WORKERS' COMPENSATION REINSURANCE ASSOCIATION

1999 ANNUAL REPORT

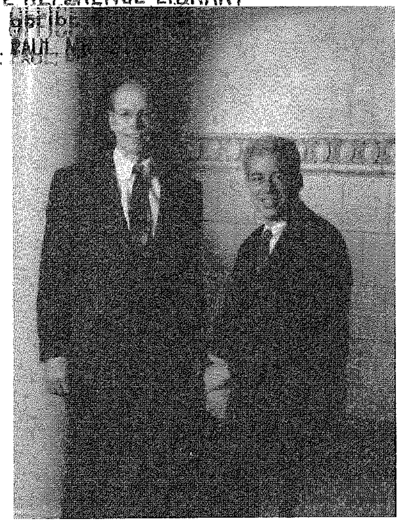
"BUILDING BRIDGES"

TO OUR MEMBERS

The WCRA enjoyed a predictably stable and productive year in 1999. Premium rates were unchanged, and premium revenues increased by a modest 4 percent from $28.6 million in 1998 to $29.8 million in 1999. Claims paid increased as expected by 6.8 percent to $35.4 million. The number of new claims reported continued to decline as a result of statutory benefit changes during the 1990s and members' increased selection of the super retention limit. The number of individual claim reimbursements continued trending upward, however, to more than 1,900 for the year. The WCRA portfolio earned an overall rate of return of 12.5 percent, once again substantially exceeding our projected long-term rate of return of 8 percent.

Thus, we're pleased to be able to report to you that the WCRA's financial position remains sound and that the association is well positioned to continue to meet your future workers' compensation reinsurance needs.

Supporting this optimistic conclusion is an independent analysis of many of the WCRA's actuarial and financial practices and policies commissioned by the Board of Directors. Every three or four years, the Board retains an independent consultant to evaluate the association's actuarial reserving methodologies and economic assumptions. In 1999, the Actuarial and Insurance Consulting Group of Deloitte & Touche LLP (D&T) undertook this evaluation. The scope of its work was broadened, however, to examine the key pricing and discounting assumptions used by the WCRA in establishing its reserves and to review the association's claims administration procedures. D&T reached the following significant conclusions.



Michael Markman, Jay Benanav

* The general inflation rate, indemnity inflation rate, and discount rate assumptions used by the association's actuaries in establishing reserves are reasonable. Medical cost assumptions are an important component and should be investigated in more detail. These assumptions are critical when establishing WCRA reserves for claims to be paid as long as 80 years into the future.
* The WCRA's funded reserve levels are conservative yet reasonable. Year-end 1999 reserves of $787.1 million are comfortably within the range of $626.8 million to $848.5 million established by D&T.
* The WCRA's use of an 8 percent discount rate is reasonable, although slightly higher than D&T's suggested rate of 7.69 percent.
* D&T concluded that the WCRA's actuarial and claims services departments are performing at "best practice" levels when compared with other reinsurers.

While the D&T study provides an excellent tool for the association to use in its efforts to continuously improve its actuarial, claims, and financial practices, it also confirms that the WCRA is being responsibly and professionally managed for the benefit of its members and the state's seriously injured workers. We particularly commend the actuarial and claims services departments for the improvements they have made in their areas of responsibility over the last several years.

In 1999, we at the WCRA began "building bridges" to our members and to the larger world on the Internet. The association's Web site at www.wcra-mn.com was activated in July and is rapidly becoming our most convenient medium for communicating with you. All of the WCRA's publications and official documents are currently available on line. Several timesaving calculators are offered, which many members have found convenient and useful in making various Minnesota workers' compensation benefit calculations. More calculators will be added during 2000. Secure sections are also planned so members will be able to use passwords to access their own WCRA claims and premium data and, ultimately, report claims and submit reimbursement requests on line.

In closing, we would like to note the departures of three individuals who have made valuable contributions to the WCRA. Thomas Driscoll of Liberty Mutual Insurance Company has served as vice chair of the Board of Directors. He announced that, because of changes in his work responsibilities, he will be leaving the Board at the end of his term in June 2000. Richard Hertle, assistant treasurer-premium auditing, left the association after 15 years of service to follow a new career path in the insurance industry. Jeffrey Fischer, director of investments, also resigned to accept another investment position. Our thanks and best wishes to Tom, Rick, and Jeff.

Michael D. Markman
Chair of the Board

Jay Y. Benanav
President and CEO

THE WCRA
BUILDING BRIDGES

Since the WCRA was established by the Minnesota Legislature in 1979, it has played a unique role in the state's workers' compensation system. Indeed, it is unique among the workers' compensation systems in all 50 states. While five states have exclusive state workers' compensation funds, the WCRA is the only statutorily created, exclusive reinsurance organization.

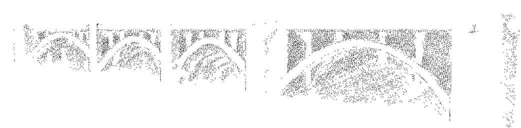
The legislators who established the WCRA recognized that, while the Board of Directors and management of the association would have a legal fiduciary responsibility to its members, as a quasi-public entity, it would affect all of the constituencies involved in the workers' compensation system. For that reason, the Board of Directors was designed to bring together representatives of insurers, employees, self-insurers, employers, state government, and the general public.

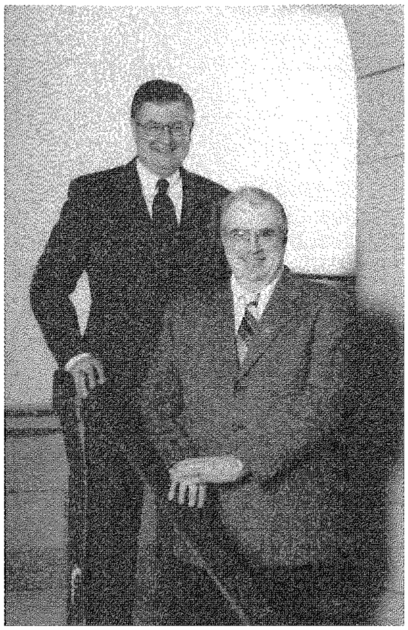
As the Minnesota workers' compensation system has evolved over time through decisions made at the Legislature and in the courts, these constituencies have often been adversaries. Yet, while the interests of organized labor, the business community, insurers, the public, and government have often differed in the legislative process over the last 20 years, their representatives have, as one long-time Board member observed, "checked their guns at the door" of the WCRA. In spite of their differences about various aspects of the workers' compensation system, the directors have come together to discharge their legal responsibility to make the WCRA operate as smoothly and efficiently as possible.

Thus, because of its central position in the workers' compensation system, the WCRA has been able to play a mediating role and has provided a setting in which these constituencies could build bridges among themselves.

Over the years, 55 individuals have served as WCRA directors. They have brought to the association varying philosophical perspectives on how the workers' compensation system should be operated. Over time, however, the collective decisions made by these individuals have allowed the WCRA to develop into a mature organization with $1.6 billion in assets in place to provide for the future stability of the state's workers' compensation system.

The following sections profile the current members of the Board of Directors and the constituencies they represent.





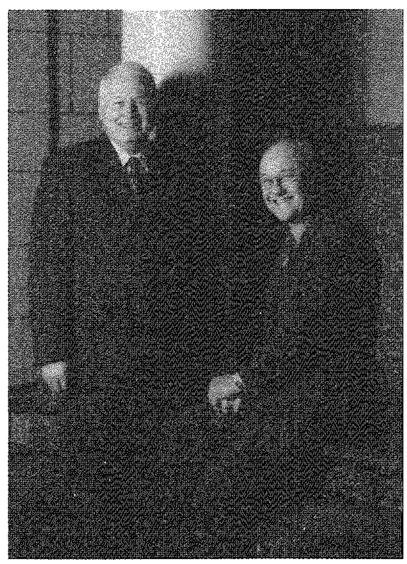
Bernard Brommer, Donald Gerdesmeier

EMPLOYEES

In 1999, an estimated 2,464,000 workers were covered under the state's workers' compensation system. Their interests on the Board of Directors are represented by two directors appointed by the Commissioner of Labor and Industry. Traditionally, commissioners have appointed individuals from among the leaders of organized labor in Minnesota. The current employee directors on the Board are Bernard Brommer, president of the Minnesota AFL-CIO, and Donald Gerdesmeier, the government affairs representative for Teamsters D.R.I.V.E.

For organized labor, the WCRA is a credible source of data on the workers' compensation system generally and on the impact the law has on the most seriously injured workers in particular. It also allows the labor representatives an opportunity to better understand the workings of the insurance industry and gives them a fresh perspective, presented in a nonadversarial environment, of what employers expect from the workers' compensation system.

While the day-to-day business activity of the WCRA consists of processing claims reimbursements, collecting premiums, managing investments, and doing the other things that insurers and reinsurers traditionally do, the employee directors continually remind the Board and staff that the ultimate beneficiaries of the work of the association are the hundreds of workers who are seriously injured on the job in the state each year.



Laurence Koll, Bradley Robinson

EMPLOYERS

Minnesota's approximately 96,000 employers are represented by two directors appointed by the

Commissioner of Labor and Industry. Both of the current employer representatives are experienced participants in workers' compensation policy debates. Laurence Koll is a senior partner in the St. Paul law firm of Koll, Morrison & Charpentier. In addition to practicing workers' compensation law, he has represented a variety of business interests on workers' compensation issues before the Legislature. He served on the Workers' Compensation Study Commission from 1977 to 1979. While he opposed establishment of the WCRA at that time, he has come to believe that the association plays an important role in stabilizing the workers' compensation system and in reducing costs for the state's employers. Bradley Robinson is president of Robinson Rubber Products, a small manufacturing company in New Hope, Minnesota. He is a long-time advocate for the interests of employers in the workers' compensation system.

Since employers purchase their workers' compensation coverage from primary insurers, most of them are not familiar with the role of the WCRA. As a result of statutory changes made by the Legislature in 1993, however, the WCRA has paid out more than $36 million in excess surplus distributions directly to all of the state's insured employers. To the extent that the association continues to operate efficiently and earns more on its investments than necessary to meet its future claims obligations, employers will continue to share in future WCRA surpluses.

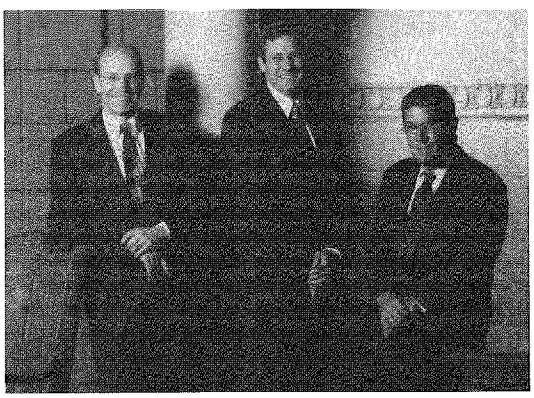
Howard Bicker. Not pictured - Pamela Wheelock

GOVERNMENT

The WCRA is regulated by the Commissioner of Labor and Industry. The Legislature, however, wanted to ensure that the financial affairs of the association were properly administered and that there was additional state government participation in managing the association. Therefore, in 1985, the law was amended to add two state officials to the Board of Directors. Howard Bicker, executive director of the Minnesota State Board of Investment, has served on the Board for the past 15 years, and Pamela Wheelock, Commissioner of Finance, became a director in 1999.

Mr. Bicker, who is responsible for managing more than $50 billion in public funds entrusted to the State Board of Investment, chairs the association's Investment Committee, which advises the Board of Directors on all policies and investment management decisions affecting the WCRA's $1.6 billion portfolio. Commissioner Wheelock and her predecessors or their authorized designees have contributed their financial management expertise and knowledge of the public policymaking process to the work of the Board.

The State of Minnesota is the largest self-insured member of the association and has received more than $16.9 million in surplus distributions and premium credits from the WCRA over the last eight years.



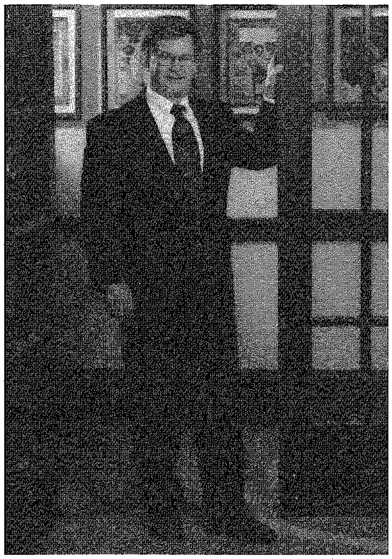
Michael Markman, Thomas Driscoll, Stephen Lilienthal. Not pictured: George Klouda

INSURERS

The four insurer representatives on the Board are Michael Markman, president of Zurich Insurance Group-U.S.; George Klouda, chair of the Board of Directors of Western National Mutual Insurance Company; Thomas Driscoll, vice president of Liberty Mutual Insurance Company; and Stephen Lilienthal, executive vice president of The St. Paul Companies' U.S. insurance operations. They are elected by the association's 443 insurer members. Traditionally, insurer representation on the Board has been balanced between foreign and domestic companies and stock and mutual companies.

The active participation of the insurance industry has been a key to the success of the operations of the WCRA. The insurer members of the Board have generously shared their time and expertise, providing policy direction and overseeing the development of the association's claims, actuarial, premium, and operational functions. Two current Board members have been particularly strong leaders in guiding the WCRA's development. Mr. Markman has played a central role in the establishment and evolution of the association. As commissioner of insurance in 1979, he helped draft the legislation creating the WCRA and oversaw its implementation. Mr. Markman has served as chair of the Board since 1986. Mr. Klouda joined the Board in 1986. He has been a strong advocate for the interests of the insurance industry and has worked to ensure that the association maintains high standards for financial integrity and responsibility.

Insurer members of the WCRA have realized tangible economic benefits from the WCRA. From 1979 through 1999, insurers paid WCRA premiums totaling $713.4 million. However, in addition to the claims already paid and the continuing reinsurance protection those premiums provide, insurers have received surplus distributions and premium credits of $686.6 million.



Gary Swoverland. Not pictured: Susan Herboldt

SELF-INSURERS

The 192 self-insurer members of the WCRA are composed of corporations, associations, and various governmental units, including the State of Minnesota. They are represented on the Board by Gary Swoverland, director of risk management and real estate for Land O'Lakes, and Susan Herboldt, safety and risk manager for Itasca County.

Self-insurers generally have been among the strongest supporters of the WCRA. They have found the WCRA to be a stable and cost-effective way of reinsuring their workers' compensation risks. The Minnesota Self-Insurers' Association has adopted a position supporting the WCRA's continued operation and opposing any legislative efforts to eliminate or substantially change the association.

Self-insurers share in any excess premium and excess surplus distributions made by the association. Since 1992, self-insurers have received surplus distributions and premium credits from the WCRA of $196.9 million, which compares to their total premiums paid of $223.4 million between 1979 and 1999.

Mary Paidosh

PUBLIC

While the general public does not have a specific, defined role in the workers' compensation system, members of the public are affected by actions taken in every part of the system. The public includes all workers and employers. Members of the public are consumers who pay for workers' compensation as part of the cost of the goods they purchase. As taxpayers, the general public pays for the cost of workers' compensation insurance and claims through the taxes it pays to all levels of government. In order to ensure that this broad public perspective is considered in the decisions made by the Board of Directors, the Legislature included one public representative. Mary Paidosh, vice president of Cherokee State Bank, has served as the public member of the Board since her appointment by the Commissioner of Labor and Industry in 1992.

Since the public members have not generally had direct professional involvement in the workers' compensation system, they have tended to bring an objective, mediating perspective to the work of the Board, helping to bridge the differences among other Board members and ensuring that the Board's actions take into consideration the broad public interest.

WCRA SENIOR MANAGEMENT

Left to right: Mary Johnson, Chief Financial Officer; Carl Cummins III, General Counsel; Jane Jasper Krumrie, Vice President -Actuarial; Elisabeth Skoglund, Vice President - Claims and Information Services; Jay Benanav, Chief Executive Officer.

MANAGEMENT'S SUMMARY ANALYSIS OF 1999 FINANCIAL RESULTS

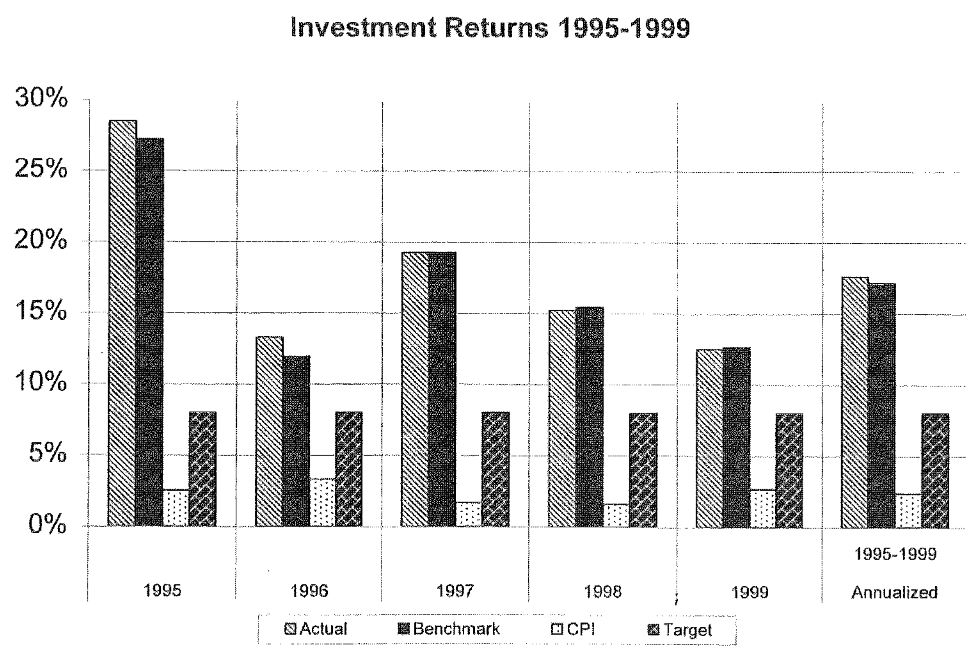
In 1999, the WCRA posted strong financial results, which continued a trend experienced over the last several years. Excellent performance of the investment portfolio combined with modest downward reserve revisions resulted in an increase in surplus of $161 million at December 31, 1999.

Investment Portfolio

The investment portfolio grew to $1,565.6 million at December 31, 1999, earning a very good absolute return of 12.51 percent for the year. On a relative basis, however, the portfolio slightly underperformed the WCRA policy benchmark return of 12.64 percent. The portfolio outperformed both the association's target earnings rate of 8 percent and the consumer price index increase of 2.68 percent for the year. From a revenue perspective, this return translated into a $145 million contribution by the portfolio to comprehensive income. Comparative returns for the last five annual periods are shown in the chart at the bottom of this page.

Liabilities for Funded Losses

The downward revisions in loss reserves of $12.4 million during 1999 are largely in response to the significant declining development in WCRA claim counts observed over the last several years. This downward development trend began in 1995 and continued through 1999. While the decreases in claim counts were smaller in 1998 and 1999 than in earlier years, the claim frequencies (claim counts relative to the loss exposure of each retention level) continued to come in lower than expected. This was the major



contributor to the year-end 1999 reserve adjustment, which produced a decrease in funded loss reserves of $69.2 million and an increase in surplus of the same amount. Incurred funded losses and loss adjustment expenses are summarized in the following table.

Discounted WCRA Funded Losses and LAE Incurred (in millions)

	1999	1998
On prior accident years:		
Present value update	$56.8	$45.7
Payments made during calendar year	35.9	33.6
Reduction of reserves for payments made	-35.9	-33.6
"Actuarial impact" portion of the reserve change*	-69.2	-14.9
	-12.4	30.8
On the current accident year:	23.9	27.3
Total funded losses and LAE incurred	$11.5	$58.1

* A reserve decrease resulting from the "actuarial impact" portion of the reserve change is also known as excess premium. The excess premium amount of $69.2 million generated by the year-end 1999 actuarial reserve analysis is quantified on a present-value basis as of December 31, 1999.

Evaluating Financial Position: Surplus

The reported surplus of $510 million at December 31, 1999, compares to $349 million at year-end 1998. Approximately $252 million of the total reported surplus at December 31, 1999, is defined as designated surplus. The Board formally evaluates the financial position of the association every five years for the purpose of considering the distribution of excess funds or the assessment of deficient funds. The association's operating rule for evaluating our financial position takes into consideration the volatility of both sides of the balance sheet: the investment portfolio and the funded loss and LAE reserves. A more detailed explanation of the guidelines for determination of surplus can be found in footnote 2 to the financial statements. The next scheduled decision by the Board of Directors as to whether a surplus distribution or assessment is necessary will be considered when the year-end 2001 financial results are reported.

Report of Independent Accountants

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

In our opinion, the accompanying balance sheets and the related statements of operations, comprehensive income and surplus and cash flows present fairly, in all material respects, the financial position of the Workers' Compensation Reinsurance Association at December 31, 1999 and 1998, 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. These financial statements are the responsibility of the Company'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, 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 the opinion expressed above.

February 8, 2000

PricewaterhouseCoopers LLP

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Balance Sheets
At December 31, 1999 and 1998
(In thousands)

ASSETS	1999	1998
Investments, at market value:		
Cash and cash equivalents (including securities lending collateral of $233,811 and $154,479 at December 31, 1999 and 1998, respectively)	$ 292,886	$ 206,206
Common and preferred stock	780,276	693,573
Bonds	492,405	429,244
Total investments	1,565,567	1,329,023
Restricted cash and cash equivalents		8,860
Uncollected reinsurance premiums:		
Due for funded losses	179	(122)
Deferred for catastrophic losses	75,759	63,766
Total uncollected reinsurance premiums	75,938	63,644
Accrued investment income	6,139	5,361
Due from securities brokers	15,434	14,218
Accounts receivable and prepaid expenses	86	107
Property and equipment, less accumulated depreciation of $571 and $681 at December 31, 1999 and 1998, respectively	437	251
Total assets	$ 1,663,601	$ 1,421,464
LIABILITIES AND SURPLUS		
Liabilities:		
Losses and loss adjustment expenses:		
Funded	$ 787,132	$ 811,573
Catastrophic	75,759	63,766
Total losses and loss adjustment expenses	862,891	875,339
Payable under securities loan agreement	233,811	154,479
Due to securities brokers	56,499	36,866
Excess funds distribution payable		5,461
Accounts payable and accrued expenses	374	306
Total liabilities	1,153,575	1,072,451
Contingencies		
Surplus from operations	364,299	146,097
Accumulated other comprehensive income	145,727	202,916
Total surplus, including designated surplus of $251,900 in 1999 and $259,700 in 1998 (Note 2)	510,026	349,013
Total liabilities and surplus	$ 1,663,601	$ 1,421,464

The accompanying notes are an integral part of the financial statements

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Statements of Operations, Comprehensive Income and Surplus
For the years ended December 31, 1999 and 1998
(In thousands)

	1999	1998
Revenues:		
Reinsurance premiums:		
Funded	$ 29,771	$ 28,620
Catastrophic	11,993	(2,221)
Premiums earned	41,764	26,399
Investment income, net of related expenses	37,723	36,350
Net realized investment gains	164,376	134,840
Total revenues	243,863	197,589
Expenses:		
Losses and loss adjustment expenses:		
Funded	11,550	58,063
Catastrophic	11,993	(2,221)
Losses and loss adjustment expenses incurred	23,543	55,842
Operating and administrative expenses	2,118	1,918
Total expenses	25,661	57,760
Net income	218,202	139,829
Other comprehensive income:		
Change in unrealized losses on securities	(57,189)	(17,912)
Comprehensive income	161,013	121,917
Surplus, beginning of year	349,013	227,096
Surplus, end of year	$ 510,026	$ 349,013

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Statements of Cash Flows
At December 31, 1999 and 1998
(In thousands)

	1999	1998
Cash flows from operating activities:		
Funded premiums collected	$ 29,470	$ 29,165
Interest and dividends received, net of related expenses	35,967	36,052
Loss and loss adjustment expenses paid	(35,991)	(33,658)
Operating and administrative expenses paid	(1,786)	(1,772)
Net cash provided by operating activities	27,660	29,787
Cash flows from investing activities:		
Sale of investments:		
Common and preferred stocks	789,397	543,116
Bonds	975,577	633,654
Purchase of investments:		
Common and preferred stocks	(732,169)	(576,593)
Bonds	(1,056,765)	(700,920)
Collateral for securities on loan	79,332	154,479
Restricted cash and cash equivalents	8,860	110,193
Purchase of equipment	(426)	(141)
Net cash provided by investing activities	63,806	163,788
Cash flows from financing activities:		
Payments on excess funds distribution payable	(4,786)	(110,667)
Net cash used in financing activities	(4,786)	(110,667)
Change in cash and cash equivalents	86,680	82,908
Cash and cash equivalents, beginning of year	206,206	123,298
Cash and cash equivalents, end of year	$ 292,886	$ 206,206

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Footnotes

1. General Information

Description of Association
In 1979, the Minnesota Legislature created the Workers' Compensation Reinsurance Association (the Association), a tax-exempt 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 under Minnesota Statutes Chapter 176 in excess of a members' retention limit.

Operating rules and procedures are prescribed by the Enabling Act, as amended, and the Plan of Operation. Amendments to the Plan of Operation 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 authorized to self-insure their workers' compensation liabilities in Minnesota are required to be members of the Association.

Retention Limit
For 1999, members selected one of three maximum per loss occurrence retention limits, which were $290,000, $580,000 or $1,160,000. For 1998, members selected one of three maximum per loss occurrence retention limits, which were $280,000, $560,000 or $1,120,000. 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, using a discount rate of eight percent, of the estimated ultimate liability for members' incurred losses up to, and including, the prefunded limit of $5.8 million per occurrence for 1999 ($5.6 million per occurrence for 1998) for funded losses reinsured by the Association;

* payments, if any, made to members on claims in excess of the prefunded limit (catastrophic losses);

* loss adjustment, operating, and administrative expenses of the Association (loss adjustment expenses incurred by members on reinsured claims are not recoverable from the Association); and

* 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 rate for the members' selected retention limit; and (2) the members' most recent actual exposure base available at the beginning of the annual billing cycle adjusted, beginning in 1996, for a factor which represents the estimated difference between the members' most recent actual exposure base and the actuarially projected exposure base. In the following year, reinsurance premium adjustments are calculated and billed or credited to members.

For insurer members, the exposure base is the standard 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 generally accepted accounting principles 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 corporate stocks and bonds, U.S. government securities and mortgage backed securities held in trust at this institution. The investment viability and return of funds held by this institution 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.

Comprehensive Income

During 1998, the Association adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." The standard 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 and unrealized gains and losses (other comprehensive income) on available-for-sale securities. The adoption of this statement for the Association does not impact the overall financial results, only the presentation of the components of net income.

The standard also requires the reporting of reclassification adjustments for unrealized gains or losses in the prior year that were subsequently realized during the current year.

The reclassification adjustments for 1999 and 1998 are as follows:

	1999	1998
Unrealized holding gains	$ 107,187	$ 116,928
Reclassification adjustment for gains included in net income	(164,376)	(134,840)
Net other comprehensive income	$ (57,189)	$ (17,912)

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.

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.

Restricted Cash and Cash Equivalents
Restricted cash and cash equivalents relate to amounts restricted for payment of the excess funds distribution payable (see Note 4). Interest earnings thereon are also restricted for payment of the excess funds distribution payable and related expenses. Interest earnings on restricted cash and cash equivalents totaled $520,000 and $1,779,000 for the years ended December 31, 1999 and 1998, respectively. The 1998 amount is included in the excess funds distribution payable as of December 31, 1998. (For discussion of excess surplus distribution, see Note 4.)

Property and Equipment
Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straightline 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 will report 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 will evaluate surplus or deficit relative to the reserves for discounted funded loss and loss adjustment expenses. This provision is intended 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 percent of reserves maintained for variations between expected and actual investment returns is calculated based upon the expected volatility (standard deviation) of the WCRA investment portfolio multiplied by two. Ten percent of reserves will be maintained for variations between expected and actual claims experience, and 22 percent of reserves will be maintained for variations between expected and actual investment returns. This amount has been reflected on the balance sheet as designated surplus.

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 more or less frequently than every five years if the Board, in 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 Minnesota Laws, Chapter 361, as interpreted by decisions of the United States District Court in *In re Workers' Compensation Refund*, entered February 11, 1994, and affirmed by the Eighth Circuit Court of Appeals on January 31, 1995; and *American Compensation Insurance Company, et al, v. David B. Gruenes, as Commissioner of the Minnesota Department of Commerce, et al.*, entered February 9, 1998.

Reinsurance Premiums

The reinsurance premiums for the calendar year coverage period for funded losses (losses up to and including the prefunded limit) consist of the billed funded premiums. The reinsurance premiums for the calendar years may also include a credit or charge to equitably distribute excess or deficient premiums for previous periods including any excess or deficient premium resulting from a retroactive change in the prefunded limit.

The reinsurance premiums to be billed in future years for catastrophic losses (losses in excess of the prefunded limit) incurred during the calendar year coverage period are recognized as revenue concurrent with the related catastrophic losses and loss adjustment expenses. The reinsurance premiums for catastrophic losses will be billed to the members of the Association when payments on those catastrophic losses are made.

Losses and Loss Adjustment Expenses

The liability for funded losses and loss adjustment expenses represents the present value, discounted at eight percent of the estimated liability for losses and loss adjustment 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 catastrophic losses and loss adjustment expenses represents the present value, discounted at eight percent of the estimated liability for losses and loss adjustment expenses of the Association for unpaid amounts in excess of the prefunded limit, as determined by actuarial projections of the Association.

The liability for losses and loss adjustment expenses at December 31, 1999 and 1998 is summarized as follows (in thousands):

	1999	1998
Funded, undiscounted	$ 3,043,982	$ 3,128,417
Discount	(2,256,850)	(2,316,844)
	787,132	811,573
Catastrophic, undiscounted	1,131,767	1,067,164
Discount	(1,056,008)	(1,003,398)
	75,759	63,766
Total	$ 862,891	$ 875,339

Activity in the funded liability for losses and loss adjustment expenses is summarized as follows (in thousands):

	1999	1998
Balance, January 1:		
Funded, undiscounted	$ 3,128,417	$ 3,110,597
Incurred related to:		
Current year	163,746	161,835
Prior years	(212,190)	(110,357)
Total incurred	(48,444)	51,478
Paid related to:		
Current year	42	38
Prior years	35,949	33,620
Total paid	35,991	33,658
Balance, December 31:		
Funded, undiscounted	3,043,982	3,128,417
Discount	(2,256,850)	(2,316,844)
	$ 787,132	$ 811,573

Reserves are reviewed periodically and updated based on current claim experience and trends. Adjustments to the estimated liability for losses and loss adjustment expenses are reflected in operating results in the year when the changes are made. These adjustments may be material to the financial statements when they occur. In 1999 and 1998, actuarial adjustments, including changes in selected ultimate loss amounts on prior accident years decreased funded discounted reserves and related losses and loss adjustment expenses by approximately $69.2 million and $14.9 million, respectively.

In 1999, the changes in selected loss and loss expense amounts are a combination of the following factors quantified below:

	December 31, 1999 Impact on Funded Undiscounted Ultimate Loss and Loss Expense (Millions)	December 31, 1999 Impact on Funded Discounted Loss and Loss Expense Reserves (Millions)
Downward development and annual adjustment of actuarial credibility weights	$ (227.9)	$ (75.1)
Changes in case reserving	---	---
Changes in pricing assumptions	15.7	5.9
1999 total	$ (212.2)	$ (69.2)

In 1998, the changes in selected loss and loss expense amounts were a combination of the following factors quantified below:

	December 31, 1998 Impact on Funded Undiscounted Ultimate Loss and Loss Expense (Millions)	December 31, 1998 Impact on Funded Discounted Loss and Loss Expense Reserves (Millions)
Downward development and annual adjustment of actuarial credibility weights	$ (118.4)	$ (25.5)
Changes in case reserving	23.4	4.2
Changes in pricing assumptions	(15.4)	6.4
1998 total	$ (110.4)	$ (14.9)

On a present value basis, the recognition of lower-than-expected claims experience is the largest contributor to the year-end 1999 reserve reduction. The bulk of this contribution comes from frequencies that are lower than anticipated in the Association's historical rates. A significant downward development in WCRA claims counts began in 1995 and continued through 1997. During both 1998 and 1999, incurred claim counts increased slightly for the low retention; however, the downward trend in incurred counts continued for the high retention, though at reduced rates of decline. In total for 1998 and 1999, incurred counts decreased by only 0.2-0.3 percent compared to decreases of 2-3 percent over the 1995-97 period. The similarities of 1998 and 1999 changes in incurred counts may indicate a stabilization in the counts of the WCRA. However, the frequencies of both the low and high retentions continue to come in lower than expected. Frequency is a much more reliable indicator than the number of incurred counts since frequency considers the number of workers exposed to the various levels of WCRA coverage. Therefore, frequency accounts for the fact that many WCRA members have chosen super retention coverage since it was first offered in 1996.

Very few enhancements have been implemented for the 1999 WCRA reserve analysis. The pricing assumptions that are used to set reserves were improved this year to reflect current knowledge about wage distributions; claim frequencies for lifetime, nonlifetime, and fatal claims; and nonlifetime severities. Both the pricing wage distribution and the nonlifetime severity changes produced increases in loss projections. The pricing frequency changes are all decreases that offset a major portion of the increases from the wage and severity adjustments. The net impact of all pricing changes is a small reserve increase.

3. 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 (IRC). The Association received a tax-exempt determination letter from the IRS dated February 7, 1997. Therefore, no provision for income taxes is included in the Association's financial statements.

4. Excess Surplus Distribution

On January 30, 1997, the Board of Directors approved excess premium and excess surplus distributions of $329.1 million to member insurers, $108.3 million to member self-insurers, and $34.0 million to Minnesota workers' compensation policyholders (Policyholders). The distributions to member insurers and member self-insurers were completed during 1997 and 1998. The excess surplus distributions to Policyholders were commenced in 1998 and completed in 1999 in accordance with the association's Operating Rule for the Determination of Surplus. Policyholders cashed 92,000 excess surplus checks in the amount of $34.9 million, including interest. In accordance with the provisions of Minnesota Statutes § 79.361, subd. 10, the Workers' Compensation Reinsurance Association will retain all unclaimed refund amounts.

5. Cash Flows

A reconciliation of net income to net cash provided by operating activities for the years ended December 31, 1999 and 1998, is as follows (in thousands):

	1999	1998
Net income	$ 218,202	$ 139,829
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized investment gains	(164,376)	(134,840)
(Increase) decrease in funded uncollected reinsurance premiums, net of accrued premium adjustments	(301)	544
(Decrease) increase in liability for funded losses and loss adjustment expenses	(24,441)	24,404
Other, net	(1,424)	(150)
Total adjustments	(190,542)	(110,042)
Net cash provided by operating activities	$ 27,660	$ 29,787

WORKERS' COMPENSATION REINSURANCE ASSOCIATION
Footnotes (continued)

6. Investments

The cost of common and preferred stocks, amortized cost of bonds, and estimated fair values at December 31, 1999 and 1998, respectively, are as follows (in thousands):

1999	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 611,700	$ 202,565	$ (40,061)	$ 774,204
Preferred stocks	6,627		(555)	6,072
Total stocks	$ 618,327	$ 202,565	$ (40,616)	$ 780,276
U.S. Treasury securities and obligations of U.S. government and agencies	$ 91,066	$ 73	$ (2,398)	$ 88,741
Corporate debt securities	262,729	1,610	(9,825)	254,514
Mortgage backed securities	154,832	326	(6,008)	149,150
Total bonds	$ 508,627	$ 2,009	$ (18,231)	$ 492,405

1998	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Common stocks	$ 489,350	$ 225,530	$ (24,759)	$ 690,121
Preferred stocks	3,660	25	(233)	3,452
Total stocks	$ 493,010	$ 225,555	$ (24,992)	$ 693,573
U.S. Treasury securities and obligations of U.S. government and agencies	$ 51,551	$ 1,467	$ (116)	$ 52,902
Corporate debt securities	215,613	3,206	(4,323)	214,496
Mortgage backed securities	159,727	2,442	(323)	161,846
Total bonds	$ 426,891	$ 7,115	$ (4,762)	$ 429,244

The amortized cost and estimated fair value of debt securities at December 31, 1999, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 17,936	$ 17,903
Due after one year through five years	129,589	127,410
Due after five years through ten years	93,616	89,369
Due after ten years	267,486	257,723
Total	$ 508,627	$ 492,405

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.

Gross gains of $181 million and $147 million, and gross losses of $16 million and $12 million, were realized on sales of investments during 1999 and 1998, respectively. Net investment income and net realized investment gains (losses) during the years ended December 31, 1999 and 1998, are summarized below (in thousands):

	Net Investment Income		Net Realized Gains (Losses)	
	1999	1998	1999	1998
Securities lending	$ 211	$ 263		
Cash and cash equivalents	3,216	3,169	$ (2,626)	$ 2,281
Common and preferred stocks	10,214	10,187	176,568	125,553
Bonds	28,721	26,687	(9,566)	7,006
Miscellaneous	403	672		
	42,765	40,978	$ 164,376	$ 134,840
Investment expenses	(5,042)	(4,628)		
	$ 37,723	$ 36,350		

To enhance the return on investments, the Association maintains a securities lending program. At December 31, 1999 and 1998, the Association had equity and fixed income securities with fair values of $225 million and $152 million out on loan, respectively. Cash of at least 102 percent of the fair value of the securities lent was held as collateral as part of the securities lending program.

During 1998, the Association adopted Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The standard requires the collateral received for securities on loan to be reflected on the balance sheet if the secured party has control over the collateral. An asset of $234 million and $154 million and the related liability representing the collateral received is reflected on the balance sheet as of December 31, 1999 and 1998, respectively.

Additionally, to further enhance the return on investments, one of the Association's investment managers has invested in interest-rate future and interest-rate option contracts, and one of the Association's investment managers has invested in currency forward contracts. To improve the tracking relative to target asset allocation and to improve portfolio efficiency and flexibility, one of the Association's investment managers has invested in interest-rate future and stock index future contracts.

Listed contracts must be traded on a market regulated by a governmental agency, and counterparties must have a long-term debt rating of "A" or better. Future contracts are marked-to-market on a daily basis with the gain or loss reported in income. Forward and option contracts are valued at fair value with the gain or loss reported in income at the time the option is exercised or the contract is settled.

WCRA

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