STATE COMPENSATION INSURANCE FUND

Statutory Basis Financial Statements

(With Independent Auditors' Report Thereon)

December 31, 2010 and 2009

KPMG LLP
Suite 1400
55 Second Street
San Francisco, CA 94105

Independent Auditors' Report

The Board of Directors
State Compensation Insurance Fund

We have audited the accompanying statutory statements of admitted assets, liabilities, and policyholders' surplus of State Compensation Insurance Fund as of December 31, 2010 and 2009, and the related statutory statements of operations and changes in policyholders' surplus, and cash flow for the years then ended. 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 in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the California Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The effects on the financial statements of the variances between the statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of State Compensation Insurance Fund as of December 31, 2010 and 2009, or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of State Compensation Insurance Fund as of December 31, 2010 and 2009, and the results of its operations and its cash flow for the years then ended, on the basis of accounting described in note 2.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on the supplemental investment risk interrogatories, supplemental summary investment schedules and the reinsurance interrogatory is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is information required to be presented. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

May 27, 2011

STATE COMPENSATION INSURANCE FUND

Statements of Admitted Assets, Liabilities, and Policyholders' Surplus
(Statutory Basis)

December 31, 2010 and 2009

(In thousands)

Admitted Assets		2010	2009
Bonds, at amortized cost	$	18,381,870	19,274,652
Real estate		384,349	384,878
Cash, cash equivalents and short-term investments		1,027,286	466,914
Receivables for securities		2,839	3,109
Total cash and investments		19,796,344	20,129,553
Premiums in the course of collection		28,212	33,870
Deferred, earned but unbilled and accrued retrospective premiums		35,636	37,706
Reinsurance recoverables		8,397	2,902
Accrued interest and dividends		161,382	173,443
Guaranty fund receivables		122,476	144,101
Due from adjusting contracts		32,415	44,917
Other assets		86,992	106,476
Total admitted assets	$	20,271,854	20,672,968
Liabilities and Policyholders' Surplus			
Estimated liabilities for:			
Losses	$	13,164,864	13,839,355
Loss adjustment expenses		1,887,911	1,889,485
Retroactive reinsurance ceded		(678,244)	(762,197)
Unearned premiums		68,630	83,919
Guaranty fund assessments liability		6,571	8,433
Amounts held in trust liability		50,375	48,410
Other liabilities		305,384	316,674
Total liabilities		14,805,491	15,424,079
Special surplus for retroactive reinsurance		576,256	576,256
Unassigned surplus		4,890,107	4,672,633
Policyholders' surplus		5,466,363	5,248,889
Total liabilities and policyholders' surplus	$	20,271,854	20,672,968

See accompanying notes to statutory basis financial statements.

STATE COMPENSATION INSURANCE FUND

Statements of Operations and Changes in Policyholders' Surplus
(Statutory Basis)

Years ended December 31, 2010 and 2009

(In thousands)

		2010	2009
Net premiums earned	$	1,135,645	1,247,737
Losses incurred		850,290	939,825
Loss adjustment expenses incurred		520,832	574,330
Underwriting and administrative expenses		409,149	456,433
Total underwriting deductions		1,780,271	1,970,588
Net underwriting loss		(644,626)	(722,851)
Investment income		921,777	956,035
Net realized capital gains		34,303	4,322
Investment expenses		(60,794)	(48,282)
Net investment income		895,286	912,075
Other income (loss):			
Gain on sale of vehicle		8	—
Loss on premiums charged off (net of recoveries)		(79,646)	(46,208)
Net income before dividends to policyholders		171,022	143,016
Dividends to policyholders		—	15
Net income		171,022	143,001
Policyholders' surplus, beginning of year		5,248,889	5,088,921
Change in nonadmitted assets		55,057	16,232
Change in net unrealized capital gains (losses)		(4,276)	4,276
Change in provision for reinsurance		(4,329)	(3,541)
Policyholders' surplus, end of year	$	5,466,363	5,248,889

See accompanying notes to statutory basis financial statements.

STATE COMPENSATION INSURANCE FUND

Statements of Cash Flows
(Statutory Basis)

Years ended December 31, 2010 and 2009

(In thousands)

		2010	2009
Premiums collected net of reinsurance	$	1,082,381	1,203,544
Net investment income		916,042	962,500
Recoveries from premiums charged off		12,545	16,463
Benefits and loss related payments		(1,530,276)	(1,590,308)
Other underwriting expenses		(871,806)	(968,873)
Net cash used in operations		(391,114)	(376,674)
Proceeds from investments sold, matured, or repaid:			
Bonds		3,796,512	4,357,982
Real estate		4	—
Short-term investments and other		270	—
Cost of investments acquired:			
Bonds		(2,907,339)	(5,130,725)
Real estate		(8,861)	(15,369)
Net cash provided by (used in) investments		880,586	(788,112)
Other cash provided		70,900	91,490
Net cash provided by financing and miscellaneous sources		70,900	91,490
Net change in cash, cash equivalents and short-term investments		560,372	(1,073,296)
Cash, cash equivalents and short-term investments, beginning of year		466,914	1,540,210
Cash, cash equivalents and short-term investments, end of year	$	1,027,286	466,914

See accompanying notes to statutory basis financial statements.

(1) History and Business

State Compensation Insurance Fund (State Fund) is a public enterprise fund established by the State of California through legislation enacted in 1913 to provide an available market for workers' compensation insurance to employers located in California. The State of California is not liable for any obligations of State Fund.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The statutory basis financial statements of State Fund have been prepared in conformity with accounting practices prescribed or permitted by the California Department of Insurance (CDI), and in accordance with the National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual, to the extent those practices and procedures do not conflict with the California Insurance Code. Subsequent events were evaluated for the Statutory Annual Statement and the statutory basis financial statements up until the statements were issued on March 2, 2011 and March 27, 2011, respectively. There have not been any subsequent events identified after the Annual Statement evaluation of subsequent events that would need to be disclosed in the statutory financial statements.

Statutory accounting practices differ in certain respects from the U.S. generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB). The significant differences from GASB are as follows:

- Investment in bonds and short-term investments are carried principally at amortized cost, whereas under GASB such investments would be carried at estimated fair value with changes in fair value reflected in net income.
- Policy acquisition costs, including commissions and premium taxes, are charged to current operations as incurred, whereas related premium income is recognized on a pro-rata basis over the periods covered by the policies. Under GASB, policy acquisition costs would be deferred and amortized to income on the same basis as premium income is recognized.
- Certain assets designated as "nonadmitted assets" are excluded from total assets. These assets, the change in which is credited or charged directly to policyholders' surplus, consist primarily of the following: premiums in the course of collection which remain outstanding over ninety days, plus all related amounts due that have been recorded on those policies; nonoperating system internally developed software costs; 10% of earned but unbilled premiums (EBUB) in excess of collateral specifically held and identifiable on a per policy basis; 10% of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party or collateral, not otherwise used; office furniture and equipment, and prepaid expenses. Under GASB, these assets would be included in total assets to the extent realizable.
- Gains on the retroactive reinsurance contract are recognized in income and established as segregated surplus. GASB requires the gains to be deferred and recognized over the estimated settlement period of the reinsured losses, using either a recovery or interest method.

- Policyholders' dividends are accrued when declared, whereas under GASB they are accrued based on amounts to be paid.
- Fees received for processing the claims of other self-insured State of California departments are netted against loss adjustment expenses, whereas under GASB they are recorded as other income.
- An allocation of rental value to space owned and occupied by State Fund is included in income and expense, whereas it is excluded under GASB.
- The statement of cash flows differs in certain respects from the presentation required by GASB, including the presentation of the changes in cash, cash equivalents and short-term investments, instead of cash and cash equivalents. Short-term investments include securities with maturities, at the time of acquisition, of one year or less. In addition, there is no reconciliation between net income and cash from operations as there would be under GASB.
- A provision for reinsurance is recorded as a liability with a corresponding adjustment to policyholders' surplus for the reinsurance receivable from unauthorized reinsurance carriers with inadequate collateral, and reinsurance recoverables over ninety days, plus all related amounts due that have been recorded on those reinsurance recoverables. Under GASB, such a provision for reinsurance is not recognized.

(b) Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with statutory accounting principles permitted or prescribed by the CDI 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, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Among the most significant estimates inherent in these statutory financial statements are the liabilities for losses, loss adjustment expenses [see note 2 (f)], the liabilities for the Company's self-insurance loss and loss adjustment expenses, and State Fund's portion of the pension and other postemployment benefit (OPEB) cost estimated by the State Controller's office based on the current actuarial valuation prepared for the State of California [see note 2 (i)].

(c) Cash, Cash Equivalents, and Short-Term Investments

Cash consists of cash in banks and on hand. Also classified as cash for financial statement purposes, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date, and cash equivalents. Cash equivalents are short-term, highly liquid investments with original maturities of three months or less that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Short-term investments are those investments when originally acquired had maturities of one year or less. State Fund's short-term investments are money market funds which are recorded at cost.

(d) Investments

Investments in bonds are valued in accordance with the requirements of the Securities Valuation Office (SVO) of the NAIC. Bonds are generally stated at amortized cost, except bonds that are defined by the NAIC as Class 3 through 6 which are stated at the lower of amortized cost or fair value. Amortization is calculated using the scientific constant yield to worst method. Mortgage-backed securities (MBS) are amortized using anticipated prepayments and are accounted for using the prospective method.

State Fund's asset manager uses a proprietary model for loss assumptions and widely accepted models for prepayment assumptions in valuing mortgage-back securities with inputs from major third party data providers. The models combine the effects of interest rates, volatility, and pre-payment speeds based on various scenario (Monte Carlo) simulations with resulting effective analytics (spreads, duration, convexity) and cash-flows on a monthly basis. Credit sensitive cash flows are calculated using propriety models which estimate future loan defaults in terms of timing and severity. Model assumptions are specific to asset class and collateral types and are regularly evaluated and adjusted where appropriate.

The carrying value for MBS has been determined in accordance with the guidelines of the NAIC. Fair value is primarily determined using a pricing hierarchy starting with a widely accepted third party vendor, followed by external broker/dealers, Bloomberg, analytic modeling and a benchmark to index model.

Declines in the value of investments that are determined to be other than temporary result in a reduction in carrying amount to fair value, or, for MBS's, to the present value of expected cash flows if management has the ability and intent to hold the MBS to recovery of that amount. The impairment charge is included as a realized loss and a new cost basis for the security is established. To determine whether an impairment is "other than temporary," State Fund considers many factors including credit quality, market analysis, current events, and management's intent to hold or dispose of the asset.

Investment expenses consist primarily of expenses incurred in the investing of funds and pursuit of investment income. Such expenses include custodial expenses, portfolio management and advisory fees for the short and long-term bonds; alteration to property, repairs and maintenance, utilities, real estate taxes, and other real property expenses for real estate investments.

(e) Real Estate, Furniture and Equipment

Real estate consists primarily of office buildings occupied by State Fund and is stated at cost less accumulated depreciation. Real estate held for sale is carried at the lower of depreciated cost or fair value less estimated cost to sell. Depreciation on buildings is computed on a straight-line basis over the estimated useful lives of the buildings (50 years).

Data processing equipment and capitalized internally developed software are carried at cost less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the assets (3 years). Depreciation on office furniture and equipment is computed on a straight-line basis

over the estimated useful lives of the assets (5 years). The aggregate amount of admitted data processing equipment (net of accumulated depreciation) is limited to 3% of State Fund's policyholders' surplus, adjusted for the carrying value of data processing equipment.

(f) Losses and Loss Adjustment Expenses

Management records its best estimate of losses and loss adjustment expenses. These liabilities include: the estimated future cost of reported claims, the cost of claims incurred but not reported, and expenses related to investigating and settling claims. State Fund does not discount these liabilities. Stated liabilities are based on actuarial estimates that are subject to considerable uncertainty. Should State Fund's losses develop in the future differently than expected from historical experience or differently than expected by current actuarial methods, actual losses could vary, perhaps significantly, from current estimates. Any differences from current recorded estimates will be reflected in operations when known (see note 7).

Management's estimates are based on its knowledge and experience about past and current events and circumstances, and its assumptions about conditions it expects to exist in the future. Factors relevant to the estimation of losses and loss adjustment expense liabilities include the estimation of the ultimate frequency and severity of losses, the level of future medical cost inflation over long periods of time, the future legal and regulatory environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed quarterly by a nationally recognized consulting actuarial firm (the Appointed Actuary). The Appointed Actuary is retained in accordance with CDI regulatory provisions as the designee to issue a statement of actuarial opinion that has been reviewed with the board of directors as required by actuarial standards of practice.

(g) Revenue Recognition and Unearned Premiums

State Fund records as premiums written deposit premiums and any subsequent additional premiums at the time related billings are issued to policyholders. Deposit premiums are a percentage of estimated annual premiums and are earned on a pro-rata basis over the policy term. Unearned premiums are the unexpired portion of deposit premiums. State Fund records an estimate for earned but unbilled premium (EBUB) as a direct adjustment to earned premiums. 10% of EBUB in excess of collateral specifically held and identifiable on a per policy basis is nonadmitted. To the extent that amounts in excess of the 10% are not anticipated to be collected, they are written off against operations in the period that the determination is made.

As of December 31, 2010 and 2009, State Fund has no liabilities related to premium deficiency reserves. State Fund considers anticipated investment income when determining the existence of a premium deficiency.

(h) Guaranty Fund and Other Assessments

In California, all insurers writing workers' compensation, including State Fund, are subject to assessment by the California Insurance Guarantee Association (CIGA) and the Department of Industrial Relations (DIR) to protect claimants against insurer insolvencies and administer various

aspects of the workers' compensation system. The 2009 and 2010 annual CIGA assessment was 2% of direct written premium. The DIR assessment aggregates to approximately 2.9% and 1.3% of direct written premium for 2010 and 2009, respectively. Annual assessments are paid in advance, based on prior year premiums with the final assessment based on reported calendar year written premium. Additional amounts owed are included in the guaranty fund assessments liability and the DIR assessments are included in other liabilities. Amounts prepaid in excess of the final assessment amount are available for credit against future assessments and included in guaranty fund receivables.

In California, all insurers are required by law to bill their policyholders a premium surcharge to cover such fund assessments. State Fund generally requires the policyholder to pay an estimated surcharge at policy inception. The surcharge relating to unexpired coverage is included in the guaranty fund assessments liability and the DIR assessments are included in other liabilities. Additional surcharges owed by policyholders are included in guaranty fund receivables and the DIR assessments are included in other assets. State Fund remains liable to assessing agencies should policyholders fail to remit premium surcharges.

State Fund expects to fund CIGA for guaranty fund assessments for at least the next year at a rate of 2.559% of future direct premiums written. Based on information currently available, State Fund expects to continue to be obligated to fund CIGA annually, at rates that are determined and announced annually.

Under the U.S. Longshoremen's and Harbor Workers' (L&H) Compensation Act, all carriers and self insurers writing U.S. L&H policies, including State Fund, are required to make payments into a Special Fund based on a pro-rated assessment determined by the Secretary of the U.S. Department of Labor. The Special Fund was created to protect injured employees or their survivors by providing for subsequent injuries as defined by the Act. State Fund recorded a liability of $11,000 and $12,000 included in the "other liabilities" account as of December 31, 2010 and 2009 respectively, for future assessments under the U.S. L&H Compensation Act.

(i) Retirement and Other Postemployment Benefit Plans

State Fund employees are employees of the State of California (the State). Consequently, State Fund employees participate in the State pension and other postemployment benefit (OPEB) plans. State Fund has no legal liability for the plans.

The State employee pension plan is administered by the Public Employees' Retirement System of the State of California (CalPERS). State Fund pays CalPERS the estimated employers' share of its current employees' retirement cost. State Fund paid pension expense of $73,249 and $68,355 for the years ended December 31, 2010 and 2009, respectively.

The State's OPEB plan provides medical, prescription drug, and dental benefits (healthcare benefits) to retired statewide employees. The authority for establishing and amending the OPEB plan lies with CalPERS while the authority for establishing and amending the funding policy lies with the State Legislature. The State's OPEB plan is a single-employer defined benefit plan. A separate actuarial valuation was not performed for State Fund.

The State's annual OPEB cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined by the State in accordance with the parameters of GASB No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The State determines the allocation for State Fund based upon the relationship of active employee health benefit costs for State Fund as compared to the total State active employee health benefit costs.

State Fund paid retiree health benefit pro rata assessments of $28,079 and $32,668 for the years ended December 31, 2010 and 2009 respectively. In January 2011, the State provided State Fund's 2010 funding requirements and its related 2010 contribution credit. For the year ended December 31, 2010, the ARC was $112,074. Of this amount, $35,242 was estimated as contributed for 2010. Accordingly, after deducting the estimated contribution of $35,242 and adding the State's ARC adjustment of $703, the remaining increase in net OPEB obligation of $77,535 accrued as additional liability for December 31, 2010. In January 2010, the State provided State Fund's 2009 funding requirements and its related 2009 contribution credit. For the year ended December 31, 2009, the ARC was $105,019. Of this amount, $35,756 was estimated as contributed for 2009. Accordingly, after deducting the estimated contribution of $35,756 and adding the State's ARC adjustment of $345, the remaining increase in net OPEB obligation of $69,608 was accrued as an additional liability for December 31, 2009.

The following table shows the components of State Fund's allocation of the State's 2010 and 2009 OPEB cost, the amount credited to the plan, and changes in the net OPEB obligation as of December 31, 2010 and 2009 are as follows:

		2010	2009
Annual required contribution	$	112,074	105,019
Adjustment to annual required contribution		703	345
Annual OPEB cost		112,777	105,364
Estimated contribution credit		(35,242)	(35,756)
Increase in net OPEB obligation		77,535	69,608
Net OPEB obligation beginning of year		227,967	158,359
Net OPEB obligation end of year	$	305,502	227,967

The percentage of annual OPEB costs contributed to the plan was 31% and 34% for 2010 and 2009, respectively.

Projection of benefits for financial reporting purposes is based on the substantive plan and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between employer and plan members to that point. The actuarial calculations reflect a long-term perspective. Actuarial valuations involve estimates of the value of reported amounts and

assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revisions as results are compared to past expectations and new estimates are made about the future. All actuarial methodology, assumptions and results discussed herein were provided to State Fund by the State of California.

Based on information provided to State Fund by the State of California, in the June 30, 2010 actuarial valuation, the individual entry-age normal cost method was used. A pay-as-you go funding scenario was used by the State of California. Under the pay-as-you-go funding scenario, the State is assumed to finance retiree healthcare benefits from assets available in the general fund. The State's actuarial assumptions included a discount rate of 4.5%, and an annual healthcare cost trend rate of 9% initially, decreasing each year over the next seven years until the ultimate rate of 4.5% is reached.

Funding progress information specifically related to State Fund's portion of the statewide OPEB plan is not available. For more details about the actuarial methods and assumptions used by the State as well as the statewide plans funding progress and status, refer to the State of California's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended 2010.

The State's unfunded actuarial accrued liabilities for the pension and OPEB plans are based on a variety of actuarial assumptions as disclosed in the State's Comprehensive Annual Financial Report. Separate actuarial valuations related to State Fund are not available. As a result, the portion of the State's unfunded pension and OPEB liabilities attributable to State Fund is not known, and will change over time.

Based on State Fund's relative number of employees, payroll and contributions, however, State Fund Management estimates that State Fund's potential share of the unfunded liabilities as of December 31, 2010 could approximate $300-400 million for the pension plan and $1,200-1,600 million for the OPEB plan. As discussed above, these estimates are subject to considerable inherent uncertainty and the ultimate liabilities could be materially greater than or less than management's current estimates.

(j) Income Taxes

State Fund is exempt from income taxation under the Internal Revenue Code. State Fund pays premium taxes to the State of California.

(k) Recently Adopted Accounting Standards

In September 2008, the NAIC issued Statement on Statutory Accounting Principles (SSAP) No. 99, *Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*, with an effective date of January 1, 2009. This statement establishes the statutory accounting principles for the treatment of premium or discount applicable to certain securities subsequent to the recognition of an other-than-temporary impairment. After recognizing OTTI, the fair value on the impairment date becomes the new cost basis, and the insurer must amortize any premium or accrete any discount to the par value by the maturity date or to realizable value if the anticipated recovery is less than par. Discount is accreted over the remaining life of the security based on the amount and timing of future

estimated cash flows. The adoption of SSAP 99 did not have a material impact on the statutory financial statements.

In September 2009, the NAIC issued SSAP No. 43 – Revised, Loan-backed and Structured Securities (SSAP 43R), which provides new guidance pertaining to loan-backed and structured securities and supersedes existing guidance regarding treatment of cash flows when quantifying changes in valuation and impairments of loan-backed and structured securities. The revised guidance requires impairment losses to be divided into interest and non-interest related portions. The non-interest portion is the difference between the present value of cash flows expected to be collected from the security and its fair value at the balance sheet date. If the company has the intent and the ability to retain the investment to recovery, then only the non-interest loss is recognized through earnings. However, if the company does not have the intent and ability to hold the investment for a period of time sufficient to recover the present value of expected cash flows, the security must be written down to fair value and the loss recognized through earnings. This guidance requires a cumulative effect adjustment to statutory surplus as of July 1, 2009. SSAP 43R further requires additional disclosures, including a listing of all investments where the present value of cash flows is less than amortized cost for securities with a recognized other-than-temporary impairment. SSAP No. 43R applies to investments held as of September 30, 2009, and to new investments purchased and held by the reporting entity after September 30, 2009. SSAR 43R does not have an impact to the Company's financial condition or results of operations. The Company does not purchase non-agency mortgage backed securities, nor does its Investment Guidelines allow such investments.

In December 2009, the NAIC issued SSAP 100, Fair Value Measurements (SSAP 10), which is effective December 31, 2010. SSAP 100 defines fair value, establishes a measurement framework, and expands related disclosures. This statement did not have a material impact to the Company’s financial condition or results of operations.

(3) Risk-Based Capital

California law imposes risk-based capital (RBC) requirements on admitted California insurance companies, including State Fund. These RBC requirements set forth a calculation to determine the required levels of policyholders’ surplus, and provide certain consequences for failure to meet these requirements. State Fund operates in conformity with the California law imposed for RBC. As of December 31, 2010, policyholders’ surplus exceeded the minimum RBC requirements.

(4) Investment Securities

The amortized cost and estimated fair value of investments in bonds as of December 31, 2010 and 2009 are as follows:

	2010			
	Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
U.S. Treasury securities and U.S. government sponsored enterprise securities	$ 4,282,986	207,156	(1,623)	4,488,519
Obligations of states and political subdivisions	608,561	13,267	(7,843)	613,985
Corporate debt securities	3,583,610	252,715	(323)	3,836,002
Special revenue	1,641,606	42,342	(25,381)	1,658,567
Other governments	260,127	15,867	—	275,994
Mortgage-backed securities	8,004,980	411,836	(14,264)	8,402,552
Totals	$ 18,381,870	943,183	(49,434)	19,275,619

	2009			
	Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
U.S. Treasury securities and U.S. government sponsored enterprise securities	$ 4,345,130	143,512	(4,589)	4,484,053
Obligations of states and political subdivisions	518,244	4,056	(15,904)	506,396
Corporate debt securities	4,235,403	207,253	(5,006)	4,437,650
Special revenue	1,514,808	14,551	(44,416)	1,484,943
Other governments	234,902	6,745	(88)	241,559
Mortgage-backed securities	8,426,165	305,543	(14,314)	8,717,394
Totals	$ 19,274,652	681,660	(84,317)	19,871,995

State Fund's mortgage-backed holdings as of December 31, 2010 and 2009 consist solely of securities issued by FNMA, GNMA, FHLMC and other government holdings, as follows:

	2010			
	Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
FNMA	$ 2,791,967	141,585	(3,996)	2,929,556
GNMA	1,905,291	115,935	(3,572)	2,017,654
FHLMC	3,304,730	154,316	(6,696)	3,452,350
Other government	2,992	—	—	2,992
Totals	$ 8,004,980	411,836	(14,264)	8,402,552

	2009			
	Amortized cost	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
FNMA	$ 3,107,033	114,074	(4,982)	3,216,125
GNMA	1,862,383	73,037	(4,855)	1,930,565
FHLMC	3,456,749	118,432	(4,477)	3,570,704
Totals	$ 8,426,165	305,543	(14,314)	8,717,394

State Fund reviews its investment portfolio to determine whether or not declines in fair value of individual securities held are other than temporary. In addition to average cost and fair value, factors including credit quality, market analysis, current events and management's judgment are used to determine whether securities are considered other than temporarily impaired. As of December 31, 2010 and 2009, 139 and 219 securities were in an unrealized loss position, which resulted in an unrealized loss of $49,434 and $84,318, respectively. State Fund management believes that volatility of the municipal bond market, resulting from the budget deficits, underfunding of pensions and healthcare benefits, and withdrawals of municipal bond mutual funds by retail investors during the 4th quarter, contributed to the unrealized loss position at the end of 2010. State Fund Management believes that these unrealized losses are only temporary and State Fund has the ability to hold and does not intend to sell these investments prior to a market recovery or to their contractual maturity. To determine whether to hold or sell an investment, State Fund's Chief Investment Officer, Investment Team and portfolio managers actively manage State Fund's investment risk by meeting weekly to discuss credit and default risk in addition to short and long term investment strategies. Additionally, State Fund's investment department independently monitors rating changes on its entire portfolio daily followed by weekly discussions as appropriate. As of December 31, 2010, 99.93% of all bonds held by State Fund were rated Class 1 by the NAIC. State Fund concluded that the gross unrealized losses of $49,434 as of December 31, 2010 were temporary in nature.

The tables below reflect the summary of temporarily impaired financial instruments as of December 31, 2010 and 2009.

	2010					
	12 months or under		Over 12 months		Total	
	Amortized cost	Gross unrealized losses	Amortized cost	Gross unrealized losses	Amortized cost	Gross unrealized losses
U.S. Treasury securities and U.S. government sponsored enterprise securities	$ 119,913	(1,623)	—	—	119,913	(1,623)
Obligations of states and political subdivisions	207,813	(7,060)	9,500	(783)	217,313	(7,843)
Corporate debt securities	24,752	(323)	—	—	24,752	(323)
Special revenue	572,869	(11,589)	137,604	(13,792)	710,473	(25,381)
Other governments	—	—	—	—	—	—
Mortgage-backed securities	787,571	(14,264)	—	—	787,571	(14,264)
Totals	$ 1,712,918	(34,859)	147,104	(14,575)	1,860,022	(49,434)

	2009					
	12 months or under		Over 12 months		Total	
	Amortized cost	Gross unrealized losses	Amortized cost	Gross unrealized losses	Amortized cost	Gross unrealized losses
U.S. Treasury securities and U.S. government sponsored enterprise securities	$ 472,553	(4,589)	—	—	472,553	(4,589)
Obligations of states and political subdivisions	348,208	(10,940)	39,307	(4,964)	387,515	(15,904)
Corporate debt securities	179,636	(3,588)	70,708	(1,418)	250,344	(5,006)
Special revenue	565,795	(14,803)	264,800	(29,613)	830,595	(44,416)
Other governments	7,310	(88)	—	—	7,310	(88)
Mortgage-backed securities	1,059,153	(13,224)	103,536	(1,091)	1,162,689	(14,315)
Totals	$ 2,632,655	(47,232)	478,351	(37,086)	3,111,006	(84,318)

The amortized cost and estimated fair value of bonds as of December 31, 2010, by contractual maturity, are shown below. 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.

	2010	
	Amortized value	**Estimated fair value**
Due in one year or less	$ 1,585,554	1,605,622
Due after one year through five years	4,642,340	4,907,102
Due after five years through ten years	2,852,612	3,086,783
Due after ten years	1,296,383	1,273,561
Mortgage-backed securities	8,004,981	8,402,552
Totals	$ 18,381,870	19,275,620

Proceeds from sales and redemptions of investments in bonds during 2010 were $3,796,512 with gross realized gains of $41,390 and gross realized losses of $7,090.

The amortized cost and estimated fair value of bonds as of December 31, 2009, by contractual maturity, are shown below. 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.

	2009	
	Amortized value	**Estimated fair value**
Due in one year or less	$ 915,629	931,968
Due after one year through five years	5,285,703	5,519,800
Due after five years through ten years	3,357,209	3,460,690
Due after ten years	1,289,946	1,242,142
Mortgage-backed securities	8,426,165	8,717,394
Totals	$ 19,274,652	19,871,994

Proceeds from sales and redemptions of investments in bonds during 2009 were $4,357,982 with gross realized gains of $59,874 and gross realized losses of $46,768.

State Fund recognized no other-than-temporary impairment in bonds for the year ended December 31, 2010. However, State Fund recognized $8,783 other-than-temporary impairment in bonds for the year ended December 31, 2009. The 2009 impairment in bonds was a result of trades where State Fund made a decision to sell the securities prior to maturity below the carrying value to reduce State Fund's credit risk. Those bonds were sold subsequently during 2009.

State Fund's investment policies limit concentration of credit risk by requiring diversification of its investments in any one issuer, industry or geographic region. Per California Insurance Code Section 11788, the State Treasurer's Office is the custodian of State Fund's long-term investment holdings.

State Fund had $67,415 and $68,096 on deposit with the Federal Reserve Bank of Saint Louis (FRBSL) to satisfy the U.S. Department of Labor regulations relating to State Fund's issuance of U.S. L&H policies as of December 31, 2010 and 2009, respectively.

State Fund does not engage in subprime residential mortgage lending nor does it invest directly in subprime fixed income securities. As of December 31, 2010, State Fund has no direct subprime mortgage related risk exposure. However, State Fund does invest in AAA rated mortgaged-backed securities that are backed by government agencies or government sponsored entities, specifically Ginnie Mae, Fannie Mae, and Freddie Mac. These types of securities are collateralized by loans but are ultimately backed by the issuing agency. Ginnie Mae securities are guaranteed by the U.S. Treasury and on December 25, 2009 Fannie Mae and Freddie Mac were granted unlimited financial assistance by the US Treasury through 2012.

State Fund as well as other State Agencies and Local Agencies are authorized to invest funds in the State of California's Pooled Money Investment Account (PMIA). State Fund's holdings in the PMIA at December 31, 2010 were $1 billion and represent 1.41% of the total $74.5 billion balance in the State of California's Pooled Money Investment Account. Investments in the PMIA at December 31, 2010 included the following: 11.44% in Loans; 13.62% in Agencies; 49.13% in U.S. Treasuries; 5.29% in Collateralized Time Deposits; 10.75% in Certificates of Deposit and Bank Notes; 9.03% in Commercial Paper and .74% in Mortgages.

(5) Fair Value of Financial Instruments

The carrying value of money market instruments including receivables, and payables, approximates fair value due to the short maturities of these investments. The Company has no assets or liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009. At December 31, 2010 and 2009, the Company did not have any material nonrecurring of non financial assets or liabilities.

(6) Real Estate, Furniture and Equipment

Real estate as of December 31, 2010 and 2009 is comprised of the following:

		2010	2009
Property occupied by the company	$	476,138	472,899
Property held for sale		5,623	—
		481,761	472,899
Accumulated depreciation		(97,412)	(88,021)
Totals	$	384,349	384,878

Furniture and equipment as of December 31, 2010 and 2009 is comprised of the following:

		2010	2009
Data processing equipment and software	$	112,502	111,177
Office furniture and equipment		184,158	174,803
		296,660	285,980
Accumulated depreciation		(258,880)	(235,292)
		37,780	50,688
Nonadmitted assets		(35,576)	(48,146)
Totals	$	2,204	2,542

Depreciation expense on real estate was $9,390 and $8,877 for the years ended December 31, 2010 and 2009, respectively. Depreciation expense on furniture and equipment was $23,610 and $24,379 for the years ended December 31, 2010 and 2009, respectively. The cost of assets retired or otherwise disposed of, and the related accumulated depreciation thereon, are removed from the accounts with any gain or loss realized upon sale or disposal, credited or charged to operations. The nonadmitted assets consist primarily of nonoperating system internally developed software costs.

(7) Estimated Liabilities for Losses and Loss Adjustment Expenses

The table below reflects changes in the estimated liabilities for losses and loss adjustment expenses over the prior 12 months through December 31, 2010 and 2009. Loss and loss adjustment expense reserves are shown net of reinsurance but gross of the impact of a loss portfolio transfer.

		2010	2009
Estimated liabilities for losses and loss adjustment expenses as of January 1, net of ceded reinsurance of $239,020 and $247,767, respectively	$	15,728,840	16,379,497
Add incurred related to:			
Current year		1,092,422	1,232,994
Prior years		278,700	281,161
Total incurred		1,371,122	1,514,155
Less paid related to:			
Current year		103,753	141,243
Prior years		1,943,434	2,023,569
Total paid		2,047,187	2,164,812
Estimated liabilities for losses and loss adjustment expenses as of December 31, net of ceded reinsurance of $232,190 and $239,020, respectively	$	15,052,775	15,728,840

Incurred losses and loss adjustment expenses relating to insured events in prior years were approximately $278,700 and $281,161 in 2010 and 2009, respectively. Increases to prior year incurred are attributable primarily to the strengthening of loss adjustment expense reserves.

State Fund writes workers' compensation insurance, a line that exposes State Fund to long-term liabilities with a potential for significant reserve variability. Management has identified the major risk factors in reserve estimation as the growth and contraction of business written by State Fund in recent years, recently enacted legislative changes affecting the line of business (i.e. reform), exposure to the retroactive impact of future legislative, regulatory and judicial decisions, and medical inflation.

State Fund had a significant increase in business volume during the 2002-2003 calendar years. Following that period of growth, a significant number of accounts returned to the private insurance market during the 2005-2010 period. This growth and contraction of business changed the mix of business over time, impacting development patterns, and contributing an element of uncertainty to loss reserve projections.

Also, in November 2003 the California Legislature passed Assembly Bill 227 and Senate Bill 228, representing a major reform of the workers' compensation system. This was followed in April 2004 by the further reforms of Senate Bill 899. These bills provide for major changes in benefit levels and the administration of claims, impacting both new claims and open claims from earlier accident years. Management has considered the impact of these reforms in estimating future liabilities; however, the

breadth of the changes and their impact on loss development patterns, and the potential for future legislative, regulatory or judicial decisions to retroactively impact currently estimated liabilities add a level of uncertainty to a current estimate of future liabilities.

Finally, the workers compensation benefit program provides medical care for the lifetime of the claimant in some cases. This exposes any current estimate of future liability to the uncertainties of future medical inflation.

These risk factors, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried estimated liabilities for losses and loss adjustment expenses.

As a workers' compensation carrier, State Fund has incidental exposure to asbestos and environmental claims. Given that State Fund's book is principally small to medium size businesses, State Fund has no significant asbestos and environmental exposure aggregations. Asbestos and environmental claims are handled in the routine course of business. Claims are made up on a per claimant basis. At December 31, 2010, State Fund identified 1,289 open asbestos cases with aggregate outstanding case reserves of $25,600, or an average outstanding case reserves of approximately $19.9 per claim. At December 31, 2009, State Fund identified 1,349 open asbestos cases with aggregate outstanding case reserves of $25,000, or an average outstanding case reserves of approximately $18.5 per claim.

State Fund establishes full case reserves for all reported asbestos and environmental claims. Incurred but not reported (IBNR) reserves are established on the book as a whole and include a provision for development of reserves on reported losses. State Fund's aggregate reserves are established based on in-house analyses, and input from external actuaries using a variety of reserve techniques, including paid loss development, incurred loss development, counts and averages, and historical loss ratios adjusted to current rate levels.

State Fund requires the insurance companies that underwrite structured settlement annuities to have an A.M. Best credit rating of A+ or better and $8 billion dollars or more in total assets at the time of purchase. The total amount of loss reserves no longer carried due to the purchase of annuities, with the claimant as payee, was $531,267 and $505,432 as of December 31, 2010 and 2009, respectively. State Fund remains liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities.

Loss reserves eliminated by annuities issued by the following companies exceeded 1% of Policyholder's Surplus as of December 31, 2010 and 2009:

		2010	2009
Genworth Financial	$	97,465	103,978
Hartford Life Insurance		112,008	109,109
Aviva Life Insurance Company		100,329	101,662
Metlife		59,314	—
Totals	$	369,116	314,749

(8) Reinsurance

For the years ended December 31, 2010 and 2009, total earned premiums ceded under the reinsurance contracts were $18,709 and $34,800, respectively.

Based upon the estimated reinsurance recoverable under reinsurance treaties for years 1968 through 1982, 1985, and 1988 through 2004, State Fund's liabilities for losses were reduced by $ 232,190 and $239,020 as of December 31, 2010 and 2009, respectively, including $71,208 and $58,571 recoverable from Munich Re America Reinsurance Co. and Reliastar Life Insurance Co., respectively, as of December 31, 2010, and $71,239 and $56,683 as of December 31, 2009, respectively.

For the year ending December 31, 2010, State Fund has no written off reinsurance balance. As of December 31, 2009, State Fund wrote off reinsurance balances due (from the companies listed below) of $115. These are reflected as losses incurred and loss adjustment expenses incurred amounting to $114 and $1, respectively.

US International Reinsurance	$	91
Classic Fire & Marine Insurance		24
Total	$	115

(a) Catastrophic Reinsurance

State Fund is exposed to earthquakes and terrorist acts. These have not had significant adverse effects on operations in the past, but could present risks in the future. State Fund purchases reinsurance protection to mitigate losses from catastrophic events.

State Fund cedes insurance risk relating to its workers' compensation business on multiple reinsurance treaties, to multiple reinsurance companies. Reinsurance agreements mitigate State Fund's liability on some individual claims, on some layers of loss, on some blocks of business and on catastrophic exposure. In accordance with statutory accounting practices, when permissible, the reinsured risks are treated for financial statement presentation purposes as though State Fund is not liable for reinsured losses. State Fund, however, has a contingent risk with respect to insurance ceded to the extent that reinsurers would be unable to meet the obligations assumed under reinsurance contracts.

In 2010, State Fund was covered for natural catastrophes by per occurrence excess of loss reinsurance treaties for $600,000 of losses excess of $300,000 for a catastrophe involving 20 or more claimants. The treaties provided one reinstatement at 100% of premium as to time, pro-rata as to amount. For terrorism, State Fund was covered by a combination of private reinsurance and the Federal Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). Private reinsurance provided $131,000 of coverage excess of a $300,000 retention on an aggregate annual basis. Above $260,000 TRIPRA provided coverage for 85% of losses related to certified acts of international terrorism having a minimum industry aggregate impact in excess of $300,000. Private reinsurance provided coverage in the 15% TRIPRA coinsurance corridor up to a limit of $527,000.

In 2009, State Fund was covered for natural catastrophes by per occurrence excess of loss reinsurance treaties for $900,000 of losses excess of $300,000 for a catastrophe involving 20 or more claimants. The treaties provided one reinstatement at 100% of premium as to time, pro-rata as to amount. For terrorism, State Fund was covered in 2009 by a combination of private reinsurance and the Federal Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). Private reinsurance provided $300,000 of coverage excess of a $300,000 retention on an aggregate annual basis. Above $340,000 TRIPRA provided coverage for 85% of losses related to certified acts of international terrorism having a minimum industry aggregate impact in excess of $300,000. Private reinsurance provided coverage in the 15% TRIPRA coinsurance corridor up to a limit of $260,000.

(b) Commutation

For the year ending December 31, 2010, State Fund has no commuted reinsurance balances.

For the year ending December 31, 2009, State Fund commuted reinsurance recoverables of $337 from LDG Reinsurance Company. These are reflected as losses incurred and loss adjustment expenses incurred amounting to $336 and $1, respectively.

(c) Loss Portfolio Transfer (LPT)

In August 2002, State Fund entered into a Loss Portfolio Transfer agreement (LPT) with XL Re Ltd. and ACE Bermuda Insurance Ltd. (the Reinsurers). The retroactive reinsurance agreement reinsured losses paid after January 1, 2002 on accident years 1980 through 1998. Under the LPT, State Fund retains liability for the first $950,000 of aggregate subject losses. In the first reinsured layer of coverage, the Reinsurers are liable for a 90% share of the next $1,150,000 of subject losses. Upon exhaustion of the first layer, State Fund retains the next $200,000 of subject losses in excess of $2,100,000. Then in a second reinsured layer, the Reinsurers are liable for a 90% share of the next $300,000 of subject losses. The maximum amount recoverable from the Reinsurers under both reinsured layers of the treaty is 90% of $1,450,000.

Under the LPT, State Fund initially recorded a retroactive ceded loss reserves credit of $1,035,000 for a payment of $728,744, thus recognizing a retroactive gain of $319,756. The gain was recorded as special surplus for retroactive reinsurance. The special surplus arising from the transaction will be considered to be earned surplus and transferred to unassigned funds (surplus) when cash recoveries from the Reinsurers exceed the total consideration paid by State Fund for the LPT. Additionally, State Fund received $1,791 as interest on monies held by the Reinsurers prior to the final consummation of the LPT. This resulted in a net amount paid by State Fund of $726,953.

By December 31, 2005, State Fund's carried gross loss reserves for the subject losses exceeded the upper limit of the second layer of the treaty. State Fund increased retroactive ceded reserves by an additional $270,000 (the $300,000 in the second layer less State Fund's 10% retention). As a result, State Fund recognized an additional retroactive gain of $256,500 ($270,000 net of a $13,500 deposit with Reinsurers for the coverage). Special surplus for retroactive reinsurance increased from $319,800 in 2004 to $576,300 at year end of 2005. The special surplus for retroactive reinsurance did not change during 2009 and 2010.

Effective January 1, 2007, XL Re Ltd. assumed all the rights and obligations of Ace Bermuda Insurance Ltd. to State Fund under the LPT through an Assumption Reinsurance and Novation Agreement.

The original LPT contained a provision under the "Large Payment Oversight" clause which was intended to address acceleration of payments due to settlement of claims. If the aggregate of Large Payments (defined as individual payments exceeding $10,000 intended to settle future liability) exceeds tabled values in the treaty (as specified at successive year ends), would void coverage on claims with subsequent Large Payments unless the Reinsurers provide prior written consent for the payments, or State Fund agreed that reimbursement would be apportioned over the life expectancy of the injured employee.

This provision was triggered in the 3rd Quarter of 2009. In order to simplify administration by all parties of this provision, the Company and the Reinsurer amended the original LPT contract to allow the deferral of subsequent Large Payments to be done on the aggregated total for each calendar quarter, based on an agreed average life expectancy for the entire body of claim involved in the LPT.

As of December 31, 2010 and 2009, cumulative subject paid losses were $1,707,145 and $1,589,341, respectively, which exceeded the $950,000 retention. These netted to total billed losses of $681,430 and $575,407 to the Reinsurers (after State Fund's 10% retention) as of December 31, 2010 and 2009, respectively, of which $626,756 and $542,803 were collected from the Reinsurers as of December 31, 2010 and 2009, respectively.

(9) Commitments and Contingencies

State Fund leases certain office space, furniture, equipment and vehicles under noncancelable operating leases.

The aggregate minimum annual lease payments under such operating leases as of December 31, 2010 were as follows:

Year:		
2011	$	35,633
2012		29,490
2013		19,256
2014		11,469
2015		3,343
Total	$	99,191

Leases for office space generally require additional payments comprising State Fund's pro-rata share of increases in real estate taxes and building operating expenses. For the years ended December 31, 2010 and 2009, the total rental expense for office space was $60,352 and $63,824, respectively, which included an allocation of rental value to space owned and occupied by State Fund of $39,379 and $38,217, respectively. Vehicle and other lease expenses were $20,792 and $19,862 for the years ended December 31, 2010 and 2009, respectively.

Lawsuits arise against State Fund in the normal course of business. Contingent liabilities arising from litigation and other matters are not considered material in relation to the financial position of State Fund.

As of December 31, 2010, State Fund's irrevocable standby letter of credit amounted to $100,000. This letter of credit protects the beneficiary in the event that State Fund does not reimburse the beneficiary for the deductible expenses incurred in relation to its auto insurance policy and the commercial general liability policy.

As of December 31, 2010, State Fund has an existing operating lease agreement with CSI Leasing which has obtained lines of credit totaling $20.9 million from various financial institutions. One creditor has a financial condition covenant that requires State Fund to maintain a minimum reported statutory basis surplus of $4.35 billion at all times. Failure to comply with the covenant may be deemed to be an Event of Default pursuant to the operating lease agreement, thus entitling CSI to exercise the remedies set forth in the agreement.

(10) Other Matters

A joint task force comprised of representatives of the California Highway Patrol, the California Department of Insurance, and the San Francisco District Attorneys' Office has informed State Fund that it has completed its investigation of allegations of potential misconduct by former employees and directors of State Fund. State Fund has been informed by the Task Force that there will be no findings or recommendations related to the investigation which would adversely impact these financial statements.

The CDI is currently conducting their triennial financial examination of the Company for the years ended December 31, 2008, 2009 and 2010.

(11) Risks and Uncertainties

On February 3, 2009, the Workers' Compensation Appeals Board (WCAB) issued two en banc decisions, one describing specific ways to challenge the diminished future earning capacity (DFEC) component of the 2005 Permanent Disability Rating Schedule (PDRS) [*Ogilvie v. City and County of San Francisco*] and the other challenging whether the AMA Guides must be used as written to dictate permanent disability ratings, [*Almaraz v. SCIF and Guzman v. Milpitas USD*]. These decisions are binding on all Appeals Board panels and Workers' Compensation Judges and affect the 2004 reforms that intended to promote consistency, uniformity and objectivity into the permanent disability rating schedule. Applicant's attorneys may now rebut both the whole person impairment listed within the AMA Guides (*Almaraz/Guzman II*), and/or the DFEC modifier of the 2005 schedule (*Ogilvie*). The decisions apply to all claims with post-1/1/05 dates of injury that are to be rated under the 2005 PDRS and they may result in more expensive permanent disability awards to injured employees, as well as significant increases in litigation costs. Petitions for Writ

of Review were filed separately for *Ogilvie*, *Almaraz*, and *Guzman*. *Ogilvie* is pending at the 1st District Court of Appeal and oral arguments are scheduled to occur on 6/22/11. *Guzman* was upheld by the Court of Appeal in the 6th District. *Almaraz* is still pending in the 5th District and it is not known whether the Court will grant review. State Fund has been monitoring the potential impacts of Ogilvie / Almarez / Guzman (OAG). Although average Permanent Disability ratings have increased due to OAG thus increasing cost trends, we feel that much of OAG is already considered in our current case reserves somewhat tempering the potential volatility on ultimate claim values. We will continue to monitor these decisions and their impact on our results.

On July 28, 2009 legislation was enacted authorizing the State of California Director of Finance acting as agent for the State of California to sell a portion of or otherwise obtain value for the State Compensation Insurance Fund's workers' compensation insurance assets and liabilities with the intent of raising $1B in state revenue and to deposit the proceeds of sale or proceeds achieved through any other disposition, less transaction costs, into the State's General Fund. On August 28, 2009, Insurance Commissioner Poizner filed a lawsuit in Sacramento Superior Court to declare the legislation unconstitutional and enjoined the Director of Finance and the Treasurer from implementing this legislation. State Fund is named in the lawsuit as a real party in interest. The legislation will sunset in January 2012.

(12) Related Parties

State Fund has an agreement with the State of California Department of Personnel Administration (DPA) to adjust the claims and process the payments related to those claims on behalf of state agencies. State Fund pays compensation benefits to the injured workers and medical benefits to the health providers. State Fund is reimbursed by the state agencies for compensation and medical benefits paid, and the cost of processing claims.

Schedule I

STATE COMPENSATION INSURANCE FUND

Supplemental Investment Risk Interrogatories

December 31, 2010

(Dollar amounts in thousands)

State Fund's total admitted assets as filed in the 2010 Annual Statement is: $ 20,271,854

State Fund's ten largest exposures to a single issuer/borrower/investment:

Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
John Deere Capital Corp.	Industrial & Miscellaneous	$ 128,957	0.6%
Bank of America Corp.	Industrial & Miscellaneous	127,029	0.6
Boeing Co.	Industrial & Miscellaneous	112,429	0.6
Praxair Inc.	Industrial & Miscellaneous	110,918	0.5
General Dynamics Corp.	Industrial & Miscellaneous	110,684	0.5
Southern California Public Power Authority PW	Special Revenue	109,753	0.5
Cisco Systems, Inc.	Industrial & Miscellaneous	100,372	0.5
Consolidated Edison Co. of NY	Industrial & Miscellaneous	95,030	0.5
Goldman Sachs Group, Inc.	Industrial & Miscellaneous	92,393	0.5
Pricoa Global Funding 1	Industrial & Miscellaneous	89,958	0.4

The amounts and percentages of State Fund's total admitted assets held in bonds by NAIC rating are as follows:

Ratings	Amount	Percentage of Total Admitted Assets
NAIC – 1	$ 18,379,528	90.7%
NAIC – 2	12,830	0.1
NAIC – 3		—
NAIC – 4		—
NAIC – 5		—
NAIC – 6		—

State Fund does not have any preferred stocks.

State Fund does not hold any foreign investments.

State Fund's Canadian investments is less than 2.5% of the total admitted assets.

State Fund's real estate is less than 2.5% of the total admitted assets.

See accompanying independent auditors' report.

Schedule II

STATE COMPENSATION INSURANCE FUND

Supplemental Summary Investment Schedules

December 31, 2010

(Dollar amounts in thousands)

State Fund had the following invested assets as of December 31, 2010:

	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount (in thousands)	**Percentage**	**Amount** (in thousands)	**Percentage**
Bonds:				
U.S. Treasury Securities	$ 1,946,520	9.8%	1,946,520	9.8%
U.S. government agency obligations (excluding mortgage-backed securities)				
Issued by US government agencies	—	—	—	—
Issued by US government sponsored agencies	2,336,466	11.8	2,336,466	11.8
Non-U.S. Government (including Canada, excluding mortgage-backed securities)	260,127	1.3	260,127	1.3
Securities issued by states, territories and possessions, and political subdivisions in the US				
States, territories, and possessions general obligations	313,790	1.6	313,790	1.6
Political subdivisions of states, territories and possessions and political subdivisions general obligations	294,771	1.5	294,771	1.5
Revenue and assessment obligations	1,641,606	8.3	1,641,606	8.3
Mortgage-backed securities (includes residential and commercial MBS)				
Pass-through securities				
Issued or guaranteed by GNMA	1,091,272	5.5	1,091,272	5.5
Issued or guaranteed by FNMA and FHLMC	4,972,188	25.1	4,972,188	25.1
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	1,893,163	9.6	1,893,163	9.6
All other	48,357	0.3	48,357	0.3
Other debt and other fixed income securities (excluding short-term)				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	3,583,610	18.1	3,583,610	18.1
Unaffiliated Non-U.S. securities (including Canada)	—	—		—
Real estate investments:				
Property occupied by the company	381,423	1.9	381,423	1.9
Property held for sale	2,926	0	2,926	0
Receivable for securities	2,839	0	2,839	0
Cash, cash equivalents and short-term investments	1,027,286	5.2	1,027,286	5.2
Total cash and investments	$ 19,796,344	100.0%	19,796,344	100.0%

See accompanying independent auditors' report.

Schedule III

STATE COMPENSATION INSURANCE FUND

Reinsurance Interrogatory

December 31, 2010

The following disclosures are limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994:

(1) State Fund has not reinsured any risk with any other entity under a quota share reinsurance contract.

(2) Except for the exception detailed below, State Fund has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

(a) A contract term longer than two years and the contract is noncancelable by State Fund during the contract term;

(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by State Fund, or an affiliate of State Fund, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

(c) Aggregate stop loss reinsurance coverage;

(d) An unconditional or unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

(f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Exception relative to (2)(f): The State Fund has entered into an LPT treaty which includes the following provision: If the aggregate paid Large Payments exceed values in a Cumulative Large Payment Loss Triggers Table, the State Fund will not affect any Large Payment exceeding $10,000 (but excepting those payments which the Company is compelled to pay by operation of §5100 through §5106 of the California Labor Code), without obtaining the Reinsurer's prior written consent. If any claim paid by the Company is inconsistent with the limitations set forth in this Article, reinsurance coverage provided pursuant to this Agreement for such claim will be void unless the Reinsurers consent, at their sole option, to provide coverage for such Large Payment, which consent will not be withheld if the Company agrees that the obligation of the Reinsurers to pay the Company for such Large Payment made by the Company in settlement of such claim will be apportioned in equal amounts to each calendar year within the life expectancy of the injured employee who is the subject of the claim.

STATE COMPENSATION INSURANCE FUND

Reinsurance Interrogatory

December 31, 2010

This provision was triggered as of the third quarter of 2010. For administrative convenience State Fund and the reinsurer have agreed that subsequent large loss payments will be recovered from the reinsurer pro rata over an agreed average life expectancy.

(3) State Fund has not, during the period covered by the statement, ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders, where:

(a) The written premium ceded to the reinsurer by State Fund or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to State Fund or its affiliates.

(4) State Fund has not ceded any risk under any reinsurance contract during the period covered by the financial statement, and either:

(a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or

(b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

State Fund has filed the Reinsurance Attestation Supplement with the CDI and NAIC with no exception.

See accompanying independent auditors' report.