SAIF CORPORATION

Surplus - The combined capital and surplus of any insurer is called retained earnings and represents the net worth of that company: the difference between its assets and liabilities. The items affecting the capital and surplus accounts are:

a. Net Income - Represents the net results of the current year's operations. These operations include the company's net underwriting gain or loss, and other income less dividends to policyholders incurred and less federal and foreign income taxes incurred. The net investment income reflects only realized capital gains or losses. SAIF Corporation pays no federal or foreign income tax.

b. Net Unrealized Capital Gains or Losses - This represents the change in the investment portfolio from one accounting period to the next. It is an analysis of the values of common and preferred stocks (market vs. book) and the bond portfolio (amortized).

c. Change in Non-Admitted Assets - This represents the reduction in surplus by the sum of the items that are of a questionable value. Some of these items are: agent's balances or uncollected premiums more than ninety days past due, furniture and fixtures, automobiles, and travel advances.

d. Other - There are various other adjustments that affect a carrier's surplus account. In the case of SAIF Corporation, the above categories are the principal adjustments to their surplus account. However, in 1980 a surplus gain of $28,130,607 was recorded and identified as "Adjustments for periods prior to 1980 - cumulative net".

The cumulative effect on the capital and surplus accounts of SAIF Corporation of the various adjustments during 1979 to 1981 is summarized as follows:

	1979	1980	1981
Surplus - Beginning	71,253,833	115,696,709	179,887,951
Surplus - Ending	115,696,709	179,887,951	182,106,631
Gain (Loss)	44,442,876	64,191,242	2,218,680

The major impact in a period of three years of the tremendous gain in surplus ($110,852,798) came from the following sources:

	1979	1980	1981
Net Underwriting Gain	$ 4,312,997	$42,842,497	$26,367,931
Net Investment Income	72,215,911	63,188,667	48,999,518
Net Realized Gain	7,919,950	8,597,064	1,883,265
Finance & Service Charges	1,400,009	1,693,813	1,253,365

After dividends to policyholders, the net income for each of the three years is:

1979	40,796,412
1980	72,351,682
1981	25,996,256

Note: SAIF Corporation pays no federal income taxes on net income.

Trade Ratio - A meaningful ratio is the relationship of premiums to policyholder surplus. From a regulatory standpoint, most insurance departments expect this ratio to be held below 3- to -1, premiums written to surplus. Many financial experts advocate that this ratio be held to 2- to -1. According to Best's Key Rating Guide, surplus is a safety factor to absorb increases above normal in loss and expense requirements or shrinkage in the value of investments. Character of assets and maintenance of proper claim reserves are of great importance. In effect, it is a safety valve to absorb the shock of unfavorable operating results. The safety valve formula, as indicated above, is commonly referred to as the relationship of premiums to surplus. A ratio of 3- to -1 is considered to be a reflection of a very solvent financial institution. These quantititave measurements, however, are tempered by other considerations. The surplus of an insurer is, therefore, directly related to claim reserve adequacy, underwriting profitability, equity in reserves, soundness of and return on investments, management, etc.

The following table will summarize the relation of earned premium to surplus as reported in SAIF's annual statement to the Insurance Department:

	1979	1980	1981
Earned Premium	222,195,463	223,195,463	157,150,931
Surplus	115,696,709	179,887,951	182,106,631
Ratio	1.92- to -1	1.24- to -1	.86- to -1

Assuming that SAIF Corporation has exercised sound claims reserving practices, has generated underwriting profits, and has a sound investment policy, the following exhibit demonstrates what the surplus requirements would be at writings to surplus ratios of 3- to 1 and 2- to 1 and shows the excess surplus of SAIF's surplus account as of 12-31-81:

	3- to 1	2- to 1
Earned Premium	157,150,931	157,150,931
Surplus	52,331,260	78,575,466
Excess Surplus	129,775,371	103,531,165

The proposed $81 million diversion of SAIF's surplus does not appear to impair its financial stability. The resultant premium writings to surplus ratio based on 12-31-81 reported figures would be 1.55- to -1 ($157,150,931/ 101,106,631).

Loss Reserves - As reported in SAIF's 1981 annual report, the provisions for unpaid benefits and loss adjustment expenses for injured workers was $590,072,884 and $35,138,430, respectively. These are funded liabilities. Therefore, the surplus account is not impaired by benefits paid to injured workers unless the losses have been improperly funded or other unknowns such as inflation, economic conditions, rate of recovery, increase in litigation, etc., adversely affect the reserves. With a writings to surplus ratio of under 2- to -1, such contingencies appear to be more than adequately financed. Benefit payments to injured workers are not jeopardized.

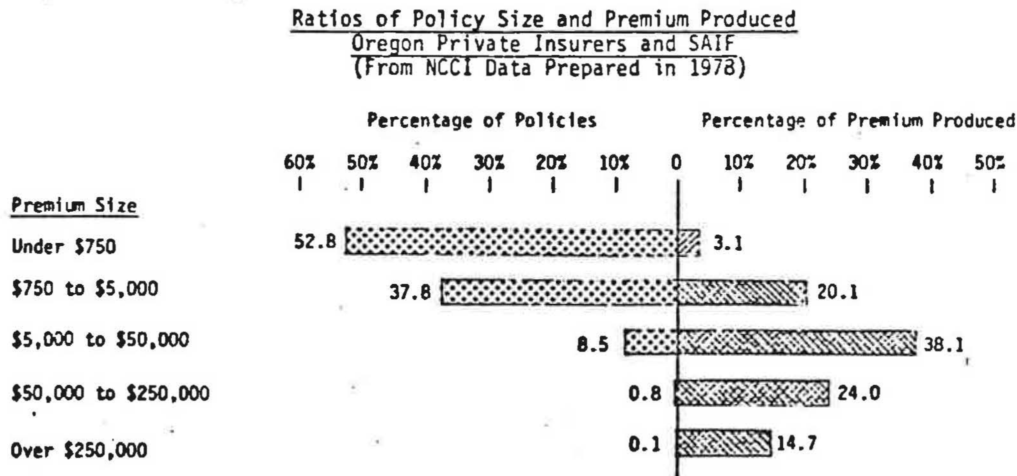
Policyholder Dividends - The amount of dividends to policyholders is a deduction in arriving at net income. The deductible figure is normally calculated on an incurred basis. Incurred for the current year means the dividends paid during the current year, plus those accrued as of the end of the year, less those accrued as of the end of the preceding year. Dividends to policyholders are amounts returned to policyholders where the amount is not fixed or guaranteed in the insurance contract but depends upon the experience of the company and the amount declared by the Board of Directors. Dividend reserves or accruals are established by management based on the type or types of dividend plans sold by the company and the amount of eligible premium subject to approval by the Board of Directors.

Dividends declared and paid in one accounting period are generally made on policies that have already expired in a prior accounting period or periods. In other words, it is very probable that the dividends declared and paid by SAIF Corporation in 1982 were funded and accounted for as a budgetary item subject, of course, to approval by the Board of Directors and based upon the dividend plans sold by SAIF during prior accounting

periods. It is a question, therefore, whether additional or greater dividends have been considered or budgeted during 1982 in recognition of what has been called the accumulation of excess surplus.

Policyholder expectations can also present unique problems and questions. The accumulation of surplus can be attributed to a number of factors briefly mentioned earlier. It can be argued that all or a majority of the policyholders insured by SAIF since the introduction of the 3-way bill in 1966 have maintained and strengthened the financial position of the insurer. How would these employers be recognized and to what degree? If a distribution of the excess surplus were to be made, what eligibility criteria would be established? How would the dividend formula be determined? Would the distribution apply only to current SAIF policyholders?

For purposes of illustration, the table below which was taken from a report dated August 1, 1980 published by the Workers' Compensation Department shows the distribution of workers' compensation insurance policies by premium size. Although the data which was produced prior to 1979 has not been extended forward, it is still considered representative of today's distribution.



An analysis of this table indicates that 90.6 percent of the policies issued to Oregon employers are under $5,000 annual premium. This same 90 percent of the Oregon employers, however, account for only 23.2 percent of the total statewide premium. Conversely, over 76 percent of the statewide premium is accounted for by less than ten percent of the employer population.

This table may only be of interest as a means of obtaining from SAIF Corporation the historical dividend distribution of SAIF by premium size. It is not uncommon for an insurer to have a premium threshold for establishing

dividend eligibility. The expectations by employers of a dividend payment from the excess surplus may dramatically diminish with knowledge of the basic dividend eligibility policy. Furthermore, most dividend plans favor the larger employer with the exception of flat dividend programs that are made available for eligible employers above a predetermined annual premium.

As a final note on future dividend expectations of SAIF policyholders, the following observations are made. It is very unlikely that SAIF policyholders will be penalized by the Governor's proposal. SAIF will continue to be a very strong financial institution. This is evidenced by their writings to surplus ratio after the removal of $81 million dollars in surplus, 1.55- to -1. After the surplus withdrawal, SAIF Corporation will continue to enjoy the federal tax exemption. Surplus will likely continue to build. SAIF's aggressive marketing posture will not diminish. Their capability to maintain and increase market share continues to be fully capitalized.

Rates - Rate levels in both SAIF Corporation and SAIF of Oregon are unlikely to be affected for the same arguments presented under the discussion of dividends. SAIF Corporation's current rate level under the Oregon Modified File and Use Statute is approximately 15 percent less than what would have been the rate level filed by the National Council on Compensation Insurance (if the NCCI were still the filing agency). Generally, SAIF Corporation is the market for the smaller employer and the larger ($200,000 and above) employer written under a cash flow or deferred billing program. Dividend representations are being made in this company.

The rate level in SAIF Corporation of Oregon is about 30 percent less than what would have been the rate level of the NCCI. This market, based on SAIF of Oregon's introduction into the Oregon marketplace, was designed to attract the medium to large size (25,000 - 100,000) policyholder. Dividend expectations in this market appear to be minimal or unlikely based on proposals made to employers.

The points to be made are twofold. First of all, the rate levels in each company are highly competitive. In all probability, these rate levels can be sustained unless the loss experience in Oregon deteriorates. A deteriorating statewide loss experience, however, will have an effect on all insurers since the NCCI will continue to promulgate advisory pure premium rates (rate level needed to pay future benefits). Carriers generally add their expense loading to the NCCI pure premium rate level.

The second major issue under the subject of rates brings the discussion back to future dividend expectations by Oregon employers under the file and use legislation. Comparisons were made of SAIF's rate levels under the new rate law with the rate level that would have been filed by the NCCI. SAIF's and any other private carrier's current dividend payments are being made subject to premiums paid by Oregon employers on the basis of rate levels in effect in 1979 and 1980 (prior to file and use). Dividend payments are generally made by the industry one year or more following the end of the employer's policy period.

The issue on dividends which is likely to be made by SAIF Corporation is that the payment of future dividends under the open rating law will be less. This is probably true. However, it is not the Governor's proposal that will impact future payouts. Under the open rating law, the margin for payment of dividends has been reduced (refer to above rate level comparisons). The reduced margin applies to all insurers.