks	$ 604,667	$ 152,364	$ (12,440)	$ 744,591
U.S. Treasury securities and obligations of U.S. government and agencies	$ 34,046	$ 1,180	$ (228)	$ 34,998
Corporate debt securities	204,681	3,899	(2,815)	205,765
Mortgage backed securities	202,233	916	(2,949)	200,200
Total bonds	$ 440,960	$ 5,995	$ (5,992)	$ 440,963

	2004			
(in thousands of dollars)	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 553,163	$ 150,400	$ (6,924)	$ 696,639
Preferred stocks	3,868	261	-	4,129
Total stocks	$ 557,031	$ 150,661	$ (6,924)	$ 700,768
U.S. Treasury securities and obligations of U.S. government and agencies	$ 50,027	$ 1,349	$ (372)	$ 51,004
Corporate debt securities	186,144	4,206	(884)	189,466
Mortgage backed securities	160,046	2,347	(660)	161,733
Total bonds	$ 396,217	$ 7,902	$ (1,916)	$ 402,203

Total unrealized losses were $18.4 million and $8.8 million at December 31, 2005 and 2004, respectively. The following tables provide a breakdown of unrealized losses at December 31, 2005 and 2004. The Association has reviewed the components and duration of these unrealized losses and concluded that the losses are temporary in nature. The unrealized losses are primarily on common stocks. The unrealized losses for stock holdings and bond holdings as of December 31, 2005 and 2004, are as follows:

Unrealized Holding Losses as of December 31, 2005

	Less than 12 months		12 months or more		Total	
(in thousands of dollars)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Common stocks	$ 148,789	$ (11,382)	$ 4,191	$ (1,058)	$ 152,980	$ (12,440)
Preferred stocks	-	-	-	-	-	-
Total stocks	$ 148,789	$ (11,382)	$ 4,191	$ (1,058)	152,980	$ (12,440)
U.S. Treasury securities and obligations of U.S. government and agencies	$ 9,665	$ (228)	$ -	$ -	$ 9,665	$ (228)
Corporate debt securities	114,270	(2,317)	13,323	(498)	127,593	(2,815)
Mortgage backed securities	142,228	(2,949)	-	-	142,228	(2,949)
Total bonds	$ 266,163	$ (5,494)	$ 13,323	$ (498)	$ 279,486	$ (5,992)

Unrealized Holding Losses as of December 31, 2004

	Less than 12 months		12 months or more		Total	
(in thousands of dollars)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Common stocks	$ 38,988	$ (3,105)	$ 23,056	$ (3,819)	$ 62,044	$ (6,924)
Preferred stocks	-	-	-	-	-	-
Total stocks	$ 38,988	$ (3,105)	$ 23,056	$ (3,819)	$ 62,044	$ (6,924)
U.S. Treasury securities and obligations of U.S. government and agencies	$ 112	$ (373)	$ -	$ -	$ 112	$ (373)
Corporate debt securities	62,247	(501)	10,986	(382)	73,233	(883)
Mortgage backed securities	65,276	(577)	5,661	(83)	70,937	(660)
Total bonds	$ 127,635	$ (1,451)	$ 16,647	$ (465)	$ 144,282	$ (1,916)

The amortized cost and estimated fair value of debt securities at December 31, 2005, by contractual maturity, are shown below:

(in thousands of dollars)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 5,763	$ 5,703
Due after one year through five years	32,780	33,964
Due after five years through ten years	66,342	67,113
Due after ten years	336,075	334,183
	$ 440,960	$ 440,963

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

During 2005, the Association made a determination that the decline in the fair value of certain of its investments was other than temporary. As a result of this determination, the cost bases of the individual securities were written down to fair value as the new cost bases, and the total amount of the write-down of approximately $.2 million was recorded in earnings as a realized loss. The Association wrote down $.9 million of individual securities to fair value in 2004.

Other comprehensive income in 2005 and 2004 is comprised of the change in unrealized gains (losses) on available-for-sale securities arising during the year and the impact of foreign currency translation adjustments on securities denominated in currency other than U.S. dollars as follows:

(in thousands of dollars)	**2005**	**2004**
Change in net unrealized gains on securities	$ 4,294	$ 30,687
Foreign currency net translation loss	(14,090)	(873)
Total other comprehensive (loss) income	$ (9,796)	$ 29,814

(in thousands of dollars)	**2005**	**2004**
Accumulated other comprehensive income consists of		
Net unrealized gains on securities	$ 140,110	$ 135,816
Foreign currency translation (loss) gain	(183)	13,907
	$ 139,927	$ 149,723

Gross gains of $114 million and $116 million, and gross losses of $47 million and $68 million, were realized on sales of investments during 2005 and 2004, respectively. Net investment income and net realized investment gains (losses) during the years ended December 31, 2005 and 2004, are summarized below:

	Net Investment Income		**Net Realized Gains (Losses)**	
(in thousands of dollars)	**2005**	**2004**	**2005**	**2004**
Cash and cash equivalents	$ 1,785	$ 937	$ (351)	$ (50)
Common and preferred stocks	10,882	10,399	65,722	49,367
Bonds	20,522	18,138	1,882	(1,429)
Securities lending	8,465	3,974	-	-
Miscellaneous	216	173	-	-
	41,870	33,621	$ 67,253	$ 47,888
Investment expenses	(5,314)	(4,993)		
Securities lending interest expense	(7,951)	(3,445)		
Securities lending bank fees	(180)	(185)		
	$ 28,425	$ 24,998		

In 2005, net realized gains consisted of gains on securities of approximately $66 million and foreign currency translation gain of $1 million. In 2004, net realized gains consisted of gains on securities of approximately $41 million and foreign currency translation gain of $7 million.

To enhance the return on investments, the Association maintains a securities lending program. At December 31, 2005, the Association temporarily did not have any securities on loan due to the year-end implementation of a new collateral investment trust. At December 31, 2004, the Association had equity and fixed income securities with fair values of $277 million on loan. Cash of at least 102% of the fair value of the securities lent was held as collateral as part of the securities lending program.

The Association reflects the collateral received for securities on loan on the balance sheet if the Association has control over the collateral. An asset of zero and approximately $284 million, and the related liability representing the collateral received, are reflected on the balance sheet at December 31, 2005 and 2004, respectively.

4. Liabilities for Losses and Loss Expenses

The liability for losses and loss expenses at December 31, 2005 and 2004, is summarized as follows:

(in thousands of dollars)	**2005**	**2004**
Funded, undiscounted	$ 4,128,080	$ 3,845,765
Discount	(2,911,734)	(2,686,622)
Funded, discounted	1,216,346	1,159,143
Unfunded, undiscounted	1,263,482	1,304,899
Discount	(1,108,980)	(1,144,075)
Unfunded, discounted	154,502	160,824
Total, discounted	$ 1,370,848	$ 1,319,967

Funded Liabilities

Activity in the funded liability for losses and loss expenses is summarized as follows:

(in thousands of dollars)	**2005**	**2004**
Balance at January 1		
Funded, undiscounted	$ 3,845,765	$ 3,602,376
Incurred related to		
Current year	256,039	185,864
Prior years	83,907	106,765
Total incurred	339,946	292,629
Paid related to		
Current year	37	397
Prior years	57,594	48,843
Total paid	57,631	49,240
Balance at December 31		
Funded, undiscounted	4,128,080	3,845,765
Discount	(2,911,734)	(2,686,622)
Funded, discounted	$ 1,216,346	$ 1,159,143

Reserves are reviewed periodically and updated based on current claims experience, trends and economic outlook.

The following table compares the present value of the Association's funded reserve changes during 2005 with those of 2004.

	2005	2004
Discount rate at year end	7.0%	7.0%

(in thousands of dollars)	2005	2004
Funded reserves as of prior year end	$ 1,159,143	$ 1,090,970
Prior year impact of actuarial adjustments	(11,739)	(5)
Payments on prior accident years	(57,594)	(48,843)
Present value update	79,103	74,638
Reserves for current accident year	47,433	42,383
Total calendar year funded reserve changes	57,203	68,173
Funded reserves as of year end	$ 1,216,346	$ 1,159,143

In 2005, the prior year impact of actuarial adjustments was the net result of changes in loss development estimates and estimates of the timing of future loss and loss expense payments. In 2004, there was only a minor prior year impact of actuarial adjustments, as there were no significant changes in loss development or actuarial assumptions.

Unfunded Liabilities

Payments on prior accident years in excess of prefunded limits totaled $429,000 and $649,000 in 2005 and 2004, respectively. Anticipated payments in excess of prefunded limits are billed as premiums for the unfunded layer.

The unfunded reserve methodology follows the funded analysis. Discount rates for unfunded reserves are the same as the funded reserves. The table below compares the present value unfunded reserve changes during 2005 with those of 2004.

(in thousands of dollars)	2005	2004
Unfunded reserves as of prior year end	$ 160,824	$ 125,537
Prior year changes		
Prior year impact of actuarial adjustments	(24,515)	17,158
Payments on prior accident years	(429)	(649)
Present value update	11,243	8,765
Reserves for the current accident year	7,379	10,013
Total calendar year unfunded reserve changes	(6,322)	35,287
Unfunded reserves as of year end	$ 154,502	$ 160,824

The prior year impact of actuarial adjustments in 2005 was the result of adjusting loss development estimates for the effect of past strengthening of medical case reserves. In 2004, the prior year impact of actuarial adjustments resulted from adjusting loss development estimates for more recent accident years to reflect the increased prevalence of medical expenses in WCRA losses following changes to workers' compensation benefit laws in 1992 and 1995.

Reserve changes for the unfunded layer do not have an impact on accumulated surplus because on the statement of operations, unfunded losses incurred (which include reserve changes) are offset by an unfunded deferred premium.

5. Income Tax Status

In 1996, the Association was granted an exemption from federal income taxes under Section 501(c)(27) of the Internal Revenue Code. The Association received a tax-exempt determination letter from the Internal Revenue Service dated February 7, 1997. Therefore, no provision for income taxes is included in the Association's financial statements.

6. Cash Flows

A reconciliation of net income (loss) to net cash provided by operating activities for the years ended December 31, 2005 and 2004, is as follows:

(in thousands of dollars)	2005	2004
Net income (loss)	$ 29,958	$ (4,718)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Net realized investment gains	(67,253)	(47,888)
Increase in funded uncollected reinsurance premiums, net of accrued premium adjustments	(2,258)	(12)
Increase in liability for funded losses and loss expenses	57,203	68,173
Other, net	1,960	(50)
Total adjustments	(10,348)	20,223
Net cash provided by operating activities	$ 19,610	$ 15,505

Net realized gains on the sale of investments are not reported as part of net cash provided by operating activities. However, net realized investment gains provide an additional source of cash flow to fund the operations of the Association.