Workers' Compensation Reinsurance Association®

2006 Annual Report

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WCRA

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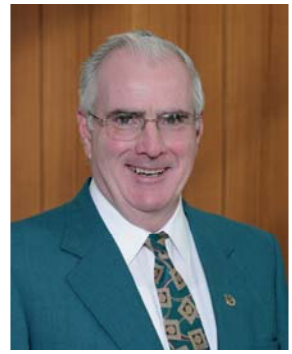

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WCRA Vision

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

Responsibility Quality Rehabilitation Service Integrity Claims Reporting Partnership Communication Reserves

A Trusted Partner Serving Minnesota Since 1979

Welcome to the Workers' Compensation Reinsurance Association (WCRA). The WCRA is a nonprofit organization that reinsures all workers' compensation insurers and self-insured employers in Minnesota. The WCRA assures financial security for Minnesota's employers and their most seriously injured workers by providing cost-effective reinsurance coverage and quality services.

This is the greeting that welcomes visitors to our website. It succinctly describes who we are and what we do, but the most prominent word on the home page is **Partner**. This focus on partnership is deliberate as we strive every day to be "A Trusted Partner" with our members.

The American Heritage College Dictionary defines partnership as "(A) relationship of individuals or groups marked by mutual cooperation and responsibility." This definition captures both the spirit we share and the legal obligations the WCRA and its members owe to each other.

For our part, we will continue to pay you the reimbursements to which you are entitled in one to two days. We will promptly review any settlement proposals you submit to us. We will provide you with expert information on the rehabilitation and treatment of catastrophic injuries. We will maintain the financial integrity of the Association for the benefit of all of our members. We will continue to enhance our web-based calculators and tools to make it easier for you to work with us. Finally, we will respectfully respond to questions you may have about the WCRA and your reinsurance coverage.

In fulfillment of these obligations, during 2006 we processed a record 2,903 claim reimbursements to our members within an average of 1.4 days per claim. Our free online calculators were used over 40,000 times to make our members' claims work easier. We earned a 9 percent return on our investment portfolio—2 percent more than our expected rate of return of 7 percent. Despite adding two new staff members, our operating expenses were 5 percent under budget. And we responded to hundreds of member inquiries regarding issues about premiums, claims, third-party administrators, and settlements.

For your part, we ask that you carefully consider your responsibilities to the Association for the collective benefit of *all* WCRA members. In recent years, we have identified several trends that have adversely impacted the Association, and we ask that you especially focus on the issues described below.

- ✦ A number of our members have failed to report a significant amount of losses to the Association. These late-reported losses in 2006 resulted in a $41 million increase in prior accident year loss reserves and a significant increase in current accident year loss reserves. As a result, substantial increases in the WCRA's premiums will be required in the coming years.
- ✦ Outstanding reimbursements totaling nearly $30 million have not been submitted by members, and the number of reimbursement requests returned to members due to lack of proper documentation has increased by 20 percent.

- Several recent settlements have been entered into without notice to the Association and were settled for significantly more than the settlement value we would have recommended.
- Home care costs for injured workers who have suffered severe spinal cord and brain injuries are a significant claim exposure. Some members have never handled a catastrophic brain or spinal cord injury claim and are unsure about the best treatment and rehabilitation resources. Several of the more than 200 reported cases of brain and spinal cord injuries have not been well-administered and are incurring home care costs that are far higher than average for such cases.
- Organizational changes and revisions to the business practices of our members affect the work of the Association. Frequent changes in third-party administrators often result in inconsistent claim administration. Some carriers have moved their workers' compensation claim administration out of state, resulting in claims being managed by individuals who are unfamiliar with Minnesota workers' compensation law. Members have merged, been acquired, or spun off with little awareness or tracking of who handles their workers' compensation liabilities or how the claims are being handled.

Your Board of Directors and WCRA management have undertaken a number of changes to address these issues and to improve the partnership with our members.

- Members are now required to report catastrophic claims to the WCRA within 15 business days of the time the member is notified of a claim. This allows our experienced claims services and rehabilitation staff to work with the member to ensure that the claimant is receiving the best possible care. In turn, this will result in the best possible outcome for the injured worker and should reduce costs over the life of the claim.
- Proposed settlements of claims are required to be reported to the WCRA in order to allow the Association's claims services staff to review the settlement proposal for accuracy and reasonableness. The member is responsible for deciding whether or not to settle a claim. When such settlements involve WCRA funds, however, the member should be aware of how the Association evaluates the settlement value of the claim.
- The Association's staff is reviewing its approaches to auditing member claims and premium reporting. Our goal is to make certain that claims are being reported accurately and in a timely manner and that the exposure base and payroll data used to calculate WCRA premiums are accurate.

We believe that good communication is the key to an effective partnership. Your Board of Directors and the WCRA staff pledge to continue to work on your behalf in a spirit of mutual cooperation and responsibility. Over the 27-year history of the WCRA, the vast majority of our members have done a good job of fulfilling their obligations to the Association. If all of those involved in the WCRA partnership do their parts, the Association will continue to provide cost-effective reinsurance coverage and quality services to its members.

David R. Young

WCRA Board Chair
David R. Young
Wausau Insurance Companies

Carl Cummins III

President and CEO
Carl W. Cummins III
WCRA

Overview

In 2006, the WCRA took a step back financially after three consecutive years of financial improvement. The Association recorded a comprehensive loss of $26 million and swung from a balance sheet surplus to a deficit. At December 31, 2006, the balance sheet deficit was $16 million, a deterioration of $26 million from the December 31, 2005 surplus of $10 million. The comprehensive loss in 2006 was due to an increase in funded loss reserves resulting from a larger-than-expected number of newly reported losses.

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, 2006 deficit of $16 million was -1 percent of funded loss reserves, a deterioration from a surplus of 1 percent of funded loss reserves at December 31, 2005, but still well within the surplus band.

During 2006, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. For 2006, premiums collected, interest and dividends from investments, losses and loss expenses paid, and operating expenses were all in line with management's expectations.

	($ millions)	
Financial Highlights	**2006**	**2005**
Funded earned premiums	$ 47	$ 51
Comprehensive (loss) income	$ (26)	$ 20
Accumulated (deficit) surplus	$ (16)	$ 10
Investment return	9%	8%
Assumed investment return	7%	7%

Operating Results and Comprehensive Loss

Premiums and Losses

The WCRA earned $47 million in funded premiums in 2006, down from $51 million in 2005. This decrease was primarily the result of two factors: a decrease in premiums resulting from prior year adjustments, and a decrease in premiums for terrorism reinsurance coverage. The terrorism reinsurance coverage expired on December 31, 2005 and was not renewed.

Funded losses and loss expenses incurred for 2006 were $185 million, up significantly from $115 million in the prior year. This increase resulted from a larger-than-expected number of newly reported losses during the year due to a significant reporting backlog within a small segment of the WCRA membership. The newly reported losses resulted in a $41 million increase in prior accident year loss reserves and a significant increase in current accident year loss reserves. In 2005, funded losses and loss expense reserves decreased modestly from the prior year due to a $12 million reduction in loss reserves in prior accident years. This prior year impact was due primarily to actuarial adjustments of loss development estimates for the effect of past strengthening of medical case reserves.

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

	($ millions)	
	2006	**2005**
Prior accident years:		
Present value update	$ 83	$ 79
Actuarial adjustments	41	(12)
Total prior accident years	124	67
Current accident year	61	48
Total funded losses and loss expenses incurred	$185	$115

Investment Performance

The investment portfolio had a total rate of return of 9 percent in 2006, up from a return of 8 percent in 2005. The 2006 return was driven by strong returns in the international and domestic stock markets. International equities returned 25 percent and domestic equities returned 9 percent. The components of investment results are shown below.

	($ millions)	
	2006	**2005**
Investment income, net of related expenses	$ 34	$ 28
Net realized investment gains	74	67
Change in unrealized gains on securities	5	(10)
Total investment results	$113	$ 85

In 2006 and 2005, the *WCRA Investment Policy* included asset allocation targets of 50 percent for domestic equities, 10 percent for international equities, and 40 percent for fixed income investments.

Comprehensive Loss

The WCRA recorded a comprehensive loss of $26 million in 2006, a significant swing from the comprehensive income of $20 million recorded in 2005. Comprehensive income (loss) consists of net income (loss) and the change in unrealized gains (losses) on investments. In 2006, the comprehensive loss was driven by an increase in loss reserves for both prior and current accident years. 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.

Balance Sheet

Assets and Liabilities

Total assets were $1,764 million at December 31, 2006 compared with $1,410 million at the end of the previous year. The increase in total assets was primarily due to an increase in securities lending collateral. At December 31, 2005, the WCRA temporarily had no 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.

Total liabilities were $1,780 million at December 31, 2006 compared with liabilities of $1,399 million at December 31, 2005. The increase in liabilities corresponded to the increase in assets, and was primarily the result of a $200 million increase 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 $1,342 million at December 31, 2006 compared with $1,216 million at December 31, 2005. 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.

	($ millions)	
	2006	**2005**
Funded reserves as of January 1	$1,216	$1,159
Losses and loss expenses incurred:		
Prior accident years	$ 124	$ 67
Current accident year	61	48
Total incurred	185	115
Losses and loss expenses paid	(59)	(58)
Funded reserves as of December 31	$1,342	$1,216

The components of prior accident years incurred losses and loss expenses are discussed above under “Operating Results and Comprehensive Loss.”

The liability for unfunded losses and loss expenses totaled $170 million at December 31, 2006 compared with $154 million at December 31, 2005. 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 increase in this liability for 2006 was driven by the present value update and reserves for the current accident year. 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. Unfunded deferred premium revenue of $16 million and negative $6 million was recognized in 2006 and 2005, respectively, concurrent with the changes in incurred unfunded losses and loss expenses. Loss payments in excess of prefunded limits totaled $815,000 and $429,000 in 2006 and 2005, respectively.

Surplus

At year-end 2006, the WCRA had an accumulated deficit of $16 million compared with a surplus of $10 million at the end of 2005. This $26 million deterioration was due to an increase in funded loss reserves resulting from a larger-than-expected number of newly reported losses. 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, 2006 deficit was -1 percent of funded reserves, compared to a surplus of 1 percent of funded reserves at December 31, 2005.

Cash Flow

During 2006, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. Cash flow from operating activities was $26 million in 2006 compared with $20 million in 2005. This $6 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 a modest 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 $74 million in 2006, up from $67 million in 2005.

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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 (deficit) surplus and of cash flows present fairly, in all material respects, the financial position of the Workers' Compensation Reinsurance Association (the "Association") at December 31, 2006 and 2005, 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 14, 2007

Workers' Compensation Reinsurance Association
Balance Sheets
December 31, 2006 and 2005

(in thousands of dollars)		2006		2005
Assets				
Investments, at market value				
Cash and cash equivalents (including securities lending collateral of $199,685 and $0 and December 31, 2006 and 2005, respectively)	**$**	**249,127**	$	50,545
Short-term		**1,714**		887
Common and preferred stock		**794,025**		744,591
Bonds		**520,473**		440,963
Total investments		**1,565,339**		1,236,986
Uncollected reinsurance premiums				
Current premiums due		**29**		126
Deferred funded premiums		**-**		2,632
Reinsurance premium receivable		**-**		2,109
Deferred for unfunded losses		**169,124**		154,567
Total uncollected reinsurance premiums		**169,153**		159,434
Accrued investment income		**4,128**		4,017
Due from securities brokers		**24,632**		8,881
Prepaid expenses and other assets		**219**		130
Property and equipment, less accumulated depreciation of $720 and $704 at December 31, 2006 and 2005, respectively		**82**		97
Total assets	**$**	**1,763,553**	$	**1,409,545**
Liabilities and Accumulated (Deficit) Surplus				
Liabilities				
Losses and loss expenses				
Funded	**$**	**1,342,320**	$	1,216,346
Unfunded		**169,528**		154,502
Total losses and loss expenses		**1,511,848**		1,370,848
Payable under securities loan agreement		**199,685**		-
Due to securities brokers		**67,590**		27,890
Accounts payable and accrued expenses		**462**		336
Total liabilities		**1,779,585**		1,399,074
Accumulated deficit from operations		**(161,049)**		(129,456)
Accumulated other comprehensive income		**145,017**		139,927
Designated accumulated (deficit) surplus (Note 2)		**(16,032)**		10,471
Total liabilities and accumulated (deficit) surplus	**$**	**1,763,553**	$	1,409,545

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

Workers' Compensation Reinsurance Association
Statements of Operations, Comprehensive Income and Accumulated (Deficit) Surplus
Years Ended December 31, 2006 and 2005

(in thousands of dollars)	**2006**	2005
Revenues		
Reinsurance premiums		
Funded earned	**$ 46,668**	$ 51,409
Unfunded deferred	**15,842**	(5,893)
Ceded reinsurance	**-**	(703)
Investment income, net of related expenses	**34,481**	28,425
Net realized investment gains	**73,523**	67,253
Total revenues	**170,514**	140,491
Expenses		
Losses and loss expenses		
Funded	**184,616**	114,834
Unfunded	**15,842**	(5,893)
Losses and loss expenses incurred	**200,458**	108,941
Operating and administrative expenses	**1,649**	1,592
Total expenses	**202,107**	110,533
Net (loss) income	**(31,593)**	29,958
Other comprehensive income (loss)		
Change in net unrealized gains on securities and foreign currency translation adjustment (Note 3)	**5,090**	(9,796)
Comprehensive (loss) income	**(26,503)**	20,162
Accumulated surplus (deficit), beginning of year	**10,471**	(9,691)
Accumulated (deficit) surplus, end of year	**$ (16,032)**	$ 10,471

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

Workers' Compensation Reinsurance Association
Statements of Cash Flows
Years Ended December 31, 2006 and 2005

(in thousands of dollars)	**2006**	**2005**
Cash flows from operating activities		
Net premiums collected	**$ 52,792**	$ 49,749
Interest and dividends received, net of related expenses	**34,487**	29,360
Losses and loss expenses paid	**(59,458)**	(58,060)
Operating and administrative expenses paid	**(1,569)**	(1,439)
Net cash provided by operating activities	**26,252**	19,610
Cash flows from investing activities		
Sale of investments		
Short-term, net	**(827)**	898
Common and preferred stocks	**634,246**	524,151
Bonds	**510,269**	439,425
Purchase of investments		
Common and preferred stocks	**(603,075)**	(506,746)
Bonds	**(567,941)**	(467,580)
Purchase of equipment	**(27)**	(30)
Net cash used in investing activities	**(27,355)**	(9,882)
Cash flows from financing activities		
Collateral for securities on loan	**199,685**	(284,364)
Net cash provided by (used in) financing activities	**199,685**	(284,364)
Net increase (decrease) in cash and cash equivalents	**198,582**	(274,636)
Cash and cash equivalents		
Beginning of year	**50,545**	325,181
End of year	**$ 249,127**	$ 50,545

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 2006, members selected one of three maximum per-loss occurrence retention limits, which were $390,000, $780,000 or $1,560,000. For 2005, members selected one of three maximum per-loss occurrence retention limits, which were $380,000, $760,000 or $1,520,000. 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 $7.8 million and $7.6 million per occurrence for 2006 and 2005, 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 losses 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 2006 or 2005.

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 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 as of December 31, 2005. This amount was collected in 2006.

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

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 $1,285,000 and $598,000 were billed in 2006 and 2005, 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.

3. Investments

The cost of common and preferred stocks, amortized cost of bonds, and estimated fair values at December 31, 2006 and 2005, are as follows:

(in thousands of dollars)	**2006** Cost/ Amortized Cost	**2006** Gross Unrealized Gains	**2006** Gross Unrealized Losses	**2006** Estimated Fair Value
Common stocks	**$ 649,639**	**$ 152,937**	**$ (10,591)**	**$ 791,985**
Preferred stocks	**1,948**	**92**	**-**	**2,040**
Total stocks	**$ 651,587**	**$ 153,029**	**$ (10,591)**	**$ 794,025**
U.S. Treasury securities and obligations of U.S. government and agencies	**$ 36,950**	**$ 1,561**	**$ (320)**	**$ 38,191**
Corporate debt securities	**252,882**	**4,725**	**(2,747)**	**254,860**
Mortgage backed securities	**228,062**	**1,663**	**(2,303)**	**227,422**
Total bonds	**$ 517,894**	**$ 7,949**	**$ (5,370)**	**$ 520,473**

(in thousands of dollars)	**2005** Cost/ Amortized Cost	**2005** Gross Unrealized Gains	**2005** Gross Unrealized Losses	**2005** 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

Total unrealized losses were $15.9 million and $18.4 million at December 31, 2006 and 2005, respectively. The following tables provide a breakdown of unrealized losses at December 31, 2006 and 2005. 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, 2006 and 2005, are as follows:

Unrealized Holding Losses as of December 31, 2006

(in thousands of dollars)	Less than 12 months Estimated Fair Value	Less than 12 months Unrealized Losses	12 months or more Estimated Fair Value	12 months or more Unrealized Losses	Total Estimated Fair Value	Total Unrealized Losses
Common stocks	**$ 87,219**	**$ (10,366)**	**$ 5,328**	**$ (225)**	**$ 92,547**	**$ (10,591)**
Preferred stocks	**-**	**-**	**-**	**-**	**-**	**-**
Total stocks	**$ 87,219**	**$ (10,366)**	**$ 5,328**	**$ (225)**	**$ 92,547**	**$ (10,591)**
U.S. Treasury securities and obligations of U.S. government and agencies	**$ 7,897**	**$ (320)**	**$ -**	**$ -**	**$ 7,897**	**$ (320)**
Corporate debt securities	**105,174**	**(1,499)**	**32,710**	**(1,248)**	**137,884**	**(2,747)**
Mortgage backed securities	**152,895**	**(2,064)**	**12,316**	**(239)**	**165,211**	**(2,303)**
Total bonds	**$ 265,966**	**$ (3,883)**	**$ 45,026**	**$ (1,487)**	**$ 310,992**	**$ (5,370)**

Unrealized Holding Losses as of December 31, 2005

(in thousands of dollars)	Less than 12 months Estimated Fair Value	Less than 12 months Unrealized Losses	12 months or more Estimated Fair Value	12 months or more Unrealized Losses	Total Estimated Fair Value	Total 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)

The amortized cost and estimated fair value of debt securities at December 31, 2006, by contractual maturity, are shown below:

(in thousands of dollars)	Amortized Cost	Estimated Fair Value
Due in one year or less	**$ 6,506**	**$ 6,506**
Due after one year through five years	**48,937**	**51,410**
Due after five years through ten years	**65,613**	**66,300**
Due after ten years	**396,838**	**396,257**
	$ 517,894	**$ 520,473**

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 2006, 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 also wrote down $.2 million of individual securities to fair value in 2005.

Other comprehensive income in 2006 and 2005 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)	**2006**	2005
Change in net unrealized gains on securities	**$ (1,455)**	$ 4,294
Foreign currency net translation gain (loss)	**6,545**	(14,090)
Total other comprehensive income (loss)	**$ 5,090**	$ (9,796)

(in thousands of dollars)	**2006**	2005
Accumulated other comprehensive income consists of		
Net unrealized gains on securities	**$ 138,655**	$ 140,110
Foreign currency translation gain (loss)	**6,362**	(183)
	$ 145,017	$ 139,927

Gross gains of $134 million and $114 million, and gross losses of $60 million and $47 million, were realized on sales of investments during 2006 and 2005, respectively. Net investment income and net realized investment gains (losses) during the years ended December 31, 2006 and 2005, are summarized below:

	Net Investment Income		Net Realized Gains (Losses)	
(in thousands of dollars)	**2006**	2005	**2006**	2005
Cash and cash equivalents	**$ 3,395**	$ 1,785	**$ 80**	$ (351)
Common and preferred stocks	**12,024**	10,882	**75,384**	65,722
Bonds	**23,646**	20,522	**(1,941)**	1,882
Securities lending	**8,042**	8,465	**-**	-
Miscellaneous	**341**	216	**-**	-
	47,448	41,870	**$ 73,523**	$ 67,253
Investment expenses	**(5,150)**	(5,314)		
Securities lending interest expense	**(7,713)**	(7,951)		
Securities lending bank fees	**(104)**	(180)		
	$ 34,481	$ 28,425		

In 2006, net realized gains consisted of gains on securities of approximately $73 million and foreign currency translation gain of $1 million. In 2005, net realized gains consisted of gains on securities of approximately $66 million and foreign currency translation gain of $1 million.

To enhance the return on investments, the Association maintains a securities lending program. At December 31, 2006, the Association had equity and fixed income securities with fair values of $194 million on loan. 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. 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 approximately $200 million and zero, and the related liability representing the collateral received, are reflected on the balance sheet at December 31, 2006 and 2005, respectively.

4. Liabilities for Losses and Loss Expenses

The liability for losses and loss expenses at December 31, 2006 and 2005, is summarized as follows:

(in thousands of dollars)	**2006**	**2005**
Funded, undiscounted	**$ 4,977,105**	$ 4,128,080
Discount	**(3,634,785)**	(2,911,734)
Funded, discounted	**1,342,320**	1,216,346
Unfunded, undiscounted	**1,414,041**	1,263,482
Discount	**(1,244,513)**	(1,108,980)
Unfunded, discounted	**169,528**	154,502
Total, discounted	**$ 1,511,848**	$ 1,370,848

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

(in thousands of dollars)	**2006**	**2005**
Balance at January 1		
Funded, undiscounted	**$ 4,128,080**	$ 3,845,765
Incurred related to		
Current year	**337,895**	256,039
Prior years	**569,773**	83,907
Total incurred	**907,668**	339,946
Paid related to		
Current year	**164**	37
Prior years	**58,479**	57,594
Total paid	**58,643**	57,631
Balance at December 31		
Funded, undiscounted	**4,977,105**	4,128,080
Discount	**(3,634,785)**	(2,911,734)
Funded, discounted	**$ 1,342,320**	$ 1,216,346

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 2006 with those of 2005.

	2006	2005
Discount rate at year end	**7.0%**	7.0%

(in thousands of dollars)	2006	2005
Funded reserves as of prior year end	**$ 1,216,346**	$ 1,159,143
Prior year impact of actuarial adjustments	**40,344**	(11,739)
Payments on prior accident years	**(58,479)**	(57,594)
Present value update	**83,098**	79,103
Reserves for current accident year	**61,011**	47,433
Total calendar year funded reserve changes	**125,974**	57,203
Funded reserves as of year end	**$ 1,342,320**	$ 1,216,346

The significant increase in funded loss reserves during 2006 resulted from a larger than expected number of newly reported losses during the year. These newly reported losses resulted from the elimination of a significant loss reporting backlog at a limited number of WCRA members. The newly reported losses resulted in a substantial increase in prior year case reserves, and also resulted in an increase in prior year reserves for losses incurred but not yet reported. The increase in reported losses for recent accident years also resulted in a higher estimate of loss reserves for the current accident year.

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.

Unfunded Liabilities
Payments on prior accident years in excess of prefunded limits totaled $815,000 and $429,000 in 2006 and 2005, 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 2006 with those of 2005.

(in thousands of dollars)	**2006**	2005
Unfunded reserves as of prior year end	**$ 154,502**	$ 160,824
Prior year changes		
Prior year impact of actuarial adjustments	**(3,765)**	(24,515)
Payments on prior accident years	**(815)**	(429)
Present value update	**10,786**	11,243
Reserves for the current accident year	**8,820**	7,379
Total calendar year unfunded reserve changes	**15,026**	(6,322)
Unfunded reserves as of year end	**$ 169,528**	$ 154,502

The prior year impact of actuarial adjustments in 2006 resulted from a slowdown in the expected timing of future payments. In 2005, the prior year impact of actuarial adjustments was the result of adjusting loss development estimates for the effect of past strengthening of medical case reserves.

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 (loss) income to net cash provided by operating activities for the years ended December 31, 2006 and 2005, is as follows:

(in thousands of dollars)	**2006**	**2005**
Net (loss) income	**$ (31,593)**	$ 29,958
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Net realized investment gains	**(73,523)**	(67,253)
Decrease (increase) in funded uncollected reinsurance premiums, net of accrued premium adjustments	**4,838**	(2,258)
Increase in liability for funded losses and loss expenses	**125,974**	57,203
Other, net	**556**	1,960
Total adjustments	**57,845**	(10,348)
Net cash provided by operating activities	**$ 26,252**	$ 19,610

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.

Carl W. Cummins III
President and CEO

WCRA 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.

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