WCRA®

WORKERS' COMPENSATION REINSURANCE ASSOCIATION®

2007 ANNUAL REPORT

Accurate

Complete

Timely

ACT: Accurate, Complete, and Timely

In order for the WCRA to optimize its reinsurance services to all of its members, we all must strive to ***ACT*** in an ***accurate***, ***complete***, and ***timely*** manner when providing information to each other.

The business partnership that the WCRA shares with its members is unique. It is the responsibility of both the WCRA and its members to ensure that the data used for premium calculations and claim reimbursements is in good order, or the membership as a whole is negatively impacted. Two recent events demonstrate the significant consequences when there are breakdowns in our information-sharing responsibilities.

During 2006, we learned that, over a five-year period, several members had inadvertently failed to report a significant number of incurred claims to the Association in a timely way. These claims were reported to us in late 2006 and early 2007. The immediate consequences were a $41 million increase in WCRA prior accident year loss reserves and an overall WCRA rate increase of 15 percent in 2008, with further projected 15 percent increases in both 2009 and 2010.

During 2007, the WCRA was compelled to initiate litigation against a large insurer member to recover millions of dollars in premiums that evidence indicates the member deliberately underpaid to the Association over many years. The consequence of this conduct was that all other WCRA members paid higher premiums than they should have.

Over the past year, we have added new staff in our premium and claims departments. Consistent with our commitment to providing high-quality services to our members, these new employees and our entire staff are available to answer questions, to provide you with information about the WCRA and its reinsurance program, and to make certain that we are all providing each other with the ***accurate***, ***complete***, and ***timely*** information necessary to ensure that all of the Association's members are treated fairly and equitably.

2007 Association Highlights

- The Association earned a 7 percent return on its investment portfolio, matching our target annual rate of return in a difficult financial market.

- After consulting with our members, we implemented an overall 15 percent premium rate increase as part of a three-year, phased-in rate adjustment necessitated by the underreporting of claims to the WCRA that occurred from 2001–2006.

- Our claims services staff processed 2,897 reimbursement requests from members for a record total of $66 million, and we added two new claims staff positions to improve services to members and strengthen our loss detection program.

- New payroll and premium reporting data requirements were implemented, and we are strengthening our premium audit program to confirm that members are reporting correctly and to ensure that all members are charged equitable and accurate premiums.

- The WCRA's rehabilitation resource database was expanded and made available to members, and we conducted educational seminars on home health care and catastrophic claims management. Seminar attendees included rehabilitation consultants, registered nurses, and members' claims staffs.

Special Recognition

In closing, we would like to recognize several individuals for their service to the Association. In 2007, Patricia Johnson of SFM and Mark Tansey of Berkley Risk Administrators Company retired from the WCRA Board of Directors, and Randall Holmberg retired as the Association's actuarial vice president. We greatly appreciated their dedication and valuable contributions to the WCRA.

Carl Cummins III

Carl W. Cummins III
WCRA President and CEO

David R. Young

David R. Young
WCRA Board Chair

Overview

In 2007, the WCRA experienced a challenging year financially. The Association recorded a comprehensive loss of $17 million and a corresponding increase in the balance sheet deficit. At December 31, 2007, the balance sheet deficit was $33 million, compared to a deficit of $16 million as of December 31, 2006. The comprehensive loss in 2007 was due primarily to an excess of current accident year losses and loss expenses over funded earned premiums.

The Board of Directors has a policy of maintaining a surplus band between +30 percent and -10 percent of the discounted funded loss reserve liability. The December 31, 2007 deficit of $33 million was -2 percent of funded loss reserves, a deterioration from -1 percent of funded loss reserves at December 31, 2006, but still well within the surplus band.

During 2007, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. For 2007, premiums collected, interest and dividends from investments, losses and loss expenses paid, and operating expenses were all in line with management's expectations. Following are financial highlights for 2007 and 2006.

($ millions)	2007	2006
Funded earned premiums	$ 43	$ 47
Comprehensive loss	$ (17)	$ (26)
Accumulated deficit	$ (33)	$ (16)
Investment return	7%	9%
Assumed investment return	7%	7%

Operating Results and Comprehensive Loss

PREMIUMS AND LOSSES

The WCRA earned $43 million in funded premiums in 2007, down from $47 million in 2006. This decrease was primarily due to prior year premium adjustments. In 2007, prior year adjustments resulted in return premiums of $.2 million, compared to prior year additional premiums of $2.7 million in 2006.

Funded losses and loss expenses incurred for 2007 were $149 million, down significantly from $185 million in the prior year. This decrease was due primarily to actuarial adjustments of prior accident year losses. In 2007, prior year loss reserves were reduced by $4 million due to favorable development on case reserves. In 2006, prior year loss reserves were increased by $41 million due to a larger-than-expected number of newly reported losses during the year. These newly reported losses resulted from the elimination of a significant reporting backlog at a limited number of WCRA members.

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

($ millions)	**2007**	**2006**
Prior accident years:		
Present value update	$ 92	$ 83
Actuarial adjustments	(4)	41
Total prior accident years	88	124
Current accident year	61	61
Total funded losses and loss expenses incurred	$149	$185

INVESTMENT PERFORMANCE

The investment portfolio had a total rate of return of 7 percent in 2007, matching the assumed rate of return, but down from a return of 9 percent in 2006. Deteriorating economic conditions, including a decline in the housing market and subprime mortgage problems, had a significant impact on the financial markets in 2007. Returns on domestic and international equities were lower. In 2007, the WCRA's domestic equities returned 7 percent and international equities returned 12 percent. In 2006, domestic equities returned 9 percent and international equities returned 25 percent. The components of investment results are shown below.

($ millions)	**2007**	**2006**
Investment income, net of related expenses	$ 37	$ 34
Net realized investment gains	62	74
Change in unrealized gains on securities	(8)	5
Total investment results	$ 91	$113

In 2007, the *WCRA Investment Policy* included asset allocation targets of 45 percent for domestic equities, 15 percent for international equities, and 40 percent for fixed income investments. In 2006, the asset allocation targets were 50 percent for domestic equities, 10 percent for international equities, and 40 percent for fixed income investments.

COMPREHENSIVE LOSS

The WCRA recorded a comprehensive loss of $17 million in 2007, an improvement from the comprehensive loss of $26 million recorded in 2006. Comprehensive income (loss) consists of net income (loss) and the change in unrealized gains (losses) on investments. In 2007, the comprehensive loss was due to the excess of current accident year losses of $61 million over earned premiums of $43 million.

The elimination of the loss reporting backlog resulted in an increase in 2007 losses, and a corresponding shortfall in 2007 rates and earned premiums. For 2006, the comprehensive loss was driven by an increase in loss reserves for both prior and current accident years, resulting from the elimination of the loss reporting backlog.

Balance Sheet

ASSETS AND LIABILITIES

Total assets were $1,942 million at December 31, 2007 compared with $1,764 million at the end of the previous year. The increase in total assets was due primarily to an increase in investments, including securities lending collateral.

Total liabilities were $1,975 million at December 31, 2007 compared with liabilities of $1,780 million at December 31, 2006. The increase in liabilities was due primarily to an increase in funded and unfunded loss and loss expense reserves.

The WCRA's largest liability is the reserve for funded losses and loss expenses. This liability totaled $1,426 million at December 31, 2007 compared with $1,342 million at December 31, 2006. This liability represents the present value, discounted at 7 percent, of the total estimated obligation for losses and loss expenses for unpaid amounts up to the prefunded limit. Because this liability involves claims that will be paid out over a period of many years, judgments as to the ultimate exposure are an important component of the loss reserving process. Reserves are reviewed on a regular basis using a variety of actuarial techniques. They are adjusted based on loss experience and as new information becomes available. Changes in the discounted liability for funded losses and loss expenses are shown below.

($ millions)	**2007**	**2006**
Funded reserves as of January 1	$1,342	$1,216
Losses and loss expenses incurred:		
Prior accident years	$ 88	$ 124
Current accident year	61	61
Total incurred	149	185
Losses and loss expenses paid	(65)	(59)
Funded reserves as of December 31	$1,426	$1,342

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

The liability for unfunded losses and loss expenses totaled $183 million at December 31, 2007 compared with $170 million at December 31, 2006. This liability represents the present value, discounted at 7 percent, of the total estimated obligation for losses and loss expenses for unpaid amounts in excess of the prefunded limit. In both 2007 and 2006, the increase in this liability was driven by the present value update and reserves for the current accident year. Unfunded deferred premium revenue of $15 million and $16 million was recognized in 2007 and 2006, respectively, concurrent with the changes in incurred unfunded losses and loss expenses. Loss payments in excess of prefunded limits totaled $1 million and $.8 million in 2007 and 2006, respectively.

DEFICIT

At year-end 2007, the WCRA had an accumulated deficit of $33 million compared with a deficit of $16 million at the end of 2006. This $17 million increase was due primarily to an excess of current accident year losses and loss expenses over funded earned premiums. The Board of Directors has a policy objective of maintaining a surplus band between +30 percent and -10 percent of the discounted funded loss reserve liability. The December 31, 2007 deficit was -2 percent of funded reserves, compared to a deficit of -1 percent of funded reserves at December 31, 2006.

Cash Flow

During 2007, the WCRA maintained adequate liquidity and continued to meet all of its financial obligations. Cash flow from operating activities was $12 million in 2007, compared with $26 million in 2006. This $14 million decrease in operating cash flow was due primarily to the combination of a decrease in premiums collected and an increase in losses and loss expenses paid. The decrease in premiums collected was due to the elimination of terrorism reinsurance coverage and a decline in premiums from prior year adjustments.

Net realized gains on the sale of investments are not reported as part of net cash provided by operating activities. However, net realized investment gains provide an additional planned source of cash flow to fund the operations of the Association. Net realized investment gains were $62 million in 2007 and $74 million in 2006.

WCRA Board of Directors

Back row, left to right:

David Hennes (*The Toro Company*); Donald Gerdesmeier (*Minnesota D.R.I.V.E.*); Robert Ditmore (*The Travelers Companies, Inc.*); Robert Lund (*SFM*); Howard Bicker (*Minnesota State Board of Investment*); Raymond Waldron (*Minnesota AFL-CIO*); Peter Sausen (*Minnesota Department of Finance*)

Front row, left to right:

David Young, Chair (*Wausau Insurance Companies*); Gary Swoverland (*Land O'Lakes, Inc.);* Michele Spencer (*Ecumen*); Allison Waggoner (*DCI, Inc.*); Wayne Simoneau (*Public Representative*)

Not pictured:

Stuart Henderson (*Western National Insurance Group*)

A Trusted Partner
Serving Minnesota
Since 1979

WCRA Senior Management

Back row, left to right:

Donald J. Swanson
Vice President—Finance/Investments and Treasurer

Carl W. Cummins III
President and CEO

Cynthia M. Smith
Vice President—Operations and Secretary

Front row, left to right:

James A. Heer
Actuarial Vice President

Elisabeth M. Skoglund
Vice President—Claims/Information Systems

WCRA VISION

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

WCRA MISSION

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

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of operations, comprehensive income and accumulated deficit and of cash flows present fairly, in all material respects, the financial position of the Workers' Compensation Reinsurance Association (the "Association") at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 27, 2008

Workers' Compensation Reinsurance Association
Balance Sheets
December 31, 2007 and 2006

(in thousands of dollars)		2007		2006
Assets				
Investments, at market value				
Cash and cash equivalents (including securities lending collateral of $262,703 and $199,685 at December 31, 2007 and 2006, respectively)	**$**	**301,855**	$	249,127
Short-term		**2,630**		1,714
Common and preferred stock		**814,521**		794,025
Bonds		**610,497**		520,473
Total investments		**1,729,503**		1,565,339
Uncollected reinsurance premiums				
Current premiums due		**520**		29
Deferred for unfunded losses		**182,954**		169,124
Total uncollected reinsurance premiums		**183,474**		169,153
Accrued investment income		**4,737**		4,128
Due from securities brokers		**23,757**		24,632
Prepaid expenses and other assets		**283**		219
Property and equipment, less accumulated depreciation of $738 and $720 at December 31, 2007 and 2006, respectively		**59**		82
Total assets	**$**	**1,941,813**	$	1,763,553
Liabilities and Accumulated Deficit				
Liabilities				
Losses and loss expenses				
Funded	**$**	**1,426,221**	$	1,342,320
Unfunded		**183,064**		169,528
Total losses and loss expenses		**1,609,285**		1,511,848
Payable under securities loan agreement		**263,977**		199,685
Due to securities brokers		**99,874**		67,590
Accounts payable and other liabilities		**2,054**		462
Total liabilities		**1,975,190**		1,779,585
Accumulated deficit from operations		**(170,479)**		(161,049)
Accumulated other comprehensive income		**137,102**		145,017
Designated accumulated deficit (Note 2)		**(33,377)**		(16,032)
Total liabilities and accumulated deficit	**$**	**1,941,813**	$	1,763,553

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

Workers' Compensation Reinsurance Association
Statements of Operations, Comprehensive Income and Accumulated Deficit
Years Ended December 31, 2007 and 2006

(in thousands of dollars)	**2007**	**2006**
Revenues		
Reinsurance premiums		
Funded earned	**$ 42,775**	$ 46,668
Unfunded deferred	**14,610**	15,842
Investment income, net of related expenses	**36,819**	34,481
Net realized investment gains	**62,169**	73,523
Total revenues	**156,373**	170,514
Expenses		
Losses and loss expenses		
Funded	**148,807**	184,616
Unfunded	**14,610**	15,842
Losses and loss expenses incurred	**163,417**	200,458
Operating and administrative expenses	**2,386**	1,649
Total expenses	**165,803**	202,107
Net loss	**(9,430)**	(31,593)
Other comprehensive income (loss)		
Change in net unrealized gains on securities and foreign currency translation adjustment (Note 3)	**(7,663)**	5,090
Comprehensive loss	**(17,093)**	(26,503)
Pension benefit obligation (Note 5)	**(252)**	-
Accumulated (deficit) surplus, beginning of year	**(16,032)**	10,471
Accumulated deficit, end of year	**$ (33,377)**	$ (16,032)

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

Workers' Compensation Reinsurance Association
Statements of Cash Flows
Years Ended December 31, 2007 and 2006

(in thousands of dollars)	**2007**	**2006**
Cash flows from operating activities		
Net premiums collected	**$ 43,959**	$ 52,792
Interest and dividends received, net of related expenses	**36,021**	34,487
Losses and loss expenses paid	**(65,980)**	(59,458)
Operating and administrative expenses paid	**(1,974)**	(1,569)
Net cash provided by operating activities	**12,026**	26,252
Cash flows from investing activities		
Sale of investments		
Short-term and securities lending collateral	**(2,190)**	(827)
Common and preferred stocks	**778,798**	634,246
Bonds	**1,031,002**	510,269
Purchase of investments		
Common and preferred stocks	**(743,876)**	(603,075)
Bonds	**(1,087,314)**	(567,941)
Purchase of equipment	**(10)**	(27)
Net cash used in investing activities	**(23,590)**	(27,355)
Cash flows from financing activities		
Collateral for securities on loan	**64,292**	199,685
Net cash provided by financing activities	**64,292**	199,685
Net increase in cash and cash equivalents	**52,728**	198,582
Cash and cash equivalents		
Beginning of year	**249,127**	50,545
End of year	**$ 301,855**	$ 249,127

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

1. General Information

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

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

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

Retention Limits
For 2007, members selected one of three maximum per-loss occurrence retention limits, which were $400,000, $800,000 or $1,600,000. For 2006, members selected one of three maximum per-loss occurrence retention limits, which were $390,000, $780,000 or $1,560,000. Retention limits are determined annually based on a formula prescribed in the Enabling Act. Minnesota workers' compensation losses incurred by members in excess of the retention limit selected are reinsured by the Association.

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

- The present value of the estimated ultimate liability for members' incurred losses above the selected retention limit up to and including the prefunded limit of $8.0 million and $7.8 million per occurrence for 2007 and 2006, respectively, for funded losses reinsured by the Association.

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

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

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

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

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

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

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

2. Summary of Significant Accounting Policies

Use of Estimates

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

Risks and Uncertainties

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

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

Comprehensive Income

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

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

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

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

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

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

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

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

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

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

Reinsurance Premiums
Funded earned reinsurance premiums are for the calendar year coverage period for funded losses (losses up to and including the prefunded limit). These premiums are billed in the current period. The reinsurance premiums for the calendar year may also include a credit or charge to equitably distribute excess or deficient premiums for previous periods, including any excess or deficient premiums resulting from a retroactive change in the prefunded limit. No excess or deficient premiums were distributed or collected in 2007 or 2006.

Unfunded deferred reinsurance premiums are to be billed in future years for unfunded losses (loss amounts in excess of the prefunded limit) incurred during the calendar year coverage period and are recognized as earned revenue concurrent with the related unfunded losses and loss expenses. Reinsurance premiums for unfunded losses are billed to the members of the Association in the calendar year when payments in excess of prefunded limits are expected to be reimbursed by the Association. The Association began billing for losses in the unfunded layer in 2003. Premiums of $780,000 and $1,285,000 were billed in 2007 and 2006, respectively.

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

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

New Accounting Pronouncements
In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurement*, which defines fair value, establishes a framework for measuring fair value and expanded disclosures about fair value measurements. Companies are required to adopt the new standard for fiscal periods beginning after November 15, 2007. The Association is evaluating the impact of this standard and does not expect it will have a material impact on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, effective for companies beginning on January 1, 2008. This statement provides entities with an option to report selected financial assets and liabilities at fair value, with the objective to reduce both the complexity in accounting for financial instruments and the volatility in earnings cased by measuring related assets and liabilities differently. The Association does not expect to adopt this standard due to the nature of its business.

3. Investments

The cost of common and preferred stocks, amortized cost of bonds, and estimated fair values at December 31, 2007 and 2006, are as follows:

(in thousands of dollars)	**2007** Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term and securities lending collateral	**$ 266,324**	**$ 2**	**$ (993)**	**$ 265,333**
Common stocks	**$ 677,647**	**$ 156,446**	**$ (21,628)**	**$ 812,465**
Preferred stocks	**1,948**	**108**	**-**	**2,056**
Total stocks	**$ 679,595**	**$ 156,554**	**$ (21,628)**	**$ 814,521**
U.S. Treasury securities and obligations of U.S. government and agencies	**$ 164,458**	**$ 8,515**	**$ (1,292)**	**$ 171,681**
Corporate debt securities	**243,830**	**4,558**	**(8,952)**	**239,436**
Mortgage backed securities	**198,790**	**1,321**	**(731)**	**199,380**
Total bonds	**$ 607,078**	**$ 14,394**	**$ (10,975)**	**$ 610,497**

(in thousands of dollars)	**2006** Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term and securities lending collateral	$ 201,399	$ -	$ -	$ 201,399
Common stocks	$ 649,639	$ 152,937	$ (10,591)	$ 791,985
Preferred stocks	1,948	92	-	2,040
Total stocks	$ 651,587	$ 153,029	$ (10,591)	$ 794,025
U.S. Treasury securities and obligations of U.S. government and agencies	$ 36,950	$ 1,561	$ (320)	$ 38,191
Corporate debt securities	252,882	4,725	(2,747)	254,860
Mortgage backed securities	228,062	1,663	(2,303)	227,422
Total bonds	$ 517,894	$ 7,949	$ (5,370)	$ 520,473

Total unrealized losses were $33.6 million and $15.9 million at December 31, 2007 and 2006, respectively. The following tables provide a breakdown of unrealized losses at December 31, 2007 and 2006. The Association has reviewed the components and duration of these unrealized losses and concluded that the losses are temporary in nature. The unrealized losses are primarily on common stocks. The unrealized losses for stock holdings and bond holdings as of December 31, 2007 and 2006, are as follows:

	Unrealized Holding Losses as of December 31, 2007					
	Less than 12 months		12 months or more		Total	
(in thousands of dollars)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Short-term and securities lending collateral	**$ 257,612**	**$ (993)**	$ -	$ -	**$ 257,612**	**$ (993)**
Common stocks	**$ 269,275**	**$ (21,628)**	**$ -**	**$ -**	**$ 269,275**	**$ (21,628)**
Preferred stocks	**-**	**-**	**-**	**-**	**-**	**-**
Total stocks	**$ 269,275**	**$ (21,628)**	**$ -**	**$ -**	**$ 269,275**	**$ (21,628)**
U.S. Treasury securities and obligations of U.S. government and agencies	**$ 21,403**	**$ (1,292)**	**$ -**	**$ -**	**$ 21,403**	**$ (1,292)**
Corporate debt securities	**95,913**	**(5,876)**	**46,342**	**(3,076)**	**142,255**	**(8,952)**
Mortgage backed securities	**48,021**	**(224)**	**31,657**	**(507)**	**79,678**	**(731)**
Total bonds	**$ 165,337**	**$ (7,392)**	**$ 77,999**	**$ (3,583)**	**$ 243,336**	**$ (10,975)**

	Unrealized Holding Losses as of December 31, 2006					
	Less than 12 months		12 months or more		Total	
(in thousands of dollars)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Common stocks	$ 87,219	$ (10,366)	$ 5,328	$ (225)	$ 92,547	$ (10,591)
Preferred stocks	-	-	-	-	-	-
Total stocks	$ 87,219	$ (10,366)	$ 5,328	$ (225)	$ 92,547	$ (10,591)
U.S. Treasury securities and obligations of U.S. government and agencies	$ 7,897	$ (320)	$ -	$ -	$ 7,897	$ (320)
Corporate debt securities	105,174	(1,499)	32,710	(1,248)	137,884	(2,747)
Mortgage backed securities	152,895	(2,064)	12,316	(239)	165,211	(2,303)
Total bonds	$ 265,966	$ (3,883)	$ 45,026	$ (1,487)	$ 310,992	$ (5,370)

The amortized cost and estimated fair value of debt securities at December 31, 2007, by contractual maturity, are shown below:

(in thousands of dollars)	Amortized Cost	Estimated Fair Value
Due in one year or less	**$ 6,462**	**$ 9,195**
Due after one year through five years	**89,819**	**92,465**
Due after five years through ten years	**81,905**	**83,972**
Due after ten years	**428,892**	**424,865**
	$ 607,078	**$ 610,497**

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

During 2007, the Association made a determination that the decline in the fair value of certain of its investments was other than temporary. As a result of this determination, the cost bases of the individual securities were written down to fair value as the new cost bases, and the total amount of the write-down of approximately $10.7 million was recorded in earnings as a realized loss. The Association also wrote down $.2 million of individual securities to fair value in 2006.

Other comprehensive income in 2007 and 2006 is comprised of the change in unrealized gains (losses) on available-for-sale securities arising during the year and the impact of foreign currency translation adjustments on securities denominated in currency other than U.S. dollars as follows:

(in thousands of dollars)	**2007**	2006
Change in net unrealized gains on securities	**$ (14,297)**	$ (1,455)
Foreign currency net translation gain (loss)	**6,634**	6,545
Total other comprehensive income (loss)	**$ (7,663)**	$ 5,090

(in thousands of dollars)	**2007**	2006
Accumulated other comprehensive income consists of		
Net unrealized gains on securities	**$ 124,357**	$ 138,655
Foreign currency translation gain (loss)	**12,997**	6,362
Pension benefit obligation	**(252)**	-
	$ 137,102	$ 145,017

Gross gains of $169 million and $134 million, and gross losses of $107 million and $60 million, were realized on sales of investments during 2007 and 2006, respectively. Net investment income and net realized investment gains (losses) during the years ended December 31, 2007 and 2006, are summarized below:

	Net Investment Income		**Net Realized Gains (Losses)**	
(in thousands of dollars)	**2007**	**2006**	**2007**	**2006**
Cash and cash equivalents	**$ 2,441**	$ 3,395	**$ 3,657**	$ 80
Common and preferred stocks	**12,565**	12,024	**61,533**	75,384
Bonds	**26,623**	23,646	**(2,579)**	(1,941)
Securities lending	**13,184**	8,042	**(442)**	-
Miscellaneous	**286**	341	**-**	-
	55,099	47,448	**$ 62,169**	$ 73,523
Investment expenses	**(5,645)**	(5,150)		
Securities lending interest expense	**(12,478)**	(7,713)		
Securities lending bank fees	**(157)**	(104)		
	$ 36,819	$ 34,481		

In 2007, net realized gains consisted of gains on securities of approximately $58 million and foreign currency translation gain of $4 million. In 2006, net realized gains consisted of gains on securities of approximately $73 million and foreign currency translation gain of $1 million.

To enhance the return on investments, the Association maintains a securities lending program. At December 31, 2007, the Association had equity and fixed income securities with fair values of $258 million on loan. At December 31, 2006, the Association had equity and fixed income securities with fair values of $194 million on loan. Cash of 102% of the fair value of the securities lent was held as collateral as part of the securities lending program.

The Association reflects the collateral received for securities on loan on the balance sheet if the Association has control over the collateral. An asset of approximately $263 million and $200 million, and the related liability representing the collateral received of $264 million and $200 million, are reflected on the balance sheet at December 31, 2007 and 2006, respectively. In 2007, the Association made a determination that a decline in the fair value of certain collateral investments was other than temporary, and a write down of approximately $.4 million was recorded in earnings as a realized loss. In addition, an unrealized loss of $.8 million was recorded to reflect a decline in fair value of collateral investments believed to be temporary.

4. Liabilities for Losses and Loss Expenses

The liability for losses and loss expenses at December 31, 2007 and 2006, is summarized as follows:

(in thousands of dollars)	**2007**	2006
Funded, undiscounted	**$ 5,749,270**	$ 4,977,105
Discount	**(4,323,049)**	(3,634,785)
Funded, discounted	**1,426,221**	1,342,320
Unfunded, undiscounted	**1,736,590**	1,414,041
Discount	**(1,553,526)**	(1,244,513)
Unfunded, discounted	**183,064**	169,528
Total, discounted	**$ 1,609,285**	$ 1,511,848

Funded Liabilities

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

(in thousands of dollars)	**2007**	2006
Balance at January 1		
Funded, undiscounted	**$ 4,977,105**	$ 4,128,080
Incurred related to		
Current year	**360,357**	337,895
Prior years	**476,714**	569,773
Total incurred	**837,071**	907,668
Paid related to		
Current year	**41**	164
Prior years	**64,865**	58,479
Total paid	**64,906**	58,643
Balance at December 31		
Funded, undiscounted	**5,749,270**	4,977,105
Discount	**(4,323,049)**	(3,634,785)
Funded, discounted	**$ 1,426,221**	$ 1,342,320

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

The following table compares the present value of the Association's funded reserve changes during 2007 with those of 2006.

	2007	**2006**
Discount rate at year end	**7.0%**	7.0%
(in thousands of dollars)	**2007**	**2006**
Funded reserves as of prior year end	**$ 1,342,320**	$ 1,216,346
Prior year impact of actuarial adjustments	**(4,145)**	40,344
Payments on prior accident years	**(64,865)**	(58,479)
Present value update	**91,692**	83,098
Reserves for current accident year	**61,219**	61,011
Total calendar year funded reserve changes	**83,901**	125,974
Funded reserves as of year end	**$ 1,426,221**	$ 1,342,320

The increase in undiscounted reserves was primarily due to a change in the Association's mortality factors. The majority of the Association's claimants receive lifetime medical and indemnity payments. Rather than solely relying on the most recent mortality table, the new mortality factors reflect the expected future improvement in mortality as projected by the Social Security Administration. The discounted reserves are less impacted because the longer payment periods are offset by higher discount factors.

In 2007, the reduction in prior years' loss reserves was due primarily to favorable development on case reserves. In 2006, the elimination of a significant loss reporting backlog at a limited number of Association members resulted in a significant increase in prior years' loss reserves

Unfunded Liabilities
Payments on prior accident years in excess of prefunded limits totaled $1,074,000 and $815,000 in 2007 and 2006, respectively. Anticipated payments in excess of prefunded limits are billed as premiums for the unfunded layer.

The unfunded reserve methodology follows the funded analysis. Discount rates for unfunded reserves are the same as the funded reserves. The table below compares the present value unfunded reserve changes during 2007 with those of 2006.

(in thousands of dollars)	**2007**	**2006**
Unfunded reserves as of prior year end	**$ 169,528**	$ 154,502
Prior year changes		
Prior year impact of actuarial adjustments	**(4,048)**	(3,765)
Payments on prior accident years	**(1,074)**	(815)
Present value update	**11,830**	10,786
Reserves for the current accident year	**6,828**	8,820
Total calendar year unfunded reserve changes	**13,536**	15,026
Unfunded reserves as of year end	**$ 183,064**	$ 169,528

The prior year impact of actuarial adjustments in 2007 resulted from changes in mortality factors, discount factors, and loss development updates. In 2006, the prior year impact of actuarial adjustments resulted from a slowdown in the expected timing of future payments.

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

5. Employee Benefit Plans

Defined Benefit Plan
The Association has a non-contributory benefit pension plan that covers employees who meet eligibility and entry date requirements. The Association uses a December 31 measurement date. The plan's current investment mix includes 68% equities and 32% debt securities. The determination of the long-term rate of return on plan assets was based on historical rates of return and future estimated returns for the individual assets classes. Based on the target allocation, the overall long-term rate of return for the plan is 8%.

(in thousands of dollars)	**2007**
Benefit obligation at end of year	**$ 1,978**
Fair value of the plan assets at the end of the year	**1,726**
Funded status (recognized as a component of accrued liabilities and accumulated comprehensive income)	**$ (252)**

Employer contributions	$	**130**
Discount rate		**6.47%**
Expected return on plan assets		**8.00%**
Rate of compensation increase		**4.00%**

Effective December 31, 2007, the Association adopted SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87,88, 106 and 132(R)*. This statement requires recognition of the overfunded or underfunded status of defined benefit plans as an asset or liability in the balance sheet and to recognize the changes in that funded status in comprehensive income in the year the changes occur.

Defined Contribution Plan

The Association sponsors a defined contribution plan, which covers employees who meet the plan's eligibility requirements and have completed the service requirements, under Section 401(k) of the Internal Revenue Code. Participants can contribute a certain percentage of their compensation (subject to annual contribution limits) to the plan. The Association will match a maximum of 6% of participant contributions. The Association's matching contribution to the plan was $94,726 and $93,095 in 2007 and 2006, respectively.

6. Income Tax Status

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

7. Cash Flows

A reconciliation of net loss to net cash provided by operating activities for the years ended December 31, 2007 and 2006, is as follows:

(in thousands of dollars)		**2007**		**2006**
Net loss	**$**	**(9,430)**	$	(31,593)
Adjustments to reconcile net loss to net cash provided by operating activities				
Net realized investment gains		**(62,169)**		(73,523)
(Increase) decrease in funded uncollected reinsurance premiums, net of accrued premium adjustments		**(491)**		4,838
Increase in liability for funded losses and loss expenses		**83,901**		125,974
Other, net		**215**		556
Total adjustments		**21,456**		57,845
Net cash provided by operating activities	**$**	**12,026**	$	26,252

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

8. Contingency

During 2007, the Association filed a lawsuit against American International Group ("AIG") in federal court charging that AIG has understated its workers' compensation premiums in Minnesota since 1985. The lawsuit seeks to recover unpaid reinsurance premiums, lost investment income, and damages for violations of the Federal Racketeer Influenced and Corrupt Organizations Act.

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