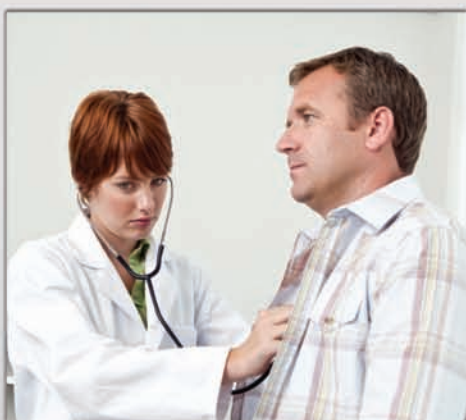


New York State Insurance Fund

Workers' Compensation & Disability Benefits Specialist

2010 Annual Report



At Your Service



since 1914



THEN... NOW... ALWAYS...™





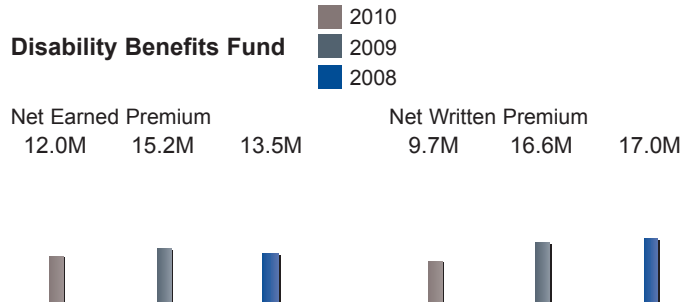
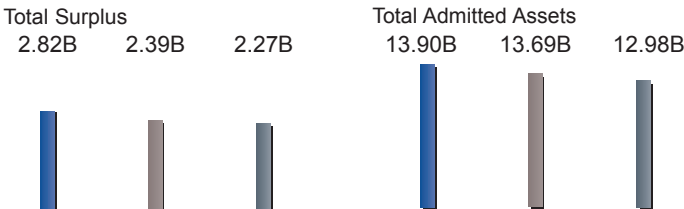
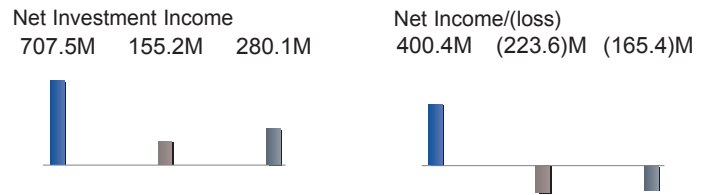
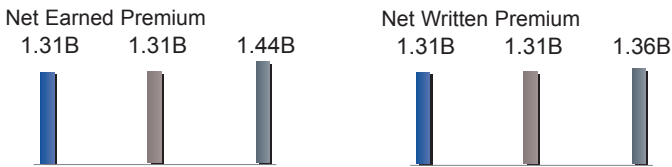
At Your Service

NYSIF focused on core mission functions in 2010 to deliver quality service to all stakeholders – claimants, businesses and medical providers – designed to enhance value and help lower costs throughout the system.

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NYSIF 2010 Annual Report

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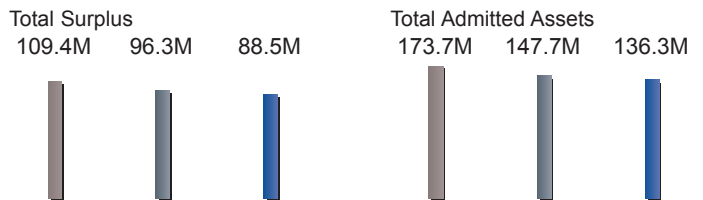
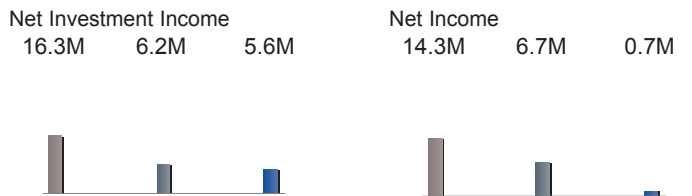
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Message

from the Governor



In one of the most challenging economic climates ever, New York State is meeting the challenge. The current economic climate has demanded strategic action to stabilize the state's finances and lay the groundwork for economic growth and job creation – steps that we have taken to place our state on a firm fiscal foundation now and for future generations.

We have tapped leaders from business, academia, labor, agriculture, non-profits and community-based organizations statewide to serve on regional councils to stimulate economic development and create jobs specific to the needs of the regions they serve. We are providing resources, instituting policies, and reaching historic agreements that have eliminated unnecessary barriers to growth and prosperity.

Our past has shown that we can work together to make New York State thrive again. That involves the challenge of a more modern, accountable and efficient way of doing business by streamlining government services, increasing institutional responsibility, and restoring confidence and performance in New York State government.

New York State's history is full of the energetic spirit of entrepreneurship, of hard working people who make businesses work, and of responsive government that has met their needs.

For 96 years, the New York State Insurance Fund has faced many challenges to deliver consistently on a mandate to make workers' compensation and disability benefits insurance available to any employer doing business in New York. Even in our state's most difficult times, the Fund has remained a reliable and trusted source in the workers' compensation market as a self-sufficient, competitive insurance carrier.

NYSIF continues to work with businesses of every size and risk – from mom and pop operations, to large corporations, to fledgling start-up companies – serving a vital function. NYSIF has maintained a significant role by using strategies to adapt to a changing business and fiscal landscape. In the process, NYSIF has helped to protect and serve millions of working people for generations.

New York State's history is full of the energetic spirit of entrepreneurship, of hard working people who make businesses work, and of responsive government that has met their needs. It is this formula that made New York State a national leader, and will lead us back on the road to prosperity.

Andrew M. Cuomo
Governor

NYSIF continues to maintain its competitive edge by increasing efficiency and reducing costs through a combination of business re-engineering and program redesign, by focusing on performance and accountability, by expanding the use of technology, by leading the fight against workers' compensation fraud, and by making customer service our first priority.

Message

from the Chairman

Faced with a highly competitive insurance market in 2010, the New York State Insurance Fund retained its status as the number one writer of workers' compensation insurance in New York. Recognized as well nationally as the sixth leading workers' compensation insurer, these rankings demonstrate NYSIF's commitment to meet every challenge while fulfilling its mission.

After 96 years, NYSIF remains reliable and stable, available to any business to meet its obligation to provide workers' compensation and disability benefits insurance for its employees in New York. Our ranking among the top insurers in the country allows us to offer insurance premium plans that extend a viable option for business and reward qualified policyholders with market-leading discounts and dividends.

NYSIF continues to maintain its competitive edge by increasing efficiency and reducing costs through a combination of business re-engineering and program redesign, by focusing on performance and accountability, by expanding the use of technology, by leading the fight against workers' compensation fraud, and by making customer service our first priority.

This is all possible due to the collective effort of a workforce that remains steadfast in its dedication to protecting businesses and injured workers and their families against the hardship and financial loss arising from on-the-job injuries and disabilities sustained off the job.

Nor would we have been able to carry our mission forward without the guidance and support of the Executive branch, our Board of Commissioners and a strong and dedicated management team. I thank all of them for allowing me the privilege to serve this organization and to serve the businesses and working men and women of New York State.



A handwritten signature in black ink, appearing to read "Robert H. Hurlbut". The signature is fluid and cursive.

Robert H. Hurlbut
Chairman

NYSIF Board of Commissioners



From left:

Denis M. Hughes

President, New York AFL-CIO

Kenneth R. Theobalds

VP, Government Affairs, Entergy Northeast

Chairman

Robert H. Hurlbut

President, The Hurlbut Trust

Eileen A. Frank

President, J.P. West, Inc.

Vice Chairman

H. Sidney Holmes III

Corporate Partner, Winston & Strawn, LLP

David E. Ourlicht

Managing Director, GAMCO Asset Mgmt.

R. Wayne LeChase

Chairman and Managing Partner, LeChase Construction

Colleen C. Gardner

(inset), Commissioner, NYS Department of Labor (ex-officio)



CASE FILE - Looking Out For People

At Your Service

Everyone gains in a Section 32 waiver agreement under Workers' Compensation Law. In exchange for settling the case, the claimant receives a lump sum payment. For the policyholder, the settlement means complete, full and final resolution of a claim. It's a win-win for all parties.

It's not everyday, however, that a claimant praises the claims service representative (CSR) handling the case, and shares that sentiment with the judge. In this case, the claimant did just that, and then wrote a letter to NYSIF to say that our CSR "really cares...she's looking out for people."

The CSR explained: "[The claimant] called often and sometimes just needed to talk. I helped expedite surgery and called the doctor and attorney many times...I guess we established a good rapport."

After 20 years at NYSIF, this CSR knows it's crucial to understand the different dimensions of a claim. "I try to evaluate each claim to the best of my knowledge on information from the employer, claimant and physicians. When the information is evaluated, I believe the best course for the claimant and the employer is to expedite the case...This leads to the best results for a return to work and recovery from an injury."



2010 Highlights

Message to our policyholders

NYSIF focused on core mission functions in 2010 to deliver quality service to all stakeholders – claimants, businesses and medical providers – designed to enhance value and help lower costs throughout the system.

In a time of economic challenges and market changes, NYSIF remained true to its original mission and remained positioned to offer a guaranteed means of insurance for any New York employer. Created by the New York State Legislature in 1914, NYSIF continues to deliver on its mandate.

Once again, our service won accolades from claimants, policyholders and providers. This annual report highlights examples of that service. Other highlights include an 88th straight year of safety group dividends, industry-low disability benefits insurance rates, a continuing commitment to communication and technology to serve customers, implementation of Medical Treatment Guidelines, and a Recommendation of Care program to reduce medical costs. In addition, NYSIF anti-fraud efforts resulted in an arrest in the largest workers' compensation fraud case ever in New York State.

We are pleased to present our 2010 annual report, summarizing these achievements:

Market Share

NYSIF had earned premium of \$1.3 billion in 2010 with 172,000 active workers' compensation policies at year's end and a 31% share of the New York workers' compensation market, which placed us as the number one workers' compensation insurance carrier in New York. Moreover, A.M. Best's mid-year credit rating showed NYSIF had moved up one place to the number six workers' compensation carrier in the United States – a position we attribute to our record of integrity, transparency and best practices in NYSIF's commitment to operational excellence.

Since 1923, safety groups have earned uninterrupted, yearly dividends for workplace safety practices that help keep workers free from harm on the job and reduce employer insurance costs.

continued to receive guaranteed cost plans with premium discounts that help lower their rates. In 2010, policyholders with the best safety records received an advance discount of 35%.



Dividends, Discounts

Working with our independent safety group managers, NYSIF returned \$161.8 million in dividends to safety group policyholders. The average dividend grew to 30.5%, a fourth straight year of average dividend growth.

As workers' compensation industry loss costs have increased in recent years, NYSIF policyholders



NYSIF offers multiple discount levels based on the loss experience of individual policyholders. The more an employer demonstrates a record of safe workplace practices, the more an employer earns in NYSIF discounts that effectively lower the cost of workers' compensation insurance. To that end, we formed a Preferred Risk Participation Plan to reward qualified, safety conscious employers. The plan includes an advanced discount of 20%, with a potential maximum return of 49% of discounted premium calculated 12 months after the policy period ends.

Disability Benefits

On January 1, 2010, NYSIF lowered its statutory disability benefits insurance rates to \$0.14 per \$100 of payroll. On April 1, 2010, NYSIF introduced "enriched" disability benefits, offering employers the opportunity to select from a range of increased benefit levels to insure employees for off-the-job injuries at the same low rates. At year's end, NYSIF had 61,857 active disability benefits policies with \$14.5 million premium in force.

Policyholders can enrich disability benefits for their employees by up to five times statutory coverage at the same low rate minimum and maximum annual premium.

Communication

We further emphasized ways to help policyholders reduce workers' compensation and disability benefits insurance costs, and to help insurance brokers to do the same for NYSIF clients. NYSIF invited brokers to forums at our Manhattan offices to meet senior managers to discuss insurance plans and programs, underwriting criteria, the importance of audit appointments and preparation, and the employer's role in limiting claims liability and enhancing proactive safety and risk management.

In our quarterly *Workers' Comp. Advisor* newsletter to policyholders and brokers we focused extensively on reducing workers' compensation costs as well as on safety issues dealing with falls, repetitive stress injuries, respiratory protection, safe patient handling, emergency preparedness, building a culture of accountability, and averting disaster. For the first time, NYSIF made the *Advisor* available electronically to nearly a quarter of our subscriber list, as we took steps to expand electronic communication with customers to reduce printing costs.



CASE FILE - Turning Anxiety to Joy

NYSIF receives many compliments for our service, but leave it to the director of a musical theatre and theatre camp to summarize the experience with accolades for one of our customer service representatives whose "sunny disposition" turned this policyholder's "anxiety to joy."

The policyholder sang these praises about the representative in an e-mail to our Customer Call Center in Binghamton: "In this day and age, I appreciated the time she spent with me, her sunny disposition, her desire to help me and, moreover, her knowledge of what it took to take care of my problem."

And, there was a second act. The e-mail continued by expressing the policyholder's appreciation of our customer service for "turning my anxiety to joy. It was refreshing to say the least."

The note caught its recipient off guard, who, like many of our customer service representatives, says she didn't expect to be singled out for doing her job, but is grateful for the applause.

"I had a great feeling when he told me that he never received this type of customer service before. Something like this is especially good when you're not expecting it."

At Your Service



We continue to encourage customers to tap NYSIF technology to self-serve through our web site. NYSIF offers a full menu of electronic tools at www.nysif.com that allow 24/7 access, including eCERTS® to print or validate certificates of insurance, and NYSIF eFROI®, to submit claims or file a first report of injury with NYSIF.

Technology

Through our broker forums and other outlets we encouraged customers to tap NYSIF technology to self-serve through our web site. We continue to emphasize a full menu of electronic tools at www.nysif.com that allow users to print or validate certificates of insurance (eCERTS®), report injuries (NYSIF eFROI®), pay their premium (eCHECK), manage their accounts, look up claims information, report fraud and obtain a quote for insurance (eQUOTE).

NYSIF Information Technology Services entered the next phase of a five-year enterprise-wide modernization project to migrate core processes from mainframes to a web-based environment. This is an upgrade aimed at keeping pace with changing technology to provide enhanced interactive and cost-effective features for NYSIF customers and staff alike.

In addition, we implemented a state-of-the-art business intelligence platform for enterprise information and performance metrics. We expanded our Document Control Center, where NYSIF converts over 8,000 records daily to electronic files, improving processing time for routine filing tasks and document retrieval. We also strengthened NYSIF information security through the implementation of new policies and a risk compliance tool set.

Explanation of Benefits

In 2010, we upgraded our web-based electronic Explanation of Benefits for medical providers, enhancing this self-serve feature on nysif.com by making more information about medical bill status and payments available electronically to providers.

Recommendation of Care

NYSIF began offering a voluntary Recommendation of Care (ROC) program for the treatment of workers' compensation injuries through a medical provider network. The program offers potential savings up to 15% on medical costs, a primary driver of workers' compensation costs. Policyholders may sign up for the ROC program on our web site, where they can access a list of network providers, just as they can access a list of pharmacies in our prescription drug program.

NYSIF **CASE FILE -** **At Your Service**
Watchful Eyes



Sometimes a conscientious NYSIF claims service representative is among the most valued assets an insurance broker can offer customers.

Such was the case for an ailing, elderly client whose domestic policy was about to go into cancellation for non-payment before our CSR stepped in, generating a glowing e-mail from a grateful broker:

"I would like to thank you for your watchful eyes and help with this account. I do wish we had more people like you in our world today... As a service/sales person all my life, I find it most important to be involved in customer service. Thanks for being a partner in that type of service."

The service involved several telephone calls to locate the policyholder, whose mailing address had changed, to keep the policy in force with no lapse in coverage. "I did not want it to cancel unnecessarily if, indeed, the coverage was still needed," said our CSR, a 23-year NYSIF employee. "I am happy I was able to provide the service for the insured, but knowing how much [the broker] appreciated my work is a bonus."

Medical Treatment Guidelines

Claims personnel completed training to prepare for the implementation of Medical Treatment Guidelines issued by the Workers' Compensation Board, effective December 1, 2010. The guidelines set a single standard of care applicable to all medical providers and insurance carriers in the treatment of workers' compensation injuries involving the knee, shoulder, neck, and mid- and lower-back. Goals include expedited quality care, improved medical outcomes, reduced treatment disputes, increased timely payments to providers and reduced medical claim costs.

Fraud

As always, NYSIF turned in a benchmark effort in leading the fight to contain workers' compensation fraud. Our anti-fraud program was responsible for 107 arrests in 2010, along with restitution and estimated future savings of \$11.3 million. NYSIF Division of Confidential Investigations continued to pursue hundreds of active cases thanks to referrals made by NYSIF case managers, underwriters and auditors in all our offices.

Since 1995 our anti-fraud program has totaled over 7,000 investigations, 1,500 arrests and nearly \$200 million in restitution and estimated savings.

More 2010 Highlights

Approximately 172,000 employers held NYSIF workers' compensation insurance policies in 2010.

NYSIF paid \$ 161.8 million in safety group dividends; the average dividend grew for a fourth straight year to 30.5%.

NYSIF conducted 16,999 safety surveys, 2,321 safety training presentations, and 102,280 premium audits.

NYSIF retired 62,351 workers' compensation claims and received 62,464 new workers' compensation claims.

NYSIF negotiated 2,265 Section 32 settlements for \$ 95.3 million in savings.

NYSIF Disability Benefits reached a record high 61,857 policies.

NYSIF saved an estimated \$ 1.1 million through its Document Control Center data processing, storage and retrieval program.

NYSIF averaged about 120,000 visitors per month to its web site.

NYSIF introduced Recommendation of Care, offering a potential 15% savings on medical claim costs. Sign up at www.nysif.com.



CASE FILE - Made My Day

No one likes the run-around. That's why in NYSIF customer service training our employees learn to take ownership of customer problems. So it was that voicemail from a satisfied customer explained how the search for information pertaining to disability benefits insurance ended with a call to NYSIF.

After spending all day on the phone searching for an answer from various sources to no avail, the customer contacted a NYSIF customer service representative who "diligently conducted research and explained in layman's terms the exact problem and the best way to resolve it."

It was a textbook example of taking ownership of a problem, as our rep. who handled the call described: "The customer had questions regarding employee withholding for disability. She did not understand the purpose of these withholdings. I explained they were to offset employer cost of providing disability benefits insurance for her employees. I found a section on disability benefits withholding on nysif.com and reviewed it with her in detail."

The voicemail concluded: "He really made my day."

At Your Service



Our initiatives in all operational areas support NYSIF's primary mission to pay proper and timely indemnity and medical benefits on behalf of injured workers and their families, ensure stability as a competitive market force, and achieve service excellence.

Just as we receive many thanks for our service, NYSIF visited loyal customers of 75, 80, 85, 90 and 95 years in 2010 to thank them and show our appreciation for their business. We count ourselves fortunate to have some of our original policyholders who have been with us every step of the way. We value our relationships with our customers above all else. And we hope that the value we place on our commitment to serving you, your employees and their families, is something you value as well.

NYSIF Management Team

NYSIF Executive Staff

From left:

Joseph Mullen

Director of Administration

Michael Miliano

Deputy General Attorney and
Assistant Secretary to the Board

Shirley Stark

Deputy Executive Director

Miriam Martinez

Director of Investments

Francine James

Secretary to the Board of
Commissioners

Jean Woodard

Deputy Executive Director

Thomas Gleason

Deputy Executive Director

Gregory Allen

General Attorney



New York State Insurance Fund Statutory Basis Financial Statements

Workers' Compensation Fund

Statement of Admitted Assets, Liabilities and Surplus

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|--|----------------------|----------------------|
| Admitted Assets | | |
| Cash and invested assets | | |
| Bonds—at NAIC carrying value | \$ 10,574,091 | \$ 10,412,216 |
| Preferred stocks | 4,197 | 20,118 |
| Common stocks | 1,275,718 | 1,154,567 |
| Real estate | 17,706 | 13,711 |
| Cash and short-term investments | 127,352 | 56,455 |
| Other invested assets | 43,914 | 48,031 |
| Security lending reinvested collateral assets | <u>233,465</u> | <u>420,889</u> |
| Total cash and invested assets | 12,276,443 | 12,125,987 |
| Premiums receivables | 135,412 | 141,054 |
| Accrued investment income | 90,909 | 93,801 |
| Other admitted assets | 98,158 | 32,942 |
| Contingent receivable from New York State | <u>1,295,000</u> | <u>1,295,000</u> |
| Total admitted assets | <u>\$ 13,895,922</u> | <u>\$ 13,688,784</u> |
| Liabilities and Surplus | | |
| Liabilities | | |
| Reserve for losses | \$ 8,029,705 | \$ 7,986,386 |
| Reserve for loss adjustment expenses | 866,572 | 855,031 |
| Unearned premiums | 331,455 | 337,605 |
| Contingent policyholder dividends | 930,625 | 1,053,502 |
| Payables for securities lending | 249,902 | 420,889 |
| Accrued expenses and other liabilities | 282,082 | 231,712 |
| Net payable due to affiliates | <u>389,420</u> | <u>408,707</u> |
| Total liabilities | <u>11,079,761</u> | <u>11,293,832</u> |
| Security fluctuation surplus | 400,000 | 400,000 |
| Catastrophe surplus | 270,179 | 319,232 |
| Special surplus from retroactive reinsurance assumed | - | - |
| Foreign terrorism catastrophe surplus | 228,938 | 188,363 |
| Domestic terrorism catastrophe surplus | 40,883 | 32,405 |
| Unassigned surplus | <u>1,876,161</u> | <u>1,454,952</u> |
| Total surplus | <u>2,816,161</u> | <u>2,394,952</u> |
| Total liabilities and surplus | <u>\$ 13,895,922</u> | <u>\$ 13,688,784</u> |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Workers' Compensation Fund

Statement of Operations

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|---------------------------------------|-------------------|---------------------|
| Underwriting income | | |
| Net written premium | \$ 1,309,759 | \$ 1,309,601 |
| | <u>1,309,759</u> | <u>1,309,601</u> |
| Net earned premium | 1,307,817 | 1,311,660 |
| | <u>1,307,817</u> | <u>1,311,660</u> |
| Underwriting expenses | | |
| Losses incurred | 1,189,613 | 1,199,289 |
| Loss adjustment expenses incurred | 178,818 | 175,428 |
| Other underwriting expenses incurred | 214,943 | 214,711 |
| | <u>1,583,374</u> | <u>1,589,428</u> |
| Total underwriting expenses | 1,583,374 | 1,589,428 |
| | <u>1,583,374</u> | <u>1,589,428</u> |
| Net underwriting loss | (275,557) | (277,768) |
| | <u>(275,557)</u> | <u>(277,768)</u> |
| Investment income earned | | |
| Investment income | 520,233 | 546,606 |
| Investment expenses | (24,862) | (21,769) |
| Net realized investment gain / (loss) | 212,081 | (369,662) |
| | <u>707,452</u> | <u>155,175</u> |
| Net investment income earned | 707,452 | 155,175 |
| | <u>707,452</u> | <u>155,175</u> |
| Other income (expenses) | | |
| Bad debt expense | (45,159) | (35,087) |
| Miscellaneous income | 52,603 | 39,042 |
| Dividends to policyholders | (38,892) | (104,921) |
| | <u>(31,448)</u> | <u>(100,966)</u> |
| Total other expenses | (31,448) | (100,966) |
| | <u>(31,448)</u> | <u>(100,966)</u> |
| Net income (loss) | \$ 400,447 | \$ (223,559) |
| | <u>\$ 400,447</u> | <u>\$ (223,559)</u> |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Workers' Compensation Fund

Statement of Surplus

Years Ended December 31, 2010 and 2009 (in thousands)

| | Security Fluctuation Surplus | Catastrophe Surplus | Special Surplus From Retroactive Reinsurance Assumed | Foreign Terrorism Catastrophe Surplus | Domestic Terrorism Catastrophe Surplus | Unassigned Surplus | Total Surplus |
|---|------------------------------------|------------------------|--|--|---|-----------------------|---------------------|
| BALANCE—January 1, 2009 | \$ 400,000 | \$ 367,649 | \$ 616 | \$ 148,571 | \$ 23,780 | \$ 1,326,496 | \$ 2,267,112 |
| Net loss | - | - | - | - | - | (223,559) | (223,559) |
| Correction of an error | - | - | - | - | - | - | - |
| Net unrealized capital gain - investments | - | - | - | - | - | 362,685 | 362,685 |
| Increase in nonadmitted assets | - | - | - | - | - | (11,286) | (11,286) |
| Decrease in retroactive reinsurance assumed | - | - | (616) | - | - | 616 | - |
| Appropriation of assigned to unassigned surplus | - | (48,417) | - | - | - | 48,417 | - |
| Appropriation of unassigned to assigned surplus | - | - | - | 39,792 | 8,625 | (48,417) | - |
| BALANCE—December 31, 2009 | 400,000 | 319,232 | - | 188,363 | 32,405 | 1,454,952 | 2,394,952 |
| Net income | - | - | - | - | - | 400,447 | 400,447 |
| Correction of an error | - | - | - | - | - | (18,637) | (18,637) |
| Net unrealized capital gain - investments | - | - | - | - | - | 22,164 | 22,164 |
| Decrease in nonadmitted assets | - | - | - | - | - | 17,235 | 17,235 |
| Decrease in retroactive reinsurance assumed | - | - | - | - | - | - | - |
| Appropriation of assigned to unassigned surplus | - | (49,053) | - | - | - | 49,053 | - |
| Appropriation of unassigned to assigned surplus | - | - | - | 40,575 | 8,478 | (49,053) | - |
| Balance - December 31, 2010 | \$ 400,000 | \$ 270,179 | \$ - | \$ 228,938 | \$ 40,883 | \$ 1,876,161 | \$ 2,816,161 |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Workers' Compensation Fund

Statement of Cash Flows

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|---|-------------------|------------------|
| Cash flows from operations | | |
| Premiums collected, net of reinsurance | \$ 1,330,021 | \$ 1,306,137 |
| Net investment income | 457,825 | 502,050 |
| Miscellaneous income (expenses) | 15,273 | 13,671 |
| Losses and loss adjustment expenses paid, net of salvage and subrogation | (1,144,877) | (1,082,519) |
| Expenses paid | (361,248) | (350,666) |
| Dividends to policyholders | (161,770) | (177,022) |
| | <u>135,224</u> | <u>211,651</u> |
| Net cash provided by operations | | |
| Cash flows from investments | | |
| Proceeds from investments sold, matured or repaid | 28,573,400 | 31,673,884 |
| Cost of investments acquired | (28,603,248) | (31,877,939) |
| | <u>(29,848)</u> | <u>(204,055)</u> |
| Net cash used in investments | | |
| Cash flows from other sources | | |
| Other (applications) sources | (34,479) | (28,188) |
| | <u>(34,479)</u> | <u>(28,188)</u> |
| Net cash used in other sources | | |
| Net change in cash and short-term investments | 70,897 | (20,592) |
| Cash and short-term investments | | |
| beginning of year | <u>56,455</u> | <u>77,047</u> |
| Cash and short-term investments | | |
| end of year | <u>\$ 127,352</u> | <u>\$ 56,455</u> |

See accompanying notes to statutory basis financial statements.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

1 - Organization and Purpose

The State Insurance Fund (the "Fund"), which includes the operations of the Workers' Compensation Fund and Disability Benefits Fund, is a nonprofit agency of the State of New York (the "State"). By statute, the Fund maintains separate records for the Workers' Compensation Fund and Disability Benefits Fund.

The Workers' Compensation Fund was established by law in 1914 to provide workers' compensation insurance for employers in the State of New York. As an agency of the State, all liabilities of the Workers' Compensation Fund are guaranteed by the State should the Workers' Compensation Fund become insolvent.

Workers' compensation insurance covers job-related disabilities and includes the cost of medical treatment.

The Workers' Compensation Fund also administers the Workers' Compensation Program for the State, which self insures.

The Workers' Compensation Fund has exposure to catastrophes, which are an inherent risk of the property-casualty insurance business, which have contributed, and may contribute, to material year-to-year fluctuations in the Workers' Compensation Fund's results of operations and financial position.

2 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying statutory basis financial statements of the Workers' Compensation Fund are presented in conformity with accounting practices prescribed by the Insurance Department of the State of New York (the "Insurance Department"). The Insurance Department recognizes only New York Statutory Accounting Practices ("NY SAP") for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under New York State Insurance Law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures Manual ("NAIC SAP"), effective January 1, 2001 and subsequent revisions, have been adopted as a component of NY SAP. The State of New York has adopted certain prescribed accounting practices that differ from those found in NAIC SAP. Specifically, EDP and related equipment, constituting a data processing, record keeping or accounting system with a cost of \$50 and greater shall be depreciated over a period not to exceed 10 years under NY SAP. In addition, the Superintendent of the Insurance Department has the right to permit other specific practices that may deviate from prescribed practices. The Workers' Compensation Fund, as prescribed by the Insurance Department or as mandated by New York State Workers' Compensation Law, discounts all loss and loss adjustment expense reserves at 5%, assign a portion of unassigned surplus for securities fluctuation, catastrophes, foreign terrorism catastrophes and domestic terrorism catastrophes, is not required to calculate Risk Based Capital calculations and records the contingent receivable from the State as an admitted asset. In addition, the Workers' Compensation Fund is prescribed to admit the entire receivable for the Urban Development Corporation as an invested asset.

The Workers' Compensation Fund discounts reserves for loss and loss adjustment expenses at 5%, resulting in an increase to statutory surplus of \$7,747,165 and \$7,178,345 as of December 31, 2010 and 2009, respectively. If no assignments of surplus were prescribed, unassigned surplus would be increased by \$940,000 as of December 31, 2010 and 2009, respectively. If the contingent receivable from the State were not prescribed as an admitted asset, total statutory surplus would be decreased by \$1,295,000 as of December 31, 2010 and 2009, respectively. If the receivable from the Urban Development Corporation was not an admitted asset, total statutory surplus would be decreased by \$43,914 and \$48,031 as of December 31, 2010 and 2009, respectively.

The cumulative effect of prescribed practices by the Insurance Department or as mandated by New York State Workers' Compensation Law on the Workers' Compensation Fund's total surplus as of December 31, 2010 and 2009 is as follows:

| | <u>2010</u> | <u>2009</u> |
|--|-----------------------|-----------------------|
| Total surplus as shown on statutory statements | <u>\$ 2,816,161</u> | <u>\$ 2,394,952</u> |
| Discounting loss and loss adjustment expense reserves at 5% * | (7,747,165) | (7,178,345) |
| WCB Assessment discount | (362,110) | (335,292) |
| Contingent receivable from State of New York | (1,295,000) | (1,295,000) |
| Other invested assets-receivable from Urban Development Corporation | <u>(43,914)</u> | <u>(48,031)</u> |
| Total cumulative affect | <u>(9,448,189)</u> | <u>(8,856,668)</u> |
| Total adjusted surplus to deficit | <u>\$ (6,632,028)</u> | <u>\$ (6,461,716)</u> |

* Under NAIC SAP, certain case reserves (tabular reserves), would be discounted at an appropriate interest rate. The amount of tabular discount at 3.5% as of December 31, 2010 and 2009, respectively, is \$4,281,496 and \$4,014,275.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

The accounting practices and procedures of NY SAP comprise a comprehensive basis of accounting other than generally accepted accounting principles ("GAAP") in the United States ("U.S. GAAP").

The more significant variances between NY SAP and U.S. GAAP which are applicable to the Workers' Compensation Fund are set forth below:

a. Bonds are generally carried at amortized cost. Under U.S. GAAP, such securities are classified into "held to maturity" and reported at amortized cost, or "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of surplus.

All single class and multi-class mortgage-backed/asset-backed securities are adjusted for the effects of changes in prepayment assumptions on the related accretion of discount or amortization of premium of such securities using either the retrospective or prospective methods. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the undiscounted estimated future cash flows. Under U.S. GAAP, all securities, purchased or retained, that represent beneficial interests in securitized assets (e.g., collateralized mortgage obligations or asset-backed securities), other than high-credit quality securities, are adjusted using the prospective method when there is a change in estimated future cash flows. If it is determined that a decline in fair value is other-than-temporary, the cost basis of the security is written down to the discounted fair value.

b. Common stocks are reported at fair value, as determined by the NAIC's Securities Valuation Office ("SVO") and other independent pricing sources and the related net unrealized capital gains and losses are reported in unassigned surplus. Dividend income generally is reported when received. Under U.S. GAAP, common stocks are classified as either "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of surplus. Dividend income is recorded when the dividends are declared.

c. Cash and short-term investments in the statement of cash flows represent cash balances and investments with initial maturities of one year or less. Under U.S. GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

d. Policy acquisition costs (principally underwriting and marketing related costs) are expensed as incurred, whereas under U.S. GAAP these costs are deferred and amortized to income on the same basis as premium income is recognized.

e. The Workers' Compensation Fund records written premiums when billed to policyholders and earns the related income over the life of the policy. Under U.S. GAAP, premiums would be recognized as written premium on the effective date of the policy and earned over the life of the policy.

f. Certain assets designated as non-admitted assets (principally premiums in the course of collection outstanding over 90 days and office furniture and equipment) are charged directly against surplus. Under U.S. GAAP, such non-admitted assets would be included in total assets, less valuation allowances.

g. EDP and related equipment with a cost of \$2 and greater are depreciated over an estimated useful life up to 3 years. Under U.S. GAAP, such non-admitted assets, would be recorded as assets, less accumulated depreciation.

h. The Workers' Compensation Fund's contingent receivable (Note 6) of \$1,295,000 from the State does not have a due date. This contingent receivable is carried at the amount transferred to the State without consideration for collectability or imputed interest. Under U.S. GAAP, such an amount would be included on the balance sheet at the amount transferred to the State, net of an appropriate allowance.

i. The reserves for losses and loss adjustment expenses are discounted to their present value using an annual effective interest rate of 5%. Under U.S. GAAP, the interest rate would be based on market rates and earnings expectations.

j. The Board of Commissioners (the "Board") may designate a reserve for security fluctuations to provide for the difference between the amortized cost of securities and their fair value. Such a reserve is established for future contingencies, rather than allocated to specific investments. In addition, the Board may assign a reasonable portion of unassigned surplus as a reserve for catastrophes.

The Insurance Department specifically prescribes the appropriation of unassigned surplus for these purposes. Under U.S. GAAP, no such reserves are established.

k. For real estate owned and occupied by the Workers' Compensation Fund, rental income and corresponding rental expense is recorded. Under U.S. GAAP, no such income or expense is recorded.

l. The balance sheet under NAIC SAP is reported net of reinsurance, while under U.S. GAAP, the balance sheet reports reinsurance recoverables, including amounts related to losses incurred but not reported, and prepaid reinsurance premiums, as an asset.

m. Comprehensive income and its components are not presented in the statutory basis financial statements.

n. The statutory basis financial statements do not include certain disclosures about and/or the consolidation of certain variable interest entities as required by U.S. GAAP under Financial Accounting Standards Board Interpretation ASC Topic 810, Consolidation of Variable Interest Entities.

The aggregate effect of the foregoing variances on the accompanying statutory basis financial statements has not been determined, however, it is presumed to be material.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

Investments

Investments are generally valued in accordance with the valuation procedures of the NAIC.

Bonds are valued in accordance with the requirements of the SVO. Bonds are principally carried at amortized cost. Discount or premium on bonds is amortized using the scientific method, which is a variation of the effective interest method. Short-term investments consist of bonds purchased within a year of the maturity date, which are stated at amortized cost. Realized gains and losses on the sale of bonds are calculated based on the difference between the amortized cost and the consideration received at the time of sale and are included in results of operations. Market value is based on market prices obtained from the SVO, and the Interactive Data Corporation ("IDC"), primarily.

For mortgaged-back fixed maturity securities, the Workers' Compensation Fund recognizes income using constant effective yield based on anticipated prepayments over the economic life of the security. Mortgaged-backed securities are accounted for under the retrospective method and prepayment assumptions are based on market conditions. When actual payments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments and any resulting adjustment is included in net investment income.

Common stocks are carried at fair value, which is obtained from the SVO. Unrealized gains and losses resulting from fair value fluctuations are reflected as a separate component of unassigned surplus. Realized gains and losses are calculated based on the difference between fair value and the consideration received at the time of sale and are included in the results of operations.

Preferred stocks are stated at cost, lower of cost or amortized cost or NAIC fair values depending on the assigned credit rating and the underlying characteristics of the security. The fair values for preferred stocks are based on quoted market prices where available. Perpetual preferred stocks are valued at estimated market value. If unavailable, the fair value was determined by the Workers' Compensation Fund using discounted cash flow models using discount rates of securities of similar maturity and credit characteristics.

Investment income earned consists primarily of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned at the ex-dividend date. Interest income on mortgage-backed and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Accrual of income is suspended for bonds and mortgage loans that are in default or when the receipt of interest payments is in doubt. Realized capital gains and losses are determined using the first in, first out ("FIFO") method.

An investment in a debt or equity security is impaired if its fair value falls below book value and the decline is considered other than temporary. Factors considered in determining whether a loss is other than temporary include the length of time and extent to which fair value has been below cost; the financial condition and near term prospects of the issuer; and the Workers' Compensation Fund's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. A debt security is impaired if it is probable that the Workers' Compensation Fund will not be able to collect all the amounts due under the security contractual terms. Equity investments are impaired when it becomes apparent that the Workers' Compensation Fund will not recover its cost over the expected holding period. Other-than-temporary declines in fair value of investments are included in realized losses. The amount included in 2010 and 2009 for realized losses related to Workers' Compensation Fund for impairment losses was \$65,364, and \$388,004, respectively.

Other invested assets, which represents a receivable from Urban Development Corporation (Note 7G), is stated at cost less principal pay downs. Interest income is recorded through statements of operations.

Real Estate

The Workers' Compensation Fund records buildings at cost less accumulated depreciation calculated over estimated useful life of 25 years, using the straight-line method. All property owned by the Workers' Compensation Fund is used substantially for its own operations. In accordance with statutory accounting practices, the Workers' Compensation Fund records both rental income and rental expense representing the imputed rent for office space occupied in buildings owned by the Workers' Compensation Fund. The amount of rental income and expense recorded in 2010 and 2009 was \$9,381 and \$8,829, respectively.

Maintenance and repairs are charged to expense as incurred.

Premiums Revenue and Related Accounts

The Workers' Compensation Fund records written premiums when billed to policyholders and earns the related income over the life of the policy.

The Workers' Compensation Fund records premium receivable as an admitted asset if the following three conditions are met: (1) a bill for the premium amount is no more than 90 days past due, (2) the bill date is within six months after the expiration of the policy year and (3) no other bill for the same policy is considered non-admitted.

At December 31, 2010 and 2009, the outstanding premium receivable net admitted balance in the Workers' Compensation Fund was \$135,413 and \$141,054. To reduce credit risk, the Workers' Compensation Fund performs ongoing evaluations of its customers' financial condition, but does not generally require collateral. The Workers' Compensation Fund routinely assesses the collectability of these receivables. Based upon Workers' Compensation Fund experience, less than 4% of net written premium may become uncollectible and the potential loss is not material to the Workers' Compensation Fund's financial condition.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

For the Workers' Compensation Fund, unearned premiums represent the pro rata portion of premiums and endorsements billed that are applicable to the unexpired terms of policies in force at the end of the year.

Earned but unbilled premium ("EBUB") is recognized through operations as an adjustment to premium earned. EBUB premium represents in-force and auditable policies on which premium has been earned but not yet been billed to the insured.

The Workers' Compensation Fund performs an analysis of uncollectible premiums receivable and realized write offs of \$45,159 and \$35,087, for the year ended December 31, 2010 and 2009, respectively, through the statutory basis statements of operations.

Expenses of the Workers' Compensation Board

The Workers' Compensation Fund, together with other insurance carriers, is required to contribute toward the expenses of the Workers' Compensation Board. The Workers' Compensation Fund contributes a proportion respective to indemnity payments processed through the Board. The amounts incurred in 2010 and 2009 to the Workers' Compensation Board to contribute toward their expenses were \$83,485 and \$54,760, respectively. A liability for unpaid amounts has been established by the application of a factor applied to reserves for losses, which is based on a review of historical billings to the Workers' Compensation Fund and is recorded in the due to affiliate balance. The liability as of December 31, 2010 and 2009 was \$420,770 and \$434,533, respectively, and recorded through the statutory basis statements of admitted assets, liabilities and surplus.

Reserves for Losses and Loss Adjustment Expenses

The reserves for losses and loss adjustment expenses ("LAE") for the Workers' Compensation Fund are based on individual case estimates and formula reserves. Additional reserves are provided for losses incurred but not reported ("IBNR") based on past experience, modified for current trends.

The reserves for losses and loss adjustment expenses of the Workers' Compensation Fund are discounted to present value using an annual effective rate of interest of 5%. The liability for losses and loss adjustment expenses of the Workers' Compensation Fund has been reduced by \$7,747,165 and \$7,178,345 as of December 31, 2010 and 2009, respectively, as a result of the discounting. This accounting practice is mandated by Section 86 of the New York State Workers' Compensation Law. These liabilities also include assessments for Sections 15.8 and 25A under the New York State Workers' Compensation Law, and expenses for investigating and settling claims.

Loss and loss adjustment expense reserves are significant in relation to surplus and a change in the timing of future payments could have a material impact on surplus. A change of 1% of discount reserves, would decrease surplus by 4%. Uncertainty also exists related to the impact of the Workers' Compensation Reform as described in (Note 10).

The Workers' Compensation Fund's reserves for losses and loss adjustment expenses are estimated by using recognized actuarial techniques. The methods for making such estimates and for establishing the resulting liability is continually reviewed and any adjustments are reflected in the period determined. An independent actuarial consulting firm reviews the estimated liability. The Workers' Compensation Fund's Management believes that the assumptions used in determining this liability are reasonable and that the amount recorded represents its best estimate of the ultimate cost of investigating, defending and settling claims. However, the Workers' Compensation Fund's actual future experience may not conform to the assumptions inherent in the determination of the liability. Accordingly, the ultimate settlement value may vary significantly from the amounts included in the statutory basis financial statements and the difference may be material.

Security Fluctuation, Catastrophic, Foreign Terrorism and Domestic Terrorism Surplus

As described above, the Board may designate a portion of unassigned surplus for security fluctuation and catastrophes as specifically prescribed by the Insurance Department. Security fluctuation surplus remained unchanged at \$400,000 as of December 31, 2010 and 2009.

The review of the catastrophe surplus in conjunction with a risk assessment of the Workers' Compensation Fund's exposures resulted in the Board decreasing the catastrophe surplus by \$49,053 and \$48,417 as of December 31, 2010 and 2009, respectively.

The Workers' Compensation Fund has exposure to significant losses from terrorism. The Terrorism Risk Insurance Act of 2002, ("TRIA") was enacted into Federal law and established a temporary Federal program in the Department of the Treasury providing a system of shared public and private compensation for insured losses resulting from foreign terrorism.

In order for a loss to be covered under TRIA, the loss must result from an event that is certified as an act of terrorism by the U.S. Secretary of Treasury. If Congress has declared war, then only workers' compensation losses would be covered by TRIA. The Terrorism Insurance Program ("Terrorism Program") generally requires that all property casualty insurers licensed in the United States participate in the Terrorism Program. The Terrorism Program became effective upon enactment and in December 2005 was extended through December 31, 2007. In December 2007, the President signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007 ("TRIPRA"), extending TRIA for another seven years through December 31, 2014. TRIPRA adds domestic terrorism to the list of covered acts, triggers a year-long study of a proposal to mandate coverage for nuclear, biological, chemical and radiological attacks and retains the government's share of insured losses for a major attack at \$100 billion.

The amount of compensation paid to participating insurers under the Terrorism Program is 85% of certified losses after the insurer's deductible portion, subject to a cap. The deductible portion under the Terrorism Program is 1% for 2002, 7% for 2003, 10% for 2004, 15% for 2005, 17.5% for 2006, and 20% for 2007 through 2014. In each year, the deductible percentage is applied to the insurer's direct earned premium from the calendar year immediately proceeding the applicable deductible year. The Terrorism Program also

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

caps the annual losses to \$100 billion in aggregate per Terrorism Program year.

Once subject losses have reached the \$100 billion aggregate in a Terrorism Program year, there is no additional reimbursement from the U.S. Treasury and an insurer that has met its deductible for the Terrorism Program year is not liable for any losses (or portion thereof) that exceed the \$100 billion cap. The Workers' Compensation Fund is responsible for a deductible of \$262,332 and \$287,942 for December 31, 2010 and 2009, respectively. The Workers' Compensation Fund assigned \$228,938 and \$188,363 of surplus which represents the estimated premium attributable to the foreign terrorism premium charge at December 31, 2010 and 2009, respectively. Beginning on October 1, 2005, the Workers' Compensation Fund began assigning a portion of premium to domestic terrorism, which totaled \$40,883 and \$32,405 as of December 31, 2010 and 2009, respectively.

Contingent Policyholder Dividends

Section 90 of the New York State Workers' Compensation Law provides that dividends may be paid to safety groups that, by cooperative effort, seek to curtail accidental injuries and occupational diseases. The estimated dividend liability recorded by the Workers' Compensation Fund is based on the available contingent balance as of the most recent group accounting date and an estimate of the contingent balance for the period since the last group accounting. The contingent balance is calculated by adding premiums billed and applicable investment income less reported losses, expenses and previous dividends. The dividends paid during the year and the change in the contingent balance during the year are reflected in the statutory basis statements of operations.

Fringe Benefits

Based on actual costs billed by various State agencies, the Workers' Compensation Fund incurred \$55,165 and \$44,976 of fringe benefits and indirect costs in 2010 and 2009, respectively.

All employees of the Workers' Compensation Fund are covered under a retirement plan administered by the New York State Employees Retirement System. For employees hired prior to July 27, 1976, the plan is noncontributory. For employees hired on or after July 27, 1976, but before 2010, the plan is partially contributory in the first 10 years of employment and noncontributory thereafter. For employees hired on or after January 1, 2010, the plan is contributory for all years of service. The portion of the fringe benefits attributed to the retirement plan for the Workers' Compensation Fund was \$20,797 and \$11,559 in 2010 and 2009, respectively.

Post-Employment Benefits

New York State Civil Service Law, Section 163.2, provides for health insurance coverage for retired employees of the Workers' Compensation Fund including their spouses and dependent children. Eligibility is determined by the membership in the New York State and Local Employees' Retirement System, enrollment in the New York State Health Insurance Program at the time of retirement, and the completion of a minimum number of years of service as required by the employees' membership tier in the retirement system.

Health insurance premiums for retired employees are equal to the premiums charged for active Workers' Compensation Fund employees. The dollar value of accumulated sick leave credits at the time of retirement is used to offset the health insurance premiums paid directly by retirees. The Workers' Compensation Fund pays the portion of the retirees' health insurance premiums covered by accumulated sick leave credits.

There were an average of 1,231 and 1,187 retirees participating in the plan for the years ended December 31, 2010 and 2009, respectively. The Workers' Compensation Fund is billed by the Department of Civil Service monthly. Expenses are recognized when paid and totaled \$10,498 and \$9,353 for the Workers' Compensation Fund for the years ended December 31, 2010 and 2009, respectively.

Income Tax

The Workers' Compensation Fund is exempt from federal income taxes. However, the Workers' Compensation Fund is subject to a New York State franchise tax. The Workers' Compensation Fund's franchise tax is calculated using a written premium-based method and is a component of other underwriting expenses. The New York State franchise tax expense was \$22,874 and \$22,570 in 2010 and 2009, respectively, and recorded through the statutory basis statements of operations.

As the Workers' Compensation Fund maintains an office and does business in the metropolitan New York area, it is also subject to the Metropolitan Transit Authority ("MTA") surcharge. The MTA surcharge is based on premiums written on businesses in the metropolitan area and wages paid to employees in the metropolitan area and is a component of other underwriting expenses. The MTA surcharge in 2010 and 2009 was \$2,845 and \$2,875, respectively, and recorded through the statutory basis statements of operations.

Concentrations of Credit Risk

Financial instruments that potentially subject the Workers' Compensation Fund to concentrations of credit risk are primarily cash and cash equivalents. Cash equivalents include investments in commercial paper of companies with high credit ratings, investments in money market securities and securities backed by the U.S. Government. Balances maintained in non-interest bearing transaction accounts in the United States are fully insured by the Federal Deposit Insurance Corporation, ("FDIC") up to \$250.

At December 31, 2010 and 2009, cash deposits in the Workers' Compensation Fund's custodian bank account were \$20,315 and \$26,168, respectively, and were not insured by the FDIC.

Risks and Uncertainties

The Workers' Compensation Fund invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market risk and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

possible that changes in values of investment securities will occur in the near term and that changes could materially affect the participants' account balances and the amounts reported in the statutory basis financial statements.

Users of these statutory basis financial statements should be aware that the financial markets' volatility in 2009 and 2010 may significantly impact the subsequent valuation of the Workers' Compensation Fund's investments.

Accordingly, the valuation of investments at December 31, 2010 and 2009 may not necessarily be indicative of amounts that could be realized in a current market exchange.

Use of Estimates

The preparation of these statutory basis financial statements in conformity with statutory 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 statutory basis financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification

Certain reclassifications have been made to the prior year's statutory basis financial statement amounts to conform to the current year's presentation.

Correction of an Error

The Workers' Compensation Fund discovered two errors in 2010 relating to the treatment of recording the reserves for the liabilities related to self-insured claims for its employees and the reporting of investment income instead of other invested assets, receivable from Urban Development Corporation ("UDC"). In prior years, other invested assets and investment income earned were overstated by \$3,164 as well as the impact on unassigned surplus. The error for the self-insured claims was identified and corrected in 2010. The liability for the current and future claims development and corresponding correction of an error was recorded through unassigned surplus of \$15,473 in accordance with NY SAP. The current year portion of the liability was reflected in the statutory basis statements of operations for \$503.

3 - Investments

Section 87 of the New York State Workers' Compensation Law specifically states the type of securities authorized for investment by the Workers' Compensation Fund and requires all such transactions to be approved by the Superintendent of Insurance. Section 87 further provides that the Commissioner of Taxation and Finance is the sole custodian of the Workers' Compensation Fund. J.P. Morgan Chase serves as the Workers' Compensation Fund's custodian for investments. The Workers' Compensation Fund has security lending agreements with J.P. Morgan Chase and Key Bank. All bank deposits are entirely insured or collateralized with securities held by J.P. Morgan Chase at December 31, 2010 and 2009, in accordance with Section 105 of the New York State Finance Law.

Chapter 473 of the Laws of 2000 and Chapter 6 of the Laws of 2007 broadened the Workers' Compensation Fund's reserve investment authority to include certain common and preferred stocks and expanded the range of fixed income issues in which the Workers' Compensation Fund may invest. The amortized cost, gross unrealized gains, gross unrealized losses and estimated market value of investments in bonds and stocks at December 31, 2010 and 2009 are as follows:

| | Cost or Book Adjusted Carrying Value | 2010 | | Estimated Market Value |
|---|---|------------------------------|-------------------------------|------------------------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | |
| U.S. Government and government agency obligations | \$ 5,298,352 | \$ 161,874 | \$ (58,861) | \$ 5,401,365 |
| Foreign government | 270,917 | 2,127 | (3,265) | 269,779 |
| States, territories, possessions and political subdivisions | 236,378 | 4,317 | (3,007) | 237,688 |
| Corporate bonds and public utilities | 3,871,266 | 264,956 | (31,985) | 4,104,237 |
| Mortgaged-backed securities | 884,619 | 52,455 | (23,054) | 914,020 |
| Hybrid securities | 12,559 | 4,019 | (22) | 16,556 |
| Total bonds | <u>10,574,091</u> | <u>489,748</u> | <u>(120,194)</u> | <u>10,943,645</u> |
| Preferred stocks | 2,840 | 1,358 | (1) | 4,197 |
| Common stocks | 1,066,519 | 212,321 | (3,122) | 1,275,718 |
| Total stocks | <u>1,069,359</u> | <u>213,679</u> | <u>(3,123)</u> | <u>1,279,915</u> |
| Total investments | <u>\$ 11,643,450</u> | <u>\$ 703,427</u> | <u>\$ (123,317)</u> | <u>\$ 12,223,560</u> |

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

| | Cost or Book Adjusted Carrying Value | 2009 | | Estimated Market Value |
|---|---|-------------------|---------------------|------------------------------|
| | | Gross | Gross | |
| | | Unrealized | Unrealized | |
| | | Gains | Losses | |
| U.S. Government and government agency obligations | \$ 5,309,349 | \$ 87,202 | \$ (121,573) | \$ 5,274,978 |
| Foreign government | 257,423 | 2,744 | (3,731) | 256,436 |
| States, territories, possessions and political subdivisions | 133,320 | 6,114 | (2,292) | 137,142 |
| Corporate bonds and public utilities | 3,608,759 | 149,105 | (82,677) | 3,675,187 |
| Mortgaged-backed securities | 1,103,365 | 14,679 | (56,404) | 1,061,640 |
| Total bonds | 10,412,216 | 259,844 | (266,677) | 10,405,383 |
| Preferred stocks | 16,293 | 3,825 | - | 20,118 |
| Common stocks | 958,675 | 199,922 | (4,030) | 1,154,567 |
| Total stocks | 974,968 | 203,747 | (4,030) | 1,174,685 |
| Total investments | \$ 11,387,184 | \$ 463,591 | \$ (270,707) | \$ 11,580,068 |

The amortized cost and market value of bonds at December 31, 2010 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because certain issuers may have the right to call or prepay obligations with or without penalties.

Mortgage-backed securities and collateralized mortgage obligations are distributed to maturity year based on an estimate of the rate of future prepayments of principal over the remaining lives of the securities. Prepayment assumptions are based on market expectations. Actual prepayment experience may vary from these estimates.

| | Amortized Cost | Market Value |
|--|----------------------|----------------------|
| Due in one year or less | \$ 127,183 | \$ 129,570 |
| Due after one year through five years | 2,807,465 | 2,878,527 |
| Due after five years through ten years | 3,033,065 | 3,162,015 |
| Due after ten years | 4,606,378 | 4,773,533 |
| Total bonds | \$ 10,574,091 | \$ 10,943,645 |

Investment income earned consists principally of interest and dividends on investments as follows:

| | 2010 | 2009 |
|---------------------------------------|------------|------------|
| Bonds | \$ 484,762 | \$ 510,465 |
| Stocks | 23,102 | 23,812 |
| Cash, and short-term investments | 764 | 605 |
| Other | 11,605 | 11,724 |
| Investment income earned | 520,233 | 546,606 |
| Investment expenses | (24,862) | (21,769) |
| Net realized investment gain / (loss) | 212,081 | (369,662) |
| Net investment income earned | \$ 707,452 | \$ 155,175 |

Net realized capital gains (losses) on investments, determined on the FIFO method using amortized cost, consist of the following:

| | 2010 | 2009 |
|------------------------------------|------------|--------------|
| Bonds | \$ 95,609 | \$ (201,029) |
| Stocks | 132,585 | (168,997) |
| Cash and short term investments | (16,113) | 364 |
| Net realized capital gain / (loss) | \$ 212,081 | \$ (369,662) |

For the Workers' Compensation Fund, proceeds from investments sold, matured or repaid during the years ended December 31, 2010 and 2009 were \$28,573,400 and \$31,673,884, respectively. These sales resulted in gross realized gains of \$354,304 and \$145,536, and gross realized losses of \$77,183 and \$85,940 in 2010 and 2009, respectively.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

to SSAP No. 43R investments was \$12,728 and \$80,862, respectively. There were no additional impairments recorded in 2010 on the basis that the present value of future expected cash flows is less than the amortized cost basis of the security as losses were identified on the basis that the Workers' Compensation Fund was unable to retain the security until recovery of amortized cost.

| | 1 Amortized Cost Basis Before Other-than- Temporary Impairment | 2 Other-than- Temporary Impairment Recognized in Loss | 3 Fair Value 1-2 |
|---|---|--|------------------------|
| OTTI recognized 1st Quarter | | | |
| a. Intent to sell | \$ 37,991 | \$ 7,694 | \$ 30,297 |
| b. Inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis | | | |
| c. Total 1st Quarter | <u>37,991</u> | <u>7,694</u> | <u>30,297</u> |
| OTTI recognized 2nd Quarter | | | |
| d. Intent to sell | 12,003 | 129 | 11,874 |
| e. Inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis | | | |
| f. Total 2nd Quarter | <u>12,003</u> | <u>129</u> | <u>11,874</u> |
| OTTI recognized 3rd Quarter | | | |
| g. Intent to sell | 15,892 | 811 | 15,081 |
| h. Inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis | | | |
| i. Total 3rd Quarter | <u>15,892</u> | <u>811</u> | <u>15,081</u> |
| OTTI recognized 4th Quarter | | | |
| j. Intent to sell | 46,636 | 20,532 | 26,104 |
| k. Inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis | | | |
| l. Total 4th Quarter | <u>46,636</u> | <u>20,532</u> | <u>26,104</u> |
| m. Annual Aggregate Total | <u>\$ 112,522</u> | <u>\$ 29,166</u> | <u>\$ 83,356</u> |

The Workers' Compensation Fund participates in securities lending programs whereby certain securities from the Workers' Compensation Fund's portfolio are loaned to other institutions for short periods of time. Under the terms of the lending agreements, the Workers' Compensation Fund receives a fee from the borrower and requires collateral with a market value at least 102% of the market value of securities loaned. The Workers' Compensation Fund maintains ownership rights to securities loaned and has the ability to sell securities while they are on loan. The Workers' Compensation Fund has an indemnification agreement with lending agents in the event a borrower becomes insolvent or fails to return securities.

The Workers' Compensation Fund had reinvested collateral assets in the amount of \$249,902 and \$420,889 as of December 31, 2010 and 2009, respectively. For the years ended December 31, 2010 and 2009, the Workers' Compensation Fund received fees of \$546 and \$2,612, respectively. The fees for the current year have been included in investment income earned in the statutory basis statements of operations. During 2010, the Workers' Compensation Fund recorded OTTI in the amount of \$16,236 in the statutory basis statement of operations.

Based on recent comments in 2010 by the Statutory Accounting Principles Working Group and a review of the properties for hybrid securities held by the Workers' Compensation Fund, it was determined that the characteristics of these securities were similar to the characteristics of a bond. Therefore during 2010 these securities were reclassified from preferred stocks to bonds using prospective treatment. As of December 31, 2010, the Workers' Compensation Fund transferred \$12,559 of securities from preferred stocks to bonds.

Fair Value of Financial Instruments

The statement value and estimated fair value of financial instruments at December 31, 2010 and 2009 are as follows:

| | <u>2010</u> | | <u>2009</u> | |
|---------------------------------|--------------------|----------------------------|--------------------|----------------------------|
| | Statement Value | Estimated Fair Value | Statement Value | Estimated Fair Value |
| Financial assets: | | | | |
| Bonds | \$ 10,574,091 | \$ 10,943,645 | \$ 10,412,216 | \$ 10,405,384 |
| Preferred stocks | 4,197 | 4,197 | 20,118 | 20,118 |
| Common stocks | 1,275,718 | 1,275,718 | 1,154,567 | 1,154,567 |
| Cash and short-term investments | 127,352 | 127,352 | 56,455 | 56,455 |
| Other invested assets | 43,914 | 43,914 | 48,031 | 48,031 |

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

Included in various investment related line items in the statutory basis financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as when impaired, or, for certain bonds and preferred stocks when carried at the lower of cost or market.

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Workers' Compensation Fund estimates fair value using methods, models and assumptions that Management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of Management estimation and judgment which become significant with increasingly complex instruments or pricing models.

Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

As of December 31, 2010, the Workers' Compensation Fund implemented SSAP No. 100 *Fair Value Measurements* ("SSAP No. 100"). SSAP No. 100 defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value.

Included in various investment related line items in the statutory basis financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as when impaired, or, for certain bonds when NAIC designations fall below a 2 and, therefore, are carried at the lower of cost or market.

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Workers' Compensation Fund estimates fair value using methods, models and assumptions that Management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management estimation and judgment which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

When available, the Workers' Compensation Fund uses quoted market prices to determine the fair values of aforementioned investment securities. When quoted market prices are not readily available or representative of fair value, pricing determinations are made based on the results of valuation models using observable market data such as recently reported trades, bid and offer information and benchmark securities. Unobservable inputs reflect the Fund's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

The Workers' Compensation Fund's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on the SSAP No. 100 hierarchy. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3).

The levels of the fair value hierarchy are as follows:

Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset and liability at the reporting date.

The following table provides information as of December 31, 2010 about the Workers' Compensation Fund's assets measured at fair value along with a brief description of the valuation technique for each type of asset.

| Assets at fair value: | Level 1 | Level 2 |
|--|--------------|-----------|
| Corporate bonds | \$ 1 | \$ 10,457 |
| Mortgage and asset-backed securities – residential | 6,175 | 17,843 |
| Preferred stocks | 4,179 | - |
| Common stocks | 1,275,718 | - |
| Total assets at fair value: | \$ 1,286,073 | \$ 28,300 |

| Assets at fair value: | Level 3 | Total |
|--|-----------|--------------|
| Corporate bonds | \$ 1,463 | \$ 11,921 |
| Mortgage and asset-backed securities – residential | 9,836 | 33,854 |
| Preferred stocks | - | 4,179 |
| Common stocks | - | 1,275,718 |
| Total assets at fair value: | \$ 11,299 | \$ 1,325,672 |

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

Low grade fixed maturity investments where fair value is lower than cost and common stocks are recorded at fair value. Securities classified into Level 1 included primarily corporate bonds and common stocks where there are quoted prices in active markets for identical securities and the source of the pricing. Unadjusted quoted prices for these securities are provided to the Workers' Compensation Fund by independent pricing services. Level 2 securities include corporate bonds and other common stock securities where pricing is based on bid evaluations. Quote prices for these securities are provided to the Workers' Compensation Fund using independent pricing services. Level 3 securities include corporate bonds and other common stock securities where pricing is based on the Workers' Compensation Fund's best estimate of fair value.

Subprime Mortgage Exposure

The subprime lending sector, also referred to as B-paper, near-prime, or second chance lending, is the sector of the mortgage lending industry which lends to borrowers who do not qualify for prime market interest rates because of poor or insufficient credit history. The term also refers to paper taken on property that cannot be sold on the primary market, including loans on certain types of investment properties and certain types of self-employed individuals. Instability in the domestic and international credit markets due to problems in the subprime sector dictates the need for additional information related to exposure to subprime mortgage related risk.

For purposes of this disclosure, subprime exposure is defined as the potential for financial loss through direct investment, indirect investment, or underwriting risk associated with risk from the subprime lending sector. For purposes of this note, subprime exposure is not limited solely to the risk associated with holding direct mortgage loans, but also includes any indirect risk through investments in debt securities, asset backed or structured securities, hedge funds, common stock, subsidiaries and affiliates, and insurance product issuance.

Although it can be difficult to determine the indirect risk exposures, it should be noted that not only does it include expected losses, it also includes the potential for losses that could occur due to significantly depressed fair value of the related assets in an illiquid market.

As it relates to the exposure described above, the following information shall be disclosed:

The Workers' Compensation Fund has identified securities in conjunction with two independent reviews performed by two outside firms, which provide either subprime or Alt-A exposure in some form within structure or collateral. The Workers' Compensation Fund's investment policy limits aggregate portfolio credit rating to investment grade with on-going rigorous credit review and monitoring at the security level by Workers' Compensation Fund personnel charged with investment oversight.

The Workers' Compensation Fund has no direct subprime exposure through investments in subprime mortgage loans.

The Workers' Compensation Fund has direct subprime exposure in mortgage backed securities. All such holdings are fixed income instruments providing risk exposure via senior tranches with more credit enhancement than deemed necessary by rating

agencies. All issues, at the time of purchase, met the Workers' Compensation Fund's stringent investment guidelines. Management regularly monitors the quality of the securities and compliance to those guidelines. Collateral is typically well seasoned. The Workers' Compensation Fund exposure at December 31, 2010 and 2009 are as follows:

| | <u>2010</u> | <u>2009</u> |
|----------------------|---------------|---------------|
| <u>Exposure</u> | | |
| Book value | \$ 76,525 | \$ 84,626 |
| Fair value | \$ 73,718 | \$ 74,236 |
| Actual cost | \$ 81,635 | \$ 87,837 |
| Total bond portfolio | \$ 10,574,091 | \$ 10,412,216 |
| % of bond portfolio | 0.7% | 0.8% |

The Workers' Compensation Fund has no underwriting exposure to subprime mortgage risk through Mortgage Guaranty or Financial Guaranty insurance coverage. None of these securities were deemed to have any issues that would lead Management to believe that they were other than temporarily impaired.

4 - Real Estate

The Workers' Compensation Fund owned real estate at December 31, 2010 and 2009 as follows:

| | <u>2010</u> | <u>2009</u> |
|---|------------------|------------------|
| Office buildings and improvements, at cost | \$ 33,425 | \$ 30,000 |
| Accumulated depreciation | <u>(20,567)</u> | <u>(19,255)</u> |
| Office buildings and improvements— net of accumulated depreciation | <u>12,858</u> | <u>10,745</u> |
| Land | 2,992 | 2,502 |
| Land Improvement | <u>1,856</u> | <u>464</u> |
| Total real estate | <u>\$ 17,706</u> | <u>\$ 13,711</u> |

5 - Non-Admitted Assets

The non-admitted assets of the Workers' Compensation Fund at December 31, 2010 and 2009 were as follows:

| | <u>2010</u> | <u>2009</u> |
|---|-------------------|-------------------|
| Premium in course of collection outstanding over 90 days | \$ 100,819 | \$ 126,496 |
| Electronic Data Equipment/Software | 1,067 | 1,912 |
| Furniture and equipment, net of accumulated depreciation | 1,303 | 1,140 |
| Other | <u>12,070</u> | <u>2,946</u> |
| Total non-admitted assets | <u>\$ 115,259</u> | <u>\$ 132,494</u> |

6 - Transactions with New York State

Over the course of several years, the Workers' Compensation Fund was required to transfer to the State in aggregate of \$1,295,000, which is noninterest bearing and is included in the

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

accompanying statutory basis of admitted assets, liabilities and surplus as a contingent receivable due to the repayment conditions. Chapter 55 of the New York State Laws of 1982 required the Workers' Compensation Fund to transfer \$190,000 out of its surplus to the general fund of the State. Chapter 28 of the New York State Laws of 1986 authorized and directed the Workers' Compensation Fund to transfer an additional \$325,000 to the general fund of the State. Chapter 47 of the New York State Laws of 1987 required the Workers' Compensation Fund to pay an additional \$300,000 (\$150,000 to the general fund of the State and \$150,000 to the State's capital fund). Chapter 7 of the New York State Laws of 1989 required the Workers' Compensation Fund to pay an additional \$250,000 to the general fund of the State. As required by Chapter 41 of the New York State Laws of 1990, the Workers' Compensation Fund transferred \$230,000 to the State's general fund. The statutes require the State to appropriate \$1,295,000 annually for the potential repayment of any portion of the aggregate contingent receivable. Such repayment by the State is required only to maintain the solvency of the Workers' Compensation Fund. These statutes specifically direct the contingent receivable to be an admitted asset.

7 - Other Invested Assets-Receiveable from the Urban Development Corporation

Chapter 190 of the New York State Laws of 1990 added section 87-h, to the Workers' Compensation Law. Section 87-h authorized the Workers' Compensation Fund to purchase the Urban Development Corporation's ("UDC") beneficial interest in securities and monies held in certain debt service reserve funds which collateralize certain project bonds issued by the UDC. The Workers' Compensation Fund purchased from the UDC the beneficial interest in one reserve fund for \$45,300 on December 13, 1990. On March 19, 1991, the Workers' Compensation Fund purchased \$12,200 of additional interests in other reserve funds. These amounts are included in the accompanying statutory statements of admitted assets, liabilities and surplus of the Workers' Compensation Fund as other invested assets. The outstanding receivable has no scheduled repayment date. The purchased beneficial interest entitles the Workers' Compensation Fund to receive periodic payments from the UDC equal to: (1) the earnings of the securities and monies within the respective debt service reserve funds and (2) reserve fund releases which represent payment of debt service due to a decrease in funding requirements as the project bonds are retired. The periodic payments to the Workers' Compensation Fund commenced on July 1, 1991 and continue as long as any of the aforementioned project bonds are outstanding. The Workers' Compensation Fund's right to receive the periodic payments is fully collateralized by an irrevocable letter of credit posted by the State at a large commercial bank. Interest received by the Workers' Compensation Fund was \$398 and \$1,997 for the years 2010 and 2009, respectively.

During 2005, UDC began repayment of the Workers' Compensation Fund's UDC holding. During 2010 the Workers' Compensation Fund received \$4,117 from the UDC as a pay-down to reduce the investment. During 2009 the Workers' Compensation Fund did not receive a paydown to reduce the

investments. The balance was \$43,914 and \$48,031 as of December 31, 2010 and 2009, respectively.

8 - Reinsurance

As part of a prior reinsurance program, the Workers' Compensation Fund reinsures certain risks with other companies. Such arrangements serve to limit the Workers' Compensation Fund's maximum loss from catastrophes, large risks and unusually hazardous risks. To the extent that any reinsuring company might be unable to meet its obligations, the Workers' Compensation Fund would be liable for its respective participation in such defaulted amounts.

The Workers' Compensation Fund purchased no reinsurance for 2010 and 2009. The Workers' Compensation Fund has reinsurance contracts to limit the impact of excess losses with a layer of \$100,000 in excess of \$100,000 of full terrorism coverage for all Workers' Compensation Fund employees for 2005. There were no premiums ceded, as shown in the Workers' Compensation Fund statutory basis statements of operations in 2010 and 2009.

The reserves for losses and loss adjustment expenses have been decreased by \$17,318 and \$17,402 for losses recoverable under reinsurance contracts as of December 31, 2010 and 2009, respectively.

The Workers' Compensation Fund had reinsurance contracts covering a portion of the Safety Group Retention Programs which terminated effective March 31, 2003. The coverage afforded under this reinsurance contract is \$9,000 in excess of \$1,000 retention per occurrence. The reserves for losses and loss adjustment expenses have been decreased by \$58,616 and \$135,883 for losses recoverable as of December 31, 2010 and 2009, respectively.

Unsecured Reinsurance Recoverables in Excess of 3% of Policyholder Surplus

The Workers' Compensation Fund does not have an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses and unearned premium with any individual reinsurers, authorized or unauthorized, that exceeds 3% of the Workers' Compensation Fund's policyholder surplus at December 31, 2010.

Commutation of Ceded Reinsurance

The Fund entered into a commutation of reinsurance agreement, or portion thereof, resulting in the complete and final settlement and discharge of all, or the commuted portion thereof, present and future obligations between parties arising out of the agreement during year ended December 31, 2010 with the following companies:

| | |
|------------------------|------------------|
| C N A | \$ 37,500 |
| Inter-Ocean Reins Ltd. | 23,000 |
| Tota | <u>\$ 60,500</u> |

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

Retroactive Reinsurance

The Workers' Compensation Fund assumed retroactive reinsurance transactions from the Liquidation Bureau of the Insurance Department for which a detailed summary is below:

| | <u>2010</u> | <u>2009</u> |
|--|-----------------|-----------------|
| | Assumed | Assumed |
| Reserves transferred: | | |
| Initial reserves | \$ 9,919 | \$ 9,919 |
| Adjustments—prior year(s) | (6,812) | (6,779) |
| Adjustments—current year | (505) | (33) |
| Total | <u>2,602</u> | <u>3,107</u> |
| Consideration paid or received: | | |
| Initial consideration | 9,919 | 9,919 |
| Adjustments—prior year(s) | - | - |
| Adjustments—current year | - | - |
| Total | <u>9,919</u> | <u>9,919</u> |
| Paid loss reimbursed or recovered: | | |
| Prior year(s) | 6,934 | 6,163 |
| Current year | 480 | 771 |
| Total | <u>\$ 7,414</u> | <u>\$ 6,934</u> |
| Special surplus from retroactive reinsurance: | | |
| Initial surplus gain or loss | | |
| Adjustments—prior year(s) | \$ - | \$ 616 |
| Adjustments—current year | - | (616) |
| Current year restricted surplus | - | - |
| Cumulative total transferred to unassigned funds | <u>\$ -</u> | <u>\$ -</u> |

All contracts of reinsurance covering losses that have occurred prior to the inception of the contract have been accounted for in conformity with the instructions contained in the NAIC SAP.

9 - Related Party Transactions

The home office properties are occupied jointly by the Workers' Compensation Fund and certain affiliates. Because of this relationship, the Workers' Compensation Fund incurs joint operating expenses subject to allocation through agreed upon arrangements based on the level of services provided. Management believes the method of allocating such expenses is fair and reasonable. The Workers' Compensation Fund allocates the cost of services rendered to the Disability Benefits Fund based on a percentage of the Disability Benefits Fund's direct and indirect salary to total salary expense.

The expenses allocated to the Disability Benefits Fund were \$1,339 and \$1,553 in 2010 and 2009, respectively.

The Workers' Compensation Fund acts as the administrator of the Aggregate Trust Fund ("ATF") by paying losses on behalf of the ATF. The ATF was created under New York State Worker's Compensation Law and is the disbursing agency for certain death and permanent disability claims exclusive of claims applicable to the Workers' Compensation Fund. The Workers' Compensation Fund charges the ATF an administrative fee of 3% of paid losses for such services. The total administration fees charged to the ATF during 2010 and 2009, were \$623 and \$582, respectively.

The Workers' Compensation Fund administers the claims for the State, which self-insures its liability for workers' compensation claims. The Workers' Compensation Fund is reimbursed for losses, allocated loss adjustment expenses, reinsurance and administrative expenses paid on behalf of the State. During 2010 and 2009, the State reimbursed the Workers' Compensation Fund \$308,096 and \$288,822, respectively, for such costs and are recorded through the statutory basis statement of operations.

The Workers' Compensation Fund makes payments to the New York State Workers' Compensation Board for various assessments and administrative expenses. The Workers' Compensation Fund paid assessments of \$433,306 and \$189,472 in 2010 and 2009 respectively. The Workers' Compensation Fund incurred administrative expenses in 2010 and 2009, related to the Workers' Compensation Board of \$83,495 and \$54,760, respectively. A liability for unpaid amounts has been established by the application of a factor applied to reserves for losses, which is based on a review of historical billings to the Workers' Compensation Fund.

The following table summarizes all affiliate balances at December 31, 2010 and 2009:

| | <u>2010</u> | <u>2009</u> |
|-------------------------------|-------------------|-------------------|
| Receivables from affiliates | | |
| Aggregate Trust Fund | \$ 51 | \$ 45 |
| Disability Benefits Fund | 252 | 268 |
| New York State | <u>31,047</u> | <u>25,513</u> |
| Total due from affiliates | <u>\$ 31,350</u> | <u>\$ 25,826</u> |
| Payable to affiliates | | |
| Workers' Compensation Board | <u>\$ 420,770</u> | <u>\$ 434,533</u> |
| Total payable to affiliates | <u>\$ 420,770</u> | <u>\$ 434,533</u> |
| Net payable due to affiliates | <u>\$ 389,420</u> | <u>\$ 408,707</u> |

10 - Workers' Compensation Reform

On March 13, 2007, former Governor Spitzer signed into law comprehensive workers' compensation reform legislation, Chapter 6 of the Laws of 2007, which includes various provisions that affect Workers' Compensation Fund's operations and statutory basis financial statements. The legislation increases the maximum weekly benefit rate that applies to all types of temporary and permanent disability from \$400 to \$500 for injuries that occur on or after July 1, 2007, \$550 for injuries that occur on or after July 1, 2008 and \$600 for injuries that occur on or after July 1, 2009. Beginning July 1, 2010, the maximum weekly benefit rate will be indexed to two-thirds of the New York State "average weekly wage" for the previous calendar year. On March 31, 2007, the Commissioner of Labor reported a State average weekly wage for 2009 of \$1,109.75. Accordingly, a maximum weekly benefit rate of \$739.83 will apply to injuries that occur on or after July 1, 2010. The legislation also increases the

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

minimum weekly benefit rate from the current amount of \$40 to \$100. Similarly, the maximum weekly rates for death benefits are increased.

The legislation closes the Special Disability Fund to new claims for accidents occurring on or after July 1, 2007. The Special Disability Fund was created under Workers' Compensation Law § 15(8)(h) and provides for reimbursement of carriers in cases involving (1) disabilities made materially and substantially greater by a pre-existing impairment, i.e., second injury cases, (2) dust diseases, and (3) concurrent employment. It is funded by carrier assessments. The legislation also provides that claims must be filed on eligible cases prior to July 1, 2010. The legislation authorizes the Special Disability Fund to enter into agreements with claimants making final settlement of the right to further benefits as provided under Workers' Compensation Law § 32 with financing through the issuance of bonds by the Dormitory Authority. The Dormitory Authority is an authority of the State of New York with power to borrow money and to issue negotiable bonds or notes.

The legislation also provides durational limits of awards for non-scheduled permanent partial disability, increases the number of non-ex officio Workers' Compensation Fund Commissioners from eight to ten, and provides for various fraud fighting provisions, additional investment authority for the Workers' Compensation Fund and authority for the Workers' Compensation Fund to enter into contracts with preferred provider organizations.

On January 31, 2008, former Governor Spitzer signed into law additional reform legislation, Chapter 11 of the Laws of 2008, which replaced the previous administered rate system for workers' compensation insurance with a loss cost system. In a loss cost system, the Rate Service Organization ("RSO") only files the portion of the rates related to losses. The legislation authorizes the Superintendent of the Insurance Department to promulgate regulations further defining loss costs to further define the new rating system. Each individual insurer must apply its own expense factors ("loss cost multipliers").

The legislation also amends Insurance Law § 2339(d) which governs differential charges by the Workers' Compensation Fund in order to conform it to the loss cost system. Under the current law, a differential charge is defined as a rate in excess of the manual rate promulgated by the New York Compensation Rating Board ("CIRB"). Under the legislation, a differential charge is a rate in excess of the applicable loss cost and the applicable expense constant. (The Workers' Compensation Fund's policyholders are entitled to challenge the reasonableness of a differential charge with an appeal to the Superintendent of the Insurance Department).

The legislation also established requirements for the governing structure of the RSO for workers' compensation and permits the RSO (currently the CIRB is licensed as the RSO for workers' compensation) to file loss costs with the Insurance Department; replaced the February 1, 2008 sunset date on all CIRB activities, including data collection, with a June 2, 2013 sunset date on its rate filing ability; and permits the Superintendent of Insurance to designate an entity as the "workers' compensation insurance rating board" to collect and analyze data in the event that there is no RSO for workers' compensation.

As certain provisions of the Workers' Compensation Reform have not been developed and implemented, management is unable to quantify at this time the aggregate effect of the changes noted in the preceding paragraphs, however, it is presumed to be material.

The New York Employment, Safety and Security Act of 1996 (Chapter 635 of the laws of 1996, amended by Chapter 648 of the Laws of 1996) was an omnibus measure reforming New York State's workers' compensation system. Changes included: the repeal of third party liability for all but the gravest of injuries, expanded use of managed care, an increased effort to combat workers' compensation fraud, a mandate for employers to institute safety programs, and a revision of reporting requirements.

Chapter 635 of the Laws of 1996 included a special assessment of all licensed workers' compensation insurance carriers including the Workers' Compensation Fund totaling \$98,000. Each individual special assessment was equivalent to the insurer's proportionate share of total loss reserves as of December 31, 1995. On January 15, 1997, the Workers' Compensation Fund paid \$52,445, which represented its share of the assessment. By decision dated May 12, 1998 (Thomas Majewski v. Broadalbin-Perth Central School District, Adirondack Mechanical Corporation), the New York Court of Appeals determined that the effective date for imposition of certain litigation reforms incorporated in Chapter 635 was limited to suits filed by claimants subsequent to September 10, 1996. The Workers' Compensation Fund established de minimis case reserves for cases subject to dismissal under Chapter 635 and, thus, any adjustment of the Workers' Compensation Fund's share of the proportionate total loss reserves savings should result in no additional payment by the Workers' Compensation Fund. The Insurance Department conducted a preliminary audit and request for reserve data in 2000 to which the Workers' Compensation Fund responded. Management is unable to project the amount of any potential refund of the assessment paid by the Workers' Compensation Fund pending completion of an audit of carrier loss reserve savings arising from Chapter 635.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

11 - Commitments

The Workers' Compensation Fund leases offices, warehouse space and vehicles under noncancellable operating leases generally varying from one to fifteen years. The Workers' Compensation Fund's aggregate minimum commitments under noncancellable operating leases at December 31, 2010, are as follows:

| | |
|-------------------------|------------------|
| 2012 | \$ 3,964 |
| 2013 | 4,070 |
| 2014 | 4,142 |
| 2015 | 4,218 |
| Thereafter | <u>13,238</u> |
| Net minimum commitments | <u>\$ 29,632</u> |

Rental expense, which includes the imputed rental expense for the Workers' Compensation Fund, was \$13,533 and \$14,404 in 2010 and 2009, respectively, and recorded through investment income earned.

12 - Reserves For Losses And Loss Adjustment Expenses

Activity in the reserves for losses and loss adjustment expenses is summarized as follows:

| | <u>2010</u> | <u>2009</u> |
|--|---------------------|---------------------|
| Balance—January 1 (net of reinsurance recoveries) | \$ 8,841,417 | \$ 8,695,678 |
| Incurred claims related to | | |
| Current year | 1,357,978 | 1,331,073 |
| Prior years | <u>10,453</u> | <u>43,644</u> |
| Total incurred | <u>1,368,431</u> | <u>1,374,717</u> |
| Paid claims related to | | |
| Current year | 175,022 | 158,139 |
| Prior years | <u>1,138,549</u> | <u>1,070,839</u> |
| Total paid | <u>1,313,571</u> | <u>1,228,978</u> |
| Balance—December 31 (net of reinsurance recoveries) | <u>\$ 8,896,277</u> | <u>\$ 8,841,417</u> |

The incurred claims relating to prior years have changed in 2010 and 2009 as a result of changes in estimates of events insured in prior years. The Workers' Compensation Fund changes also reflect the amortization of the discount on reserves.

13 - Surplus

There were no restrictions placed on the Workers' Compensation Fund's surplus, including for whom the surplus is being held.

Changes in balances of special surplus funds from December 31, 2009 to December 31, 2010, are due to appropriations to the catastrophe, foreign terrorism reserves, and domestic terrorism reserves.

Unassigned surplus is increased/(decreased) by each item below as follows:

| | <u>2010</u> | <u>2009</u> |
|---------------------------|-------------------|-------------------|
| Unrealized gains (losses) | \$ 202,525 | \$ 180,361 |
| Nonadmitted assets | <u>115,259</u> | <u>132,494</u> |
| Total | <u>\$ 317,784</u> | <u>\$ 312,855</u> |

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

14 - Other Underwriting Expenses

The components of other underwriting expenses are as follows:

| | <u>2010</u> | <u>2009</u> |
|---|-------------------|-------------------|
| Advertising | \$ 132 | \$ 112 |
| Boards, bureaus and associations | 8,473 | 9,841 |
| Audit of assured's records | 273 | 537 |
| Salaries and payroll taxes | 79,849 | 73,752 |
| Employee relations and welfare | 24,420 | 19,866 |
| Insurance | 154 | 166 |
| Travel and travel items | 1,011 | 1,079 |
| Rent and rent items | 6,469 | 6,338 |
| Equipment | 201 | 216 |
| Cost or depreciation of EDP equipment and software | 5,727 | 5,368 |
| Printing and stationery | 454 | 515 |
| Postage and telephone | 2,886 | 3,240 |
| Legal and auditing | 2,017 | 2,194 |
| Taxes, licenses and fees | 90,146 | 98,136 |
| Reimbursements by uninsured plans | (13,116) | (13,000) |
| Miscellaneous expenses | 5,847 | 6,351 |
| | <u>\$ 214,943</u> | <u>\$ 214,711</u> |

15 - Contingencies

From time to time the Workers' Compensation Fund is involved in pending and threatened litigation in the normal course of business in which claims for monetary damages are asserted. In the opinion of management, the ultimate liability, if any, arising from such pending or threatened litigation is not expected to have material effect on the results of operations, liquidity, or financial position of the Workers' Compensation Fund.

16 - Reconciliation to Annual Statement

During 2010 and 2009 there were no reconciling items between the Workers' Compensation Fund's audited statutory basis financial statements and statutory annual statement filed.

17 - Health Care Reform

On March 23, 2010, President Barack Obama signed into law the Patient Protection and Affordable Care Act (H.R.3590/P.L. 111-148) seeking to provide health care to all Americans. It establishes requirements for all new health benefits plans offered in the individual and small group market and establishes state exchanges for qualified health care benefit plans. Although it does not appear that this legislation is aimed at regulating the health care benefits paid by workers' compensation insurers such as the Workers' Compensation Fund, upon implementation of this legislation over a period of years, effects may become clear that are not discernable at this time.

18 - Subsequent Events

Subsequent events have been reviewed in accordance with SSAP No. 9R, Subsequent Events, for both annual statement reporting and through issuance of these audited statutory basis financial statements. Subsequent events were initially reviewed through February 26, 2011 for annual statement reporting, which is the date when the annual statements was issued and filed with the NAIC and the Insurance Department. After this date, subsequent events have been reviewed through May 31, 2011, the date which these audited statements were available to be issued.

Type I

The Workers' Compensation Fund did not experience an event that provided additional evidence with respect to conditions that existed at the date of the statutory basis balance sheet and affected estimated inherent in the process of preparing the statutory basis financial statements.

Type II

The Workers' Compensation Fund did not experience an event that provided evidence with respect to conditions that did not exist at the date of the statutory basis balance sheet but arose subsequent to December 31, 2010.

Notes to NYSIF Statutory Basis Financial Statements

Workers' Compensation Fund Years Ended December 31, 2010 and 2009 (in thousands)

The following table depicts the changes in fair value of Workers' Compensation Fund's bond and stock portfolio between December 31, 2010 and March 31, 2011:

| | Cost or Book Adjusted Carrying Value | Fair Value | Net Unrealized Gain or (Loss) |
|--|--|----------------------|-------------------------------------|
| As of December 31, 2010: | | | |
| U.S. Government Obligations | \$ 3,727,959 | \$ 3,743,387 | \$ 15,428 |
| Other Government Obligations | 507,296 | 507,467 | 171 |
| Special Revenue Obligations, MBS | 1,570,393 | 1,657,979 | 87,586 |
| Industrial & Miscellaneous, non MBS | 3,871,266 | 4,104,237 | 232,971 |
| Residential Mortgage-backed Securities | 470,426 | 494,163 | 23,737 |
| Commercial Mortgage-backed Securities | 414,192 | 419,857 | 5,665 |
| Hybrid Securities | 12,559 | 16,556 | 3,997 |
| Stocks | 1,069,359 | 1,279,915 | 210,556 |
| Total | <u>\$ 11,643,450</u> | <u>\$ 12,223,561</u> | <u>\$ 580,111</u> |
| As of March 31, 2011: | | | |
| U.S. Government Obligations | \$ 3,795,683 | \$ 3,752,525 | \$ (43,158) |
| Other Government Obligations | 495,506 | 491,723 | (3,783) |
| Special Revenue Obligations, MBS | 1,594,662 | 1,669,204 | 74,542 |
| Industrial & Miscellaneous, non MBS | 3,794,011 | 4,010,287 | 216,276 |
| Residential Mortgage-backed Securities | 300,477 | 340,601 | 40,124 |
| Commercial Mortgage-backed Securities | 398,734 | 409,655 | 10,921 |
| Hybrid Securities | 112,930 | 111,533 | (1,397) |
| Stocks | 1,115,122 | 1,371,020 | 255,898 |
| Total | <u>\$ 11,607,125</u> | <u>\$ 12,156,548</u> | <u>\$ 549,423</u> |
| Interperiod changes: | | | |
| U.S. Government Obligations | \$ 67,724 | \$ 9,138 | \$ (58,586) |
| Other Government Obligations | (11,790) | (15,744) | (3,954) |
| Special Revenue Obligations, MBS | 24,269 | 11,225 | (13,044) |
| Industrial & Miscellaneous, non MBS | (77,255) | (93,950) | (16,695) |
| Residential Mortgage-backed Securities | (169,949) | (153,562) | 16,387 |
| Commercial Mortgage-backed Securities | (15,458) | (10,202) | 5,256 |
| Hybrid Securities | 100,371 | 94,977 | (5,394) |
| Stocks | 45,763 | 91,105 | 45,342 |
| Total | <u>\$ (36,325)</u> | <u>\$ (67,013)</u> | <u>\$ (30,688)</u> |

As the table depicts, the Workers' Compensation Fund's fair value position of its bond and stock portfolio has declined subsequent to year end 2010. In addition, the Workers' Compensation Fund's has the ability to hold this portfolio to maturity. Furthermore, the average credit quality of the portfolio remains principally invest-grade, indicating a high likelihood of full collectability. Consequently, the Workers' Compensation Fund believes that any necessary criteria for impairment with respect to its portfolio holdings as of December 31, 2010 and subsequent is not met and therefore the Workers' Compensation Fund has not adjusted its surplus for the unrealized losses noted above.

The Workers' Compensation Fund recognized impairment for the first three months end of March 31, 2011 in the amount of \$5,044.



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Independent Auditors' Report

To the Board of Commissioners
The State Insurance Fund Workers' Compensation Fund
New York, New York

We have audited the accompanying statutory basis statement of admitted assets, liabilities and surplus of the State Insurance Fund Workers' Compensation Fund (the "Fund") as of December 31, 2010, and the related statutory basis statements of operations, surplus, and cash flows for the year then ended. These statutory basis financial statements are the responsibility of the Fund's management. Our responsibility is to report on these statutory basis financial statements based on our audit. The 2009 statutory basis financial statements were audited by Amper, Politziner & Mattia, LLP, whose practice was combined with the practice of Eisner LLP to form EisnerAmper LLP as of August 16, 2010 and whose report dated May 14, 2010, expressed an unqualified opinion on those statutory basis financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statutory basis 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 Fund'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 statutory basis financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statutory basis financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the accompanying statutory basis financial statements of the Fund have been prepared in conformity with accounting practices prescribed by the Insurance Department of the State of New York (the "Insurance Department"), and such practices differ from accounting principles generally accepted in the United States of America. The effects on the statutory basis financial statements of the differences between accounting practices prescribed by the Insurance Department and accounting principles generally accepted in the United States of America, 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 statutory basis financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Workers' Compensation Fund as of December 31, 2010, or the results of its operations, surplus or its cash flows for the year then ended.

However, in our opinion, the 2010 statutory basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Workers' Compensation Fund as of December 31, 2010, and the results of its operations, surplus and its cash flows for the year then ended, in conformity with the accounting practices prescribed by the Insurance Department, as described in Note 2.

As described in Note 2A, the Workers' Compensation Fund has significant prescribed accounting practices that are mandated by New York State Workers' Compensation Law. As discussed in Note 2A and Note 2F, the Workers' Compensation Fund discounts all reserves for loss and loss adjustment expenses at 5% and, therefore, a relatively small change in the timing of future payments could have a material impact on surplus.

As described in Note 10, certain provisions of the Workers' Compensation Reform have not been developed and implemented. Therefore Management is unable to determine the impact on the statutory basis financial statements.

EisnerAmper LLP

May 31, 2011
New York, New York

New York State Insurance Fund Statutory Basis Financial Statements

Disability Benefits Fund

Statement of Admitted Assets, Liabilities and Surplus

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|--|-------------------|-------------------|
| Admitted assets | | |
| Cash and invested assets | | |
| Bonds—at NAIC carrying value | \$ 116,068 | \$ 124,608 |
| Preferred stocks | 246 | 4,922 |
| Common stocks, at market value | 446 | 280 |
| Cash and short-term investments | <u>5,765</u> | <u>9,608</u> |
| Total cash and invested assets | 122,525 | 139,418 |
| Premiums receivable | 2,797 | 3,222 |
| Accrued investment income | 1,103 | 985 |
| Receivable for securities | <u>47,297</u> | <u>4,055</u> |
| Total admitted assets | <u>\$ 173,722</u> | <u>\$ 147,680</u> |
| Liabilities and surplus | | |
| Liabilities | | |
| Reserve for losses | \$ 4,441 | \$ 4,695 |
| Reserve for loss adjustment expenses | 250 | 337 |
| Unearned premiums | 30,654 | 32,937 |
| Due to affiliate | 252 | 140 |
| Payable for securities | 25,853 | 3,730 |
| Accrued expenses and other liabilities | <u>2,887</u> | <u>9,531</u> |
| Total liabilities | <u>64,337</u> | <u>51,370</u> |
| Surplus | | |
| Security fluctuation surplus | 4,000 | 4,000 |
| Catastrophe surplus | 4,000 | 4,000 |
| Unassigned surplus | <u>101,385</u> | <u>88,310</u> |
| Total surplus | <u>109,385</u> | <u>96,310</u> |
| Total liabilities and surplus | <u>\$ 173,722</u> | <u>\$ 147,680</u> |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Disability Benefits Fund

Statement of Operations

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|--------------------------------------|-------------|-------------|
| Underwriting income | | |
| Net written premium | \$ 9,715 | \$ 16,594 |
| Net earned premium | 11,998 | 15,218 |
| Underwriting expenses | | |
| Losses incurred | 10,452 | 10,774 |
| Loss adjustment expenses incurred | 804 | 1,061 |
| Other underwriting expenses incurred | 2,708 | 2,956 |
| Total underwriting expenses | 13,964 | 14,791 |
| Net underwriting (loss) income | (1,966) | 427 |
| Investment income earned | | |
| Investment income | 5,266 | 5,245 |
| Investment expenses | (152) | (183) |
| Net realized investment gains | 11,159 | 1,109 |
| Net investment income earned | 16,273 | 6,171 |
| Other income (expenses) | | |
| Bad debt expense | (283) | (468) |
| Miscellaneous income | 256 | 537 |
| Total other (expenses) income | (27) | 69 |
| Net income | \$ 14,280 | \$ 6,667 |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Disability Benefits Fund

Statement of Surplus

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|---|-------------|-------------|
| Balance - January 1 | \$ 96,310 | \$ 88,537 |
| Net income | 14,280 | 6,667 |
| Net unrealized capital (losses) gains - investments | (846) | 1,138 |
| (Increase) decrease in nonadmitted assets | (250) | (32) |
| Current period surplus adjustments | (109) | - |
| Net increase (decrease) in surplus | 13,075 | 7,773 |
| Balance -December 31 | \$ 109,385 | \$ 96,310 |

See accompanying notes to statutory basis financial statements.

New York State Insurance Fund Statutory Basis Financial Statements

Disability Benefits Fund

Statement of Cash Flows

Years Ended December 31, 2010 and 2009 (in thousands)

| | <u>2010</u> | <u>2009</u> |
|---|-------------|-------------|
| Cash flows from operations | | |
| Premiums collected, net of reinsurance | \$ 3,235 | \$ 16,046 |
| Net investment income | 5,045 | 5,631 |
| Miscellaneous (expenses) income | (27) | 69 |
| Losses and loss adjustment expenses paid, net of salvage and subrogation | (10,706) | (10,903) |
| Expenses paid | (3,235) | (4,425) |
| | (5,688) | 6,418 |
| Net cash (used in) provided by operations | | |
| Cash flows from investments | | |
| Proceeds from investments sold, matured or repaid | 6,582,700 | 5,805,362 |
| Cost of investments acquired | (6,580,497) | (5,806,625) |
| | 2,203 | (1,263) |
| Net cash provided by (used in) investments | | |
| Cash flows from miscellaneous sources | | |
| Net transfers to miscellaneous sources | (358) | (157) |
| | (358) | (157) |
| Net cash used in miscellaneous sources | | |
| Net change in cash and short-term Investments | (3,843) | 4,998 |
| Cash and short-term investments Beginning of year | 9,608 | 4,610 |
| Cash and short-term investments End of year | \$ 5,765 | \$ 9,608 |

See accompanying notes to statutory basis financial statements.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

1 - Organization and Purpose

The State Insurance Fund (the "Fund"), which includes the operations of the Workers' Compensation Fund and the Disability Benefits Fund, is a nonprofit agency of the State of New York (the "State"). By statute, the Fund maintains separate records for the Workers' Compensation Fund and Disability Benefits Fund.

The Disability Benefits Fund received authority to write disability benefits insurance in 1950. As an agency of the State, all liabilities of the Disability Benefits Fund are guaranteed by the State should the Disability Benefits Fund become insolvent.

Disability benefits insurance covers off-the-job injury and sickness, but not medical care payments.

2 - Summary of Significant Accounting Practices

Basis of Presentation

The accompanying statutory basis financial statements of the Disability Benefits Fund are presented in conformity with accounting practices prescribed by the Insurance Department of the State of New York (the "Insurance Department"). The Insurance Department recognizes only New York Statutory Accounting Practices ("NY SAP") for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under New York State Insurance Law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures Manual ("NAIC SAP"), effective January 1, 2001 and subsequent revisions, have been adopted as a component of NY SAP. The State of New York has adopted certain prescribed accounting practices that differ from those found in NAIC SAP. Specifically, EDP and related equipment, constituting a data processing, record keeping or accounting system with a cost of \$50 and greater shall be depreciated over a period not to exceed 10 years under NY SAP. In addition, the Superintendent of the Insurance Department has the right to permit other specific practices that may deviate from prescribed practices. The Disability Benefits Fund assigns a portion of unassigned surplus for securities fluctuation and catastrophes and is not required to calculate Risk Based Capital calculations.

If no assignments of surplus were prescribed, unassigned surplus would remain unchanged at \$8,000 as of December 31, 2010 and 2009, respectively, with no change in total statutory surplus.

The accounting practices and procedures of NY SAP comprise a comprehensive basis of accounting other than accounting principles generally accepted in the United States ("U.S. GAAP").

The more significant variances between NY SAP and U.S. GAAP which are applicable to the Disability Benefits Fund are set forth below:

- a. Bonds are generally carried at amortized cost. Under U.S. GAAP, such securities are classified into "held to maturity" and reported at amortized cost, or "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of surplus.
- b. Common stocks are reported at fair value, as determined by the NAIC's Securities Valuation Office ("SVO") and other independent pricing sources and the related net unrealized capital gains and losses are reported in unassigned surplus. Dividend income generally is reported when received. Under U.S. GAAP, common stocks are classified as either "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported as a separate component of surplus. Dividend income is recorded when the dividends are declared.
- Cash and short-term investments in the statutory basis statements of cash flows represent cash balances and investments with initial maturities of one year or less. Under U.S. GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.
- c. Policy acquisition costs (principally underwriting and marketing related costs) are expensed as incurred, whereas under U.S. GAAP these costs are deferred and amortized to income on the same basis as premium income is recognized.
- d. Certain assets designated as non-admitted assets (principally premiums in the course of collection outstanding over 90 days and office furniture and equipment) are charged directly against surplus. Under U.S. GAAP, such non-admitted assets would be included in total assets, less valuation allowances.
- e. EDP and related equipment with a cost of \$2 and greater are depreciated over an estimated useful life up to 3 years. Under U.S. GAAP, such non-admitted assets, would be recorded as assets, less accumulated depreciation.
- f. The Board of Commissioners (the "Board") may designate a reserve for security fluctuations to provide for the difference between the amortized cost of securities and their fair value. Such a reserve is established for future contingencies, rather than allocated to specific investments. In addition, the Board may assign a reasonable portion of unassigned surplus as a reserve for catastrophes. The Insurance Department specifically permits the appropriation of unassigned surplus for these purposes. Under U.S. GAAP, no such reserves are established.
- g. Comprehensive income and its components are not presented in the statutory basis financial statements.

h. The statutory basis financial statements do not include certain disclosures about and/or the consolidation of certain variable interest entities as required by U.S. GAAP under Financial Accounting Standards Board Interpretation ASC Topic 810, consolidation of variable interest entities.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

The aggregate effect of the foregoing variances on the accompanying statutory basis financial statements has not been determined however it is presumed to be material.

i. This Disability Benefits Fund records written premium based on the policy effective date and earns the related income over the life of the policy through the statutory basis statements of operations.

Investments

Investments are generally valued in accordance with the valuation procedures of the NAIC.

Bonds are valued in accordance with the requirements of the SVO. Bonds are principally carried at amortized cost. Discount or premium on bonds is amortized using the scientific method, which is a variation of the effective interest method. Short-term investments consist of bonds purchased within a year of the maturity date, which are stated at amortized cost. Realized gains and losses on the sale of bonds are calculated based on the difference between the amortized cost and the consideration received at the time of sale and are included in results of operations. Market value is based on market prices obtained from the SVO and the Interactive Data Corporation ("IDC") primarily.

Common stocks are carried at fair value, which is obtained from the SVO. Unrealized gains and losses resulting from fair value fluctuations are reflected as a separate component of unassigned surplus. Realized gains and losses are calculated based on the difference between fair value and the consideration received at the time of sale and are included in the statutory basis statements of operations.

Preferred stocks are stated at cost, lower of cost or amortized cost or NAIC fair values depending on the assigned credit rating and the underlying characteristics of the security. The fair values for preferred stocks are based on quoted market prices where available. If unavailable, the fair value was determined by the Disability Benefits Fund using discounted cash flow models using discount rates of securities of similar maturity and credit characteristics. Perpetual preferred stocks are valued at estimated market value.

Investment income earned consists primarily of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned at the ex-dividend date. Interest income on mortgage-backed and asset-backed securities is determined on the effective yield method based on estimated principal repayments. Accrual of income is suspended for bonds and mortgage loans that are in default or when the receipt of interest payments is in doubt. Realized capital gains and losses are determined using the first in first out ("FIFO") method.

An investment in a debt or equity security is impaired if its fair value falls below book value and the decline is considered other than temporary. Factors considered in determining whether a loss is other than temporary include the length of time and extent to which fair value has been below cost; the financial condition and near term prospects of the issuer; and the Disability Benefits Fund's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. A debt security is impaired if it is probable that the Disability Benefits Fund will not be able to collect all the amounts due under the security contractual terms. Equity investments are impaired when it becomes apparent that the Disability Benefits Fund will not recover its cost over the expected holding period. Other-than-temporary declines in fair value of investments are included in realized losses. The amount included in 2010 and 2009 for realized losses related to Disability Benefits Fund for impairment losses was \$174 and \$1,442, respectively.

Premiums Revenue and Related Accounts

The Disability Benefits Fund records written premiums on the effective date of the policy and earns premium over the life of the policy.

The Disability Benefits Fund records premium receivable as an admitted asset if the following three conditions are met: (1) a bill for the premium amount is no more than 90 days past due, (2) the bill date is within six months after the expiration of the policy year and (3) no other bill for the same policy is considered non-admitted.

The outstanding premium receivable net admitted balance in the Disability Benefits Fund was \$2,797 and \$3,222 or 61% and 63% of gross premium receivable at December 31, 2010 and 2009, respectively. To reduce credit risk, the Disability Benefits Fund performs ongoing evaluations of its customers' financial condition but does not generally require collateral. The Disability Benefits Fund routinely assesses the collectability of its receivables. Based upon the Disability Benefits Fund's experience, less than 2% of net written premium may become uncollectible and the potential loss is not material to the Disability Benefits Fund's financial condition.

For the Disability Benefits Fund, unearned premiums represent the pro rata portion of premiums and endorsements written that are applicable to the unexpired term of policies in force at the end of the year.

The Disability Benefits Fund routinely assesses the collectability of these receivables. Based upon the Disability Benefits Fund's experience, less than 2% of net written premium may become uncollectible and the potential loss is not material to the Disability Benefits Fund's financial condition.

The Disability Benefits Fund performs an analysis of uncollectible premium receivable and realized write offs of \$283 and \$468 for the year ended December 31, 2010 and 2009, respectively, through the statutory basis statements of operations.

Expenses of the Workers' Compensation Board

Based on the payrolls covered through written premiums, the Disability Benefits Fund contributes a proportional share of the cost of payments to disabled unemployed individuals administered by the Workers' Compensation Board. The amounts paid in 2010 and 2009 to the Workers' Compensation Board to contribute to their expenses were \$623 and \$252, respectively.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

Reserves for Losses and Loss Adjustment Expenses

The reserves for losses and loss adjustment expenses of the Disability Benefits Fund are based on individual case estimates for losses attributable to policy years prior to the current year, and on an average cost basis for the current year and for incurred but not reported (IBNR) amounts. These liabilities also include expenses for investigating and settling claims. The Disability Benefits Fund's reserves for losses and loss adjustment expenses are estimated by using recognized actuarial techniques. The methods for making such estimates and for establishing the resulting liability are continually reviewed and any adjustments are reflected in the period determined. An independent actuarial consulting firm reviews the estimated liability. The Disability Benefits Fund's management believes that the assumptions used in determining this liability are reasonable and that the amount recorded represents its best estimate of the ultimate cost of investigating, defending and settling claims. However, the Disability Benefits Fund's actual future experience may not conform to the assumptions inherent in the determination of the liability. Accordingly, the ultimate settlement value may vary significantly from the amounts included in the statutory basis financial statements and the difference may be material.

Security Fluctuation and Catastrophic Surplus

As described above, the Board may designate a portion of unassigned surplus for security fluctuation and catastrophes as specifically prescribed by the Insurance Department. A review of the security fluctuation surplus in conjunction with the Disability Benefits Fund's portfolio remained unchanged at \$4,000 as of December 31, 2009 and 2010. The review of the catastrophe surplus in conjunction with a risk assessment of the Disability Benefits Fund's exposures resulted in the Board maintaining the catastrophe surplus at \$4,000 as of December 31, 2009 and 2010.

Fringe Benefits

Based on actual costs billed by various State agencies, the Disability Benefits Fund incurred \$532 and \$479 of fringe benefits and indirect costs in 2010 and 2009, respectively recorded through other underwriting expenses.

All employees of the Disability Benefits Fund are covered under a retirement plan administered by the New York State Employees Retirement System. For employees hired prior to July 27, 1976, the plan is noncontributory. For employees hired on or after July 27, 1976, but before 2010, the plan is partially contributory in the first 10 years of employment and noncontributory thereafter. For employees hired on or after January 1, 2010, the plan is contributory for all years of service. The portion of the fringe benefits attributed to the retirement plan for the Disability Benefits Fund was \$169 and \$117 in 2010 and 2009, respectively.

Post-Employment Benefits

New York State Civil Service Law, Section 163.2, provides for health insurance coverage for retired employees of the Disability Benefits Fund including their spouses and dependent children. Eligibility is determined by the membership in the New York State and Local Employees' Retirement System, enrollment in the New York State Health Insurance Program at the time of retirement, and the completion of a minimum number of years of service as required by the employees' membership tier in the retirement system.

Health insurance premiums for retired employees are equal to the premiums charged for active Disability Benefits Fund's employees. The dollar value of accumulated sick leave credits at the time of retirement is used to offset the health insurance premiums paid directly by retirees. The Disability Benefits Fund pays the portion of the retirees' health insurance premiums covered by accumulated sick leave credits.

The Disability Benefits Fund is billed by the Department of Civil Service monthly. Expenses are recognized when paid and totaled \$74 and \$94 for the Disability Benefits Fund for the years ended December 31, 2010 and 2009, respectively.

Income Tax

The Disability Benefits Fund is exempt from federal income taxes. However, the Disability Benefits Fund is subject to a New York State franchise tax. The Disability Benefits Fund's franchise tax is calculated using a written premium-based method and is a component of other underwriting expenses. The New York State franchise tax expense was \$170 and \$290 in 2010 and 2009, respectively and recorded through the statutory basis statements of operations.

The Disability Benefits Fund maintains an office and does business in the metropolitan New York area and is subject to the Metropolitan Transit Authority ("MTA") surcharge. The MTA surcharge is based on premiums written on businesses in the metropolitan area and wages paid to employees in the metropolitan area and is a component of other underwriting expenses. The MTA surcharge in 2010 and 2009 was \$23 and \$37, respectively, for the Disability Benefits Fund and recorded through the statutory basis statements of operations.

Concentrations of Credit Risk

Financial instruments that potentially subject the Disability Benefits Fund to concentrations of credit risk are primarily cash and cash equivalents. Cash equivalents include investments in commercial paper of companies with high credit ratings, investments in money market securities and securities backed by the U.S. Government. Balances maintained in non-interest bearing transaction accounts in the United States are fully insured by the Federal Deposit Insurance Corporation, ("FDIC") up to \$250.

At December 31, 2010 and 2009, cash and cash equivalent deposits in the Disability Benefits Fund's custodian bank account were \$10,004 and \$10,073 and were not insured by the FDIC.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

Risks and Uncertainties

The Disability Benefits Fund invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market risk and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that changes could materially affect the participants' account balances and the amounts reported in the statutory basis financial statements.

Users of these statutory basis financial statements should be aware that the financial markets' volatility in 2010 and 2009 may significantly impact the subsequent valuation of the Disability Benefits Fund's investments.

Accordingly, the valuation of investments at December 31, 2010 may not necessarily be indicative of amounts that could be realized in a current market exchange.

Use of Estimates

The preparation of these statutory basis financial statements in conformity with statutory basis 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 statutory basis financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification

Certain reclassifications have been made to the prior year's statutory basis financial statements amounts to conform to the current year's presentation.

Correction of an Error

The Disability Benefits Fund had an error in the treatment of the recording the reserves for the liability related to self-insured claims for its employees. The error was identified and corrected in 2010. The liability for the current and future claims development and corresponding correction of an error was recorded through unassigned surplus of \$109 in accordance with NY SAP. The current year portion of the liability was reflected in the statutory basis statements of operations for \$4.

3 - Investments

Section 87 of the New York State Workers' Compensation Law specifically states the type of securities authorized for investment by the Disability Benefits Fund and requires all such transactions to be approved by the Superintendent of Insurance Department. Section 87 further provides that the Commissioner of Taxation and Finance is the sole custodian of the Disability Benefits Fund. J.P. Morgan Chase serves as the Disability Benefits Fund's custodian for investments. The Disability Benefits Fund has security lending agreements with J.P. Morgan Chase and Key Bank. All bank deposits are entirely insured or collateralized with securities held by J.P. Morgan Chase at December 31, 2010, in accordance with Section 105 of the New York State Finance Law.

Chapter 473 of the Laws of 2000 and Chapter 6 of the Laws of 2007 broadened the Disability Benefits Fund's reserve investment authority to include certain common and preferred stocks and expanded the range of fixed income issues in which the Disability Benefits Fund may invest. The amortized cost, gross unrealized gains, gross unrealized losses and estimated market value of investments in bonds and stocks at December 31, 2010 and 2009 are as follows:

| | Cost or Book Adjusted Carrying Value | <u>2010</u> Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
|---|--|---|-------------------------------|------------------------------|
| U.S. Government and government agency obligations | \$ 75,924 | \$ 2,649 | \$ (388) | \$ 78,185 |
| All other governments | 9,992 | 117 | (127) | 9,982 |
| Corporate bonds and public utilities | 26,653 | 975 | (177) | 27,451 |
| Hybrid securities | 3,499 | 1,335 | (1) | 4,833 |
| Total bonds | 116,068 | 5,076 | (693) | 120,451 |
| Preferred stocks | 178 | 68 | - | 246 |
| Common stocks | 342 | 104 | - | 446 |
| Total stocks | 520 | 172 | - | 692 |
| Total investments | \$ 116,588 | \$ 5,248 | \$ (693) | \$ 121,143 |

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

| | Cost or Book Adjusted Carrying Value | 2009 | | Estimated Market Value |
|---|--|------------------------------|-------------------------------|------------------------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | |
| U.S. Government and government agency obligations | \$ 92,916 | \$ 1,219 | \$ (1,720) | \$ 92,415 |
| All other governments | 4,991 | - | (41) | 4,950 |
| Corporate bonds and public utilities | 26,701 | 647 | (1,113) | 26,235 |
| Total bonds | 124,608 | 1,866 | (2,874) | 123,600 |
| Preferred stocks | 3,842 | 1,080 | - | 4,922 |
| Common stocks | 342 | - | (62) | 280 |
| Total stocks | 4,184 | 1,080 | (62) | 5,202 |
| Total investments | \$ 128,792 | \$ 2,946 | \$ (2,936) | \$ 128,802 |

The amortized cost and market value of bonds at December 31, 2010 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because certain issuers may have the right to call or prepay obligations with or without penalties.

| | Amortized Cost | Market Value |
|--|-------------------|-------------------|
| Due in one year or less | \$ 1,010 | \$ 1,058 |
| Due after one year through five years | 42,684 | 43,283 |
| Due after five years through ten years | 43,997 | 46,421 |
| Due after ten years | 28,377 | 29,689 |
| Total bonds | \$ 116,068 | \$ 120,451 |

Investment income earned consists principally of interest and dividends on investments as follows:

| | 2010 | 2009 |
|-------------------------------------|------------------|-----------------|
| Bonds | \$ 5,199 | \$ 4,848 |
| Stocks | 27 | 366 |
| Cash and short-term investments | 22 | 31 |
| Other | 18 | - |
| Investment income | 5,266 | 5,245 |
| Investment expenses | (152) | (183) |
| Net realized investment gain | 11,159 | 1,109 |
| Net investment income earned | \$ 16,273 | \$ 6,171 |

Net realized capital gains (losses) on investments, determined on the FIFO method using amortized cost, consist of the following:

| | 2010 | 2009 |
|-----------------------------------|------------------|-----------------|
| Bonds | \$ 11,039 | \$ 967 |
| Stocks | 113 | 112 |
| Cash and short-term investments | 7 | 30 |
| Net realized capital gains | \$ 11,159 | \$ 1,109 |

For the Disability Benefits Fund, proceeds from investments sold, matured or repaid during the years ended December 31, 2010 and 2009 were \$6,582,700 and \$5,805,362 respectively. These sales resulted in gross realized gains of \$11,955 and \$4,117 and gross realized losses of \$629 and \$1,596 in 2010 and 2009, respectively.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

Fund maintained ownership rights to securities loaned and had the ability to sell securities while they were on loan. The Disability Benefits Fund had an indemnification agreement with lending agents in the event a borrower became insolvent or fails to return securities.

The Disability Benefits Fund had no securities on loan as of December 31, 2010 and 2009, respectively. For the years ended December 31, 2010 and 2009, the Disability Benefits Fund received fees of \$0 and \$1,547, respectively. These fees have been included in investment income earned.

Based on comments by the Statutory Accounting Principles Working Group and a review of the properties for hybrid securities held by the Disability Benefits Fund, it was determined that the characteristics of these securities were similar to the characteristics of a bond. Therefore during 2010 these securities were reclassified from preferred stocks to bonds using prospective treatment. As of December 31, 2010, the Disability Benefits Fund transferred \$3,499 of securities from preferred stocks to bonds.

Fair Value of Financial Instruments

The statement value and estimated fair value of financial instruments at December 31, 2010 and 2009 are as follows:

| | 2010 | | 2009 | |
|---------------------------------|-----------------|----------------------|-----------------|----------------------|
| | Statement Value | Estimated Fair Value | Statement Value | Estimated Fair Value |
| Financial assets: | | | | |
| Bonds | \$ 116,068 | \$ 120,451 | \$ 124,608 | \$ 123,600 |
| Preferred stocks | 246 | 246 | 4,922 | 4,922 |
| Common stocks | 446 | 446 | 280 | 280 |
| Cash and short-term investments | 5,765 | 5,765 | 9,608 | 9,608 |

Included in various investment related line items in the statutory basis financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as when impaired, or, for certain bonds and preferred stocks when carried at the lower of cost or market.

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Disability Benefits Fund estimates fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management's estimation and judgment which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

As of December 31, 2010, the Disability Benefits Fund implemented SSAP No. 100 *Fair Value Measurements* ("SSAP No. 100"). SSAP No. 100 defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value.

Included in various investment related line items in the statutory basis financial statements are certain financial instruments carried at fair value. Other financial instruments are periodically

measured at fair value, such as when impaired, or, for certain bonds when NAIC designations fall below 2 and therefore are carried at the lower of cost or market.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Disability Benefits Fund estimates fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management's estimation and judgment which becomes significant with increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

When available, the Disability Benefits Fund used quoted market prices to determine the fair values of aforementioned investment securities. When quoted market prices are not readily available or representative of fair value, pricing determinations are made based on the results of valuation models using observable market data such as recently reported trades, bid and offer information and benchmark securities. There were no investments with unobservable inputs. Unobservable inputs reflect the Disability Benefits Fund's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

The Disability Benefits Fund's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on the SSAP No. 100 hierarchy. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

(Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3).

The levels of the fair value hierarchy are as follows:

Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Disability Benefits Fund's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

The following table provides information as of December 31, 2010 about the Disability Benefits Fund's assets measured at fair value along with a brief description of the valuation technique for each type of asset.

| Assets at fair value: | Level 1 | Level 2 | Level 3 | Total |
|-----------------------------|---------|---------|---------|--------|
| Preferred stocks | \$ 246 | \$ - | \$ - | \$ 246 |
| Common stocks | 446 | - | - | 446 |
| Total assets at fair value: | \$ 692 | \$ - | \$ - | \$ 692 |

Low grade fixed maturity investments where fair value is lower than cost and common stocks are recorded at fair value. Securities classified into level 1 included primarily corporate bonds and common stocks where there are quoted prices in active markets for identical securities and the source of the pricing. Unadjusted quoted prices for these securities are provided to the Disability Benefits Fund by independent pricing services. Quote prices for these securities are provided to the Disability Benefits Fund using independent pricing services. The Disability Benefits Fund did not have any Level 2 and Level 3 securities.

Subprime Mortgage Exposure

The Disability Benefits Fund had no exposures to subprime mortgage loans at December 31, 2010 and 2009.

4 - Non-Admitted Assets

The non-admitted assets of the Disability Benefits Fund at December 31, 2010 and 2009 were as follows:

| | 2010 | 2009 |
|--|--------|--------|
| Premium in course of collection outstanding over 90 days | \$ 125 | \$ 112 |
| Other | 266 | 29 |
| Total non-admitted assets | \$ 391 | \$ 141 |

5 - Related Party Transactions

The home office properties are occupied jointly by the Workers' Compensation Fund and Disability Benefits Fund. Because of this relationship, the Disability Benefits Fund incurs joint operating expenses subject to allocation through agreed upon arrangements based on the level of services provided. Management believes the method of allocating such expenses is fair and reasonable.

The Workers' Compensation Fund allocates the cost of services rendered to the Disability Benefits Fund based on a percentage of the Disability Benefits Fund's direct and indirect salary to total salary expense. The expenses allocated to the Disability Benefits Fund were \$1,339 and \$1,553 in 2010 and 2009, respectively.

The Disability Benefits Fund makes payments to the New York State Workers' Compensation Board for various assessments and administrative expenses. Based on the payrolls covered through written premiums, the Disability Benefits Fund contributes a proportional share of the cost of payments to disabled unemployed individuals administered by the Workers' Compensation Board. The amounts paid in 2010 and 2009 to the Workers' Compensation Board to contribute to their expenses were \$623 and \$252, respectively.

The following schedule summarizes all affiliate balances at December 31, 2010 and 2009:

| | | |
|--|--------|--------|
| (Receivable from) payable to affiliate | | |
| Workers' Compensation Fund | \$ 252 | \$ 269 |
| New York State Workers' Compensation Board | - | (129) |
| Total | \$ 252 | \$ 140 |

6 - Reserves for Losses and Loss Adjustment Expenses

Activity in the reserves for losses and loss adjustment expenses is summarized as follows:

| | 2010 | 2009 |
|----------------------------|----------|----------|
| Balance—January 1 | \$ 5,032 | \$ 5,195 |
| Incurred claims related to | | |
| Current year | 14,308 | 14,688 |
| Prior years | (3,052) | (2,853) |
| Total incurred | 11,256 | 11,835 |
| Paid claims related to | | |
| Current year | 9,363 | 9,703 |
| Prior years | 2,234 | 2,295 |
| Total paid | 11,597 | 11,998 |
| Balance—December 31 | \$ 4,691 | \$ 5,032 |

The incurred claims relating to prior years have changed in 2010 and 2009 as a result of changes in estimates of events incurred in prior years.

Notes to NYSIF Statutory Basis Financial Statements

Disability Benefits Fund Years Ended December 31, 2010 and 2009 (in thousands)

7 - Surplus

There were no restrictions placed on the Disability Benefits Fund's surplus, including for whom the surplus is being held.

There were no changes in balances of special surplus funds as of December 31, 2010 and December 31, 2009. Unassigned surplus is (decreased)/increased by each item below as follows:

| | <u>2010</u> | <u>2009</u> |
|-----------------------------------|-----------------|---------------|
| Unrealized gains | \$ 172 | \$ 1,018 |
| Nonadmitted assets | (391) | (141) |
| Current period surplus adjustment | (109) | - |
| Total | <u>\$ (328)</u> | <u>\$ 877</u> |

8 - Other Underwriting Expenses

The components of other underwriting expenses are as follows:

| | <u>2010</u> | <u>2009</u> |
|--------------------------------|-----------------|-----------------|
| Salaries and payroll taxes | \$ 504 | \$ 669 |
| Employee relations and welfare | 233 | 210 |
| Travel and travel items | 1 | 1 |
| Equipment | - | 3 |
| Legal and auditing | 1 | 5 |
| Taxes, licenses and fees | 731 | 611 |
| Miscellaneous expenses | 1,238 | 1,457 |
| Total | <u>\$ 2,708</u> | <u>\$ 2,956</u> |

9 - Contingencies

From time to time the Disability Benefits Fund is involved in pending and threatened litigation in the normal course of business in which claims for monetary damages are asserted. In the opinion of Management, the ultimate liability, if any, arising from such pending or threatened litigation is not expected to have material effect on the results of operations, liquidity, or financial position of the Disability Benefits Fund.

10 - Subsequent Events

Subsequent events have been reviewed in accordance with SSAP No. 9R, Subsequent Events, for both annual statement reporting and through issuance of these audited statutory basis financial statements. Subsequent events were initially reviewed through February 26, 2010 for annual statement reporting, which is the date when the annual statements was issued and filed with the NAIC and the Insurance Department. After this date, subsequent events have been reviewed through May 31, 2011, the date which these audited statements were available to be issued.

Type I

The Disability Benefits Fund did not experience an event that provided additional evidence with respect to conditions that

existed at the date of the statutory basis statement of admitted assets, liabilities and surplus and affected estimated inherent in the process of preparing the statutory basis financial statements.

Type II

The Disability Benefits Fund did not experience an event that provided evidence with respect to conditions that did not exist at the date of the statutory basis statement of admitted assets, liabilities, and surplus but arose subsequent to December 31, 2010.

The following table depicts the changes in fair value of the Disability Benefits Fund's bond and stock between December 31, 2010 and March 31, 2011:

| | Cost or Book Adjusted Carrying Value | Fair Value | Net Unrealized Gain or (Loss) |
|-------------------------------------|--|-------------------|-------------------------------------|
| As of December 31, 2010: | | | |
| U.S. Government Obligations | \$ 75,924 | \$ 78,185 | \$ 2,261 |
| Other Government Obligations | 9,992 | 9,982 | (10) |
| Industrial & Miscellaneous, non MBS | 26,653 | 27,451 | 798 |
| Hybrid securities | 3,499 | 4,833 | 1,334 |
| Stocks | 692 | 342 | (350) |
| Total | <u>\$ 116,760</u> | <u>\$ 120,793</u> | <u>\$ 4,033</u> |
| As of March 31, 2011: | | | |
| U.S. Government Obligations | \$ 88,002 | \$ 90,055 | \$ 2,053 |
| Other Government Obligations | 9,989 | 9,901 | (88) |
| Industrial & Miscellaneous, non MBS | 26,672 | 27,539 | 867 |
| Hybrid securities | 3,499 | 4,920 | 1,421 |
| Stocks | 696 | 519 | (177) |
| Total | <u>\$ 128,858</u> | <u>\$ 132,934</u> | <u>\$ 4,076</u> |
| Interperiod changes: | | | |
| U.S. Government Obligations | \$ 12,078 | \$ 11,870 | \$ (208) |
| Other Government Obligations | (3) | (81) | (78) |
| Industrial & Miscellaneous, non MBS | 19 | 88 | 69 |
| Hybrid securities | - | 87 | 87 |
| Stocks | 4 | 177 | 173 |
| Total | <u>\$ 12,098</u> | <u>\$ 12,141</u> | <u>\$ 43</u> |

As the table depicts, the Disability Benefits Fund's fair value position of its bond and stock portfolio have improved subsequent to year end 2010. The Disability Benefits Fund has the ability to hold this portfolio to maturity. Furthermore, the average credit quality of the portfolio remains principally invest-grade, indicating a high likelihood of full collectability. Consequently, the Disability Benefits Fund believes that any necessary criteria for impairment with respect to its portfolio holdings as of December 31, 2010 and subsequent is not met and therefore the Disability Benefits Fund has not adjusted its capital and surplus for the unrealized losses noted above.

The Disability Benefits Fund recognized impairments for the first three months ended March 31, 2011 in the amount of \$1.



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Independent Auditors' Report

To the Board of Commissioners
The State Insurance Fund Disability Benefits Fund
New York, New York

We have audited the accompanying statutory basis statement of admitted assets, liabilities and surplus of the State Insurance Fund Disability Benefits Fund (the "Fund") as of December 31, 2010, and the related statutory basis statements of operations, surplus, and cash flows for the year then ended. These statutory basis financial statements are the responsibility of the Fund's management. Our responsibility is to report on these statutory basis financial statements based on our audit. The 2009 statutory basis financial statements were audited by Amper, Politziner & Mattia, LLP, whose practice was combined with the practice of Eisner LLP to form EisnerAmper LLP as of August 16, 2010 and whose report dated May 14, 2010, expressed an unqualified opinion on those statutory basis financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statutory basis 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 Fund'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 statutory basis financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statutory basis financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the accompanying statutory basis financial statements of the Fund have been prepared in conformity with accounting practices prescribed by the Insurance Department of the State of New York (the "Insurance Department"), and such practices differ from accounting principles generally accepted in the United State of America. The effects on the statutory basis financial statements of the differences between accounting practices prescribed by the Insurance Department and accounting principles generally accepted in the United States of America, 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 statutory basis financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Disability Benefits Fund as of December 31, 2010, or the results of its operations, surplus or its cash flows for the year then ended.

However, in our opinion, the 2010 statutory basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Disability Benefits Fund as of December 31, 2010, and the results of its operations, surplus and its cash flows for the year then ended, in conformity with the accounting practices prescribed by the Insurance Department, as described in Note 2.

EisnerAmper LLP

May 31, 2011
New York, New York

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THE NEW YORK STATE INSURANCE FUND

Workers' Compensation and Disability Benefits Specialist

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Andrew M. Cuomo, Governor

Robert H. Hurlbut, Chairman

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NYSIF Mission Statement

Provide timely and appropriate indemnity and medical payments to injured workers.

Drive down the cost of workers' compensation insurance for businesses operating in New York State.

Ensure that all New York businesses have a market for workers' compensation insurance available to them at a fair price.

Maintain a solvent State Fund that is always available for New York businesses.

Be a competitive force in the marketplace as an industry leader in price, quality and service.