# GOOD MAKES GOOD

# PINNACOL ASSURANCE
## 2010 Annual Report

Food Bank of the Rockies


Goodwill Industries of Denver

Pikes Peak Library District



PINNACOL
ASSURANCE

# GOOD MAKES GOOD

# INTRODUCTION



**By being good at what we do, Pinnacol Assurance enables thousands of businesses statewide to do good things for the people of Colorado.**

**This annual report provides a behind-the-scenes glimpse into the work of three important Colorado nonprofits and how Pinnacol helps them protect their employees. Our role is to deliver excellent service, safety education and claims management so these organizations can keep on giving.**

**These nonprofits are near to our hearts not only because they're our customers, but because they embrace the spirit of giving that is so central to Pinnacol's own values and culture.**

## Policyholder Profiles

### FOOD BANK OF THE ROCKIES

The Food Bank of the Rockies' mission is to fight hunger and feed hope among the needy of Northern Colorado and Wyoming. The organization collects food from all conceivable sources—restaurants, farmers, grocery stores—and distributes it to soup kitchens and other third-party hunger programs.


A Food Bank of the Rockies employee shelves donated food items.

In essence, they are a large-scale logistics and distribution machine that powers hundreds of smaller charities.

So how does workers' compensation insurance factor into such lofty aspirations? Enormously, according to Kevin Seggelke, president and CEO, Food Bank of the Rockies.

"We're stewards of donated assets, and we don't like to spend money on anything other than the distribution of food," Seggelke says. "So the safer and healthier our employees are, the more food we can distribute—because we're not using donated dollars on insurance claims."

The Food Bank's workers' comp policy not only protects its employees, but also brings the organization thousands of dollars in complimentary services each year, notes Gina Griego, Pinnacol Assurance claims representative.

"The Food Bank has access to our in-house nurses, legal staff and safety consultants—all for free," Griego says. "That's a tremendous benefit to a nonprofit organization."

One recent piece of advice was prehire essential-functions testing, recommended by Dana Foley, Pinnacol safety consultant. The program ensures that applicants have the basic physical strength and ability to do a job without inordinate risk of injury.

"The Food Bank has some unique challenges," Foley says. "Their employees have diverse responsibilities within an ever-changing environment. One day, they may be moving lots of small cans and boxes, and the next day unloading giant crates and truckloads of food. The organization also relies on a large base of untrained volunteers."

With so much at risk, planning for the inevitable is crucial—especially for a nonprofit organization, whose ability to serve could be crippled by the cost of one serious workplace injury.

"If I didn't have assurance that my potential liabilities were covered, that would keep me up at night," Marshall Aster, chief financial officer, Food Bank of the Rockies, says. "Having Pinnacol there, watching my back, helps me sleep."

## GOODWILL INDUSTRIES OF DENVER

For the employees of Goodwill Industries of Denver, a job is more than just a job. It's a steppingstone toward self-sufficiency and a better life.


A Goodwill Industries of Denver employee receives a donation.

"Our mission is to create opportunities for individuals to change their lives through the power of work," says Jesse Wolff, president and CEO, Goodwill Industries of Denver. "The adults we work with might be able to get off government assistance. The high school kids in our career-development program are better-prepared for the job market. And our disabled workers gain self-esteem.

"In the end, the community benefits greatly from all the things our participants do," Wolff says.

The nonprofit touches the lives of 30,000 people each year through its career counselors, who are imbedded in high schools across Denver; its welfare-to-work job placement services in Adams and Arapahoe counties; its sorting and packing jobs for the disabled; and its 31 retail stores and donation centers throughout the metro area.

Of Goodwill's 1,000 employees, most perform warehouse and backroom duties at the retail stores, involving heavy boxes, awkward objects, palettes and the operation of forklifts and trucks. The risk for injury is high, and accidents happen.

Because employees have so much riding on their jobs, financially and emotionally, the priority is to help them return to work quickly. Pinnacol Assurance Return-to-Work Specialist Amy Hughes helped Goodwill put a streamlined program into place.

"Amy has been tremendous for Goodwill," says Nora Rimando, safety coordinator, Goodwill Industries of Denver. "She was instrumental in developing the modified job descriptions we needed in order to bring employees back to work in temporary roles, quickly. That way, our employee doesn't lose wages or time."

Hughes says there are many creative opportunities in the "front of the house" to help ease injured employees back into a work environment. These included tagging and pricing clothing and sitting on the floor to organize books or videos.

"Goodwill has a real appetite for learning and for being the best they can be," Hughes says. "I really appreciate that about them."

Much like Pinnacol's own long history in Colorado, Goodwill's roots here date back to the early 1900s. What began as a support organization for returning World War I veterans and immigrants has expanded into a multichanneled strategy for ending the cycle of poverty across all ages and abilities.

"Pinnacol's contributions in the community are really important," CEO Wolff says. "But your willingness to partner with nonprofit policyholders, especially, allows both parties the opportunity to do a lot of good."

## PIKES PEAK LIBRARY DISTRICT

For the Pikes Peak Library District in El Paso County, Colorado, bringing information resources to the community has been a passion for more than 100 years. The District today operates two main libraries, 10 physical branches, one virtual branch and two mobile libraries that cater to the needs of children, teens, adults and seniors.

"We see ourselves as community builders," says John Courtney, associate director of support services and human resources, Pikes Peak Library District. "We try to lift up the community through all the resources we have, and it's very wonderful and complex."

Like most nonprofit organizations, the District depends heavily on donations. “We’re highly conscientious about doing the absolute most with what we have,” Courtney says. The organization is diligent in identifying ways to improve efficiency, patron services and even the work environment for its employees.

“We’ve built a culture here that’s familial, and we take care of our employees,” Courtney explains. “We want them to be able to go home to their families and work in their yards. If they’re hurt on the job, they’re not going to be able to do those things.”

Pinnacol Assurance has helped the District take a proactive approach to workplace safety. In recent years, the District experienced a huge increase in the number of electronic holds being put on books, according to Nancy Milvid, wellness and safety coordinator, Pikes Peak Library District. Staff worked harder and faster to fulfill the increased demand. Not surprisingly, injuries soared.

A “Toddler Time” class at Pikes Peak Library District.

“Fortunately, our Pinnacol safety consultant (Ellen Sarvay) knew exactly what to do,” Milvid says. “She guided us as we implemented a safety program, devised safety rules that were specific to our business, earned our workers’ compensation cost-containment certification, and instituted ergonomic testing.”

Once all the pieces were in place, the District saw a decrease in employee injuries almost immediately. Today they’re experiencing far fewer claims—costs are down and injuries are less severe.

“They’ve done an incredible job giving their employees the tools they need to stay healthy,” says Jeni Schietzelt, medical claims associate, Pinnacol Assurance. “I hope we allow workers’ comp to not be such a big part of what they need to do every day. That way, they can focus on serving the community.”

Courtney seems to validate that hope.

“I feel we’ve gotten very good support from Pinnacol,” Courtney says. “And our numbers show we’re doing much better this year … so thank you very much.”

# GOOD MAKES GOOD

## PRESIDENT'S MESSAGE



**Ken Ross**, President and Chief Executive Officer of Pinnacol Assurance

**As a workers' compensation insurance company, Pinnacol Assurance operates largely in the background of its policyholders' businesses, helping them prevent accidents, protect their employees and manage costs.**

**Granted, when someone gets hurt on the job, we move to the forefront, making sure that employee receives the care and compensation he or she needs. But for the most part, we are a quiet, supportive presence, offering:**

- **Personal and attentive customer service**
- **Unmatched safety training**
- **Efficient claims management**

### Good Makes Good

Being the best at what we do allows our nonprofit policyholders—organizations like Food Bank of the Rockies, Goodwill Industries of Denver and Pikes Peak Library District—to continue opening doors of opportunity for Coloradans, including some of our neediest citizens. With limited resources, these nonprofits need all hands on deck to meet the daily needs of those who depend on them. The absence of just one injured employee deals a disproportionate blow to these thinly staffed organizations. Fortunately, Pinnacol's safety resources are available, at no- or low-cost, to train policyholders on how to keep their employees safe and productive. We're proud to play a supporting role in the success of these much-needed nonprofits.

We also feel a special kinship with these organizations because their spirit of giving is so similar to our own. Pinnacol gives back to the Colorado communities that have supported us for 95 years, through:


Pinnacol employees put food items in boxes for the company's canned food drive.

- **Scholarships:** Since its inception a decade ago, the **Pinnacol Foundation** has provided well over $1 million in scholarships to the children of Colorado workers seriously injured or killed on the job—regardless of which insurance company handled the parent's claim.
- **Volunteer Time:** Pinnacol is a national leader in corporate volunteerism. In 2010, almost every Pinnacol employee—98 percent—volunteered with local nonprofit organizations on company time, through our employee-run ***Pinnacol in Action*** program.
- **Educational Partnerships:** While we've long supported Colorado kids through our volunteer efforts and scholarship program, we recently turned our attention to gaps in higher education, particularly the lack of risk management and insurance programs in the western U.S.

Throughout 2010, Pinnacol collaborated with the University of Colorado Denver Business School to develop curriculum for a new risk management and insurance program. We also provided $5 million, over seven years, to help establish the Pinnacol Assurance Center for Risk Management and Insurance Studies at the University of Colorado Denver Business School.

## Staying Focused on Our Customers

In 2010, our employees have continued to maintain a sharp focus on our customers. For example:

- Policyholder satisfaction is at an all-time high of 8.9 on a 10-point scale.
- Policyholder retention was a robust 92 percent.
- Premium rates decreased for the fifth year in a row, for a cumulative rate reduction of 50 percent. Rate reductions are, among other things, a sign that we are operating efficiently.

We also moved ahead on ambitious initiatives in 2010, such as our Health Risk Management Program, which is helping almost 18,000 of our policyholders' employees to live healthier, more active lives. Employers, in turn, benefit from fewer employee injuries, reduced workers' compensation and health insurance costs, and greater productivity on the job.

Fifty percent of all enrollees are actively participating in the program—an outstanding rate, considering the national average for wellness program participation is just 8 percent. Health coaching has been especially popular, with 20 percent of participants initiating conversations with a live coach.

Other 2010 achievements include our first-ever Bilingual Conference on Workplace Safety, which drew more than 200 construction workers and their supervisors. The conference included hands-on training in lab and classroom settings, with much of the instruction provided in Spanish.

In 2010, we also revamped our traditional safety seminars to better suit policyholders' needs. The results were two comprehensive Risk Management Symposiums, held in Denver and Grand Junction, which offered multiple classes in a consolidated format. These events were offered at no cost to our policyholders, and response was overwhelming.

## Looking Ahead

We anticipate that our Health Risk Management Program will reach its goal of 30,000 enrollees by late 2011. We also expect to double participation rates in 2011—that is, the number of enrollees who complete an annual health-risk assessment and seek assistance from a health coach. Our groundbreaking Risk Management Symposiums and Bilingual Conference will be offered again in 2011, reaching yet more policyholders and their employees with safety training they can put to use immediately.

I'd like to thank Food Bank of the Rockies, Goodwill Industries of Denver and Pikes Peak Library District for all that they do for Coloradans, for letting us share their stories in this report, and for allowing us to be part of something bigger than ourselves.

**Ken Ross**
President and Chief Executive Officer

# YEAR IN REVIEW



It's fair to say that, in 2010, we received mixed signals about Colorado's economic condition. Some indicators pointed toward a slow rebound, others toward stagnation. The only certainty is that our path to recovery remains tenuous.

Now more than ever, businesses need a workers' compensation insurance company they can count on. It's hard enough just staying in business these days. And with staffing cut to the bone, each employee is precious. That's why we hold ourselves to the highest standards in customer service, safety training, claims management and medical care coordination.

In the bigger picture, Pinnacol Assurance's stability translates into affordable rates and dividends—both of which contribute to a friendly business climate. In 2010, Colorado had the fifth-lowest workers' comp rates in the nation. In fact, we've decreased rates by more than 50 percent over the past five years. And for seven consecutive years, we've distributed dividends to eligible policyholders, pumping nearly $400 million back into the state's economy.

# 2010 Highlights

## FINANCIAL STABILITY

**Premium earned:** $345 million in 2010

**Premium rate reduction:** 9 percent reduction over 2009, saving business owners more than $33 million

## DIVIDEND DISTRIBUTIONS

**General dividends:** $47 million in 2010

## POLICYHOLDER SATISFACTION AND RETENTION

**Policyholder satisfaction:** 8.9 on a 10-point scale, an all-time high

**Policyholder retention:** 92 percent of customers kept their business with Pinnacol in 2010

## EMPLOYEE SATISFACTION

**"Best Place to Work" awards:** From the Great Place to Work® Institute and *ColoradoBiz* magazine

## COMMUNITY INVOLVEMENT

***Pinnacol in Action:*** 580 employees, or 98 percent of our staff, volunteered a total of 5,852 hours in 2010

**The Pinnacol Foundation:** 96 scholarships, totaling $290,250, awarded to the children of Colorado workers seriously injured or killed on the job

**Educational Partnerships:** $5 million donated, over seven years, to help establish the Pinnacol Assurance Center for Risk Management and Insurance Studies at the University of Colorado Denver Business School

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# FINANCIAL PERFORMANCE




***"My business has never had a workers' comp claim. So what am I getting for my premium?"***

**We hear this quite a bit at Pinnacol Assurance and throughout the industry, as workers' comp insurance is mandatory in most states. Small-business owners, in particular, question the connection between their premium dollars and benefits received.**

## Insurance: Defined

Insurance involves the pooling of similar types of risk and the transfer of that risk to a central entity, such as an insurance company. Customers pay a predictable premium in exchange for almost unlimited protection. When a "loss" occurs (in the case of workers' comp, an employee injury), the insurer provides a level of compensation that often exceeds the amount of premium paid.

Without workers' compensation insurance, a small business could be wiped out by a single severe injury or fatality.

## The Value of "Peace of Mind"

- Protection for something that's of great value, the well-being of employees
- Assurance that if something bad happens, it won't financially destroy a business
- Financial security to shield business owners from unexpected risks

While you may not be able to hold these things in your hand, they are worthwhile—maybe priceless. Our goal at Pinnacol is to provide peace of mind at a fair and predictable price. In fact, a price that's gone down a cumulative 50 percent over the past five years.

With 55,000 Colorado businesses counting on us, it's imperative that Pinnacol remain strong and secure. Once again, 2010 results were positive:

| | |
|---|---|
| **Premium earned:** | $345 million |
| **Investment portfolio yield:** | 4.7 percent |
| **General dividends:** | $47 million |
| **Policyholder retention rate:** | 92 percent |

# ABOUT US




**Pinnacol Assurance's role in Colorado's insurance market is unique and a bit complex.**

**Since 1915, we've been the assured source of workers' compensation insurance for Colorado businesses. That means we serve as a safety net for any Colorado company—no matter how small, unproven or hazardous it is or what its accident history may be. These high-risk companies make up what's called the "residual market."**

## Serving the Residual Market

Pinnacol has fine-tuned the art of underwriting. With 95 years' experience, we're experts at evaluating risk—or a customer's potential for workplace accidents—and determining an appropriate premium price. Solid underwriting protects Pinnacol's financial stability. It also ensures that our safety-conscious customers aren't subsidizing those who are not.

We're most proud of the seamless, customer-friendly manner in which we serve the residual market. These policyholders receive the same level of personalized service, safety instruction and diligent claims management as our other customers.

## Stark Contrast to Other States

Pinnacol offers a stark contrast to what goes on in many states, where high-risk businesses must be declined by two or three insurers before gaining admittance into an assigned-risk pool. Businesses are then assigned to a pool of insurers, who share the burden of serving the residual market. Compared to Pinnacol's approach—accept all businesses, price premiums carefully and deliver great service across the board—we think other states' processes are less customer-friendly and efficient, and more bureaucratic.

# A Challenge—Not Free Business

Pinnacol's residual-market role benefits the state of Colorado and, ironically, our competitors. Without Pinnacol, the state would have to administer an assigned-risk pool, and private insurers would have to serve businesses that aren't very profitable to them.

Make no mistake, the residual market isn't "free business" from the state. It's high-risk business that private insurers reject. Pinnacol shoulders this responsibility alone, and we do it with passion.

# The Preferred Choice

Customer-service excellence, financial stability and good corporate citizenship have taken Pinnacol far beyond its original charter as the "insurer of last resort."

Over the years, Pinnacol has evolved into Colorado's preferred choice for workers' compensation insurance. The majority of our 55,000 policyholders choose us over the competition not because they have to, but because they want to.

## POLICYHOLDER SATISFACTION

Pinnacol's policyholder satisfaction levels are at an all-time high and well above industry norms:

- Policyholder satisfaction was 8.9 out of 10 points on our 2010 survey.
- A full 92 percent of policyholders chose to keep their business with Pinnacol in 2010.

## CORPORATE CITIZENSHIP

Our employees embrace opportunities to give back to the Colorado communities that support us:

The Pinnacol Foundation awards college scholarships to the children of Colorado workers seriously injured or killed on the job—regardless of which insurer handled the parent's claim. In 2010, 96 scholarships were awarded, totaling $290,250.

*Pinnacol in Action* is an employee-run volunteer program that supports Colorado nonprofits. In 2010, 98 percent of Pinnacol employees volunteered in some fashion, spending a total of 5,852 hours volunteering in the community.

Educational partnerships allow Pinnacol to fill gaps in higher education for risk management and insurance programming. In 2010, Pinnacol donated $5 million, over seven years, to establish a new risk management and insurance program at the University of Colorado Denver Business School.

## HONORS AND RECOGNITION

Pinnacol was the proud recipient of two "Best Place to Work" awards in 2010:

- Great Place to Work® Institute
- *ColoradoBiz* magazine

# Leadership



## Board of Directors

**From left to right: John Cevette**, Employee Representative; **Richard Rivera, M.D.**, M.P.H., Employer Representative; **Ryan Hettich, CPA, CPCU**, Employer Representative; **Robert J. (R.J.) Jolly**, Employer Farm and Ranch Representative; **Blair Richardson (Board Chair)**, Employee Representative; **John Plotkin**, Employer Representative; **Nonie Rivale Willisch**, Employee Representative; **Gary O. Johnson (Board Vice-Chair)**, Insurance Representative; **Robert C. McDaniel**, Finance & Investment Representative. **Served in 2010: Debra Lovejoy, David Stevens and Paul Suss (not pictured)**

Pinnacol Assurance's board of directors provides the company with vision, oversight and objective business counsel. Its members are appointed by Colorado's governor and confirmed by the state Senate. Our current board has insurance, financial and corporate-governance expertise. They represent a wide range of perspectives, including those of small businesses, large corporations, employees, medical providers, and rural farm and ranch owners.

## Executive Team

**From left to right: Daniel F. O'Neil**, Vice President of Business Operations and General Counsel; **Jeff Tetrick**, Vice President and Chief Financial Officer; **Kenneth J. Ross**, President and CEO; **Carole B. Sumption**, Vice President of Corporate Resources; **Robert Norris**, Vice President of Strategic Development and Chief Information Officer; **Don M. Collins**, Vice President of Communications and Chief Marketing Officer

The executive team is responsible for developing and executing Pinnacol's business strategy. They are accountable for Pinnacol's day-to-day operations, customer service and financial health. They also set the tone in terms of volunteerism and community involvement.

Pinnacol employees are encouraged to spend 12 hours per year, on company time, volunteering with local nonprofits. Our executives walk the talk by contributing their business acumen on the boards of several nonprofits and by pitching in, alongside other employees, at leaf-raking events and food drives.

# GOOD MAKES GOOD

## CORPORATE CITIZENSHIP



**Pinnacol Assurance has a long-standing tradition of giving back to the communities where we live and work. Corporate citizenship supports our values and reflects our sense of responsibility to Colorado, the state we've called home for 95 years.**

**In 2010, we contributed $1.4 million to community organizations across Colorado. Corporate citizenship is so important to Pinnacol that we count it among our top six strategic initiatives. We believe corporate citizenship encompasses positive economic influence, ethical conduct, civic engagement, philanthropy, employee volunteerism and environmental concern.**

**Being a good corporate citizen is at the very heart of our culture. Our employees take great pride in going beyond the call of duty for injured workers and policyholders. They invest their time, expertise and often emotion in helping those we serve. That spirit of giving overflows into the larger community around us.**

### PINNACOL'S CORPORATE CITIZENSHIP EFFORTS ARE CHANNELED INTO THREE MAIN PROGRAMS:


Pinnacol employees volunteer for the 9Health Fair.

***Pinnacol in Action:*** *Pinnacol in Action* is an employee-run volunteer program that supports Colorado nonprofits. In 2010, volunteerism reached an all-time high, with **98 percent** of Pinnacol employees spending a total of **5,852 hours** in the community. We give employees 12 hours of paid time off each year for volunteering.

**The Pinnacol Foundation:** The Foundation awards postsecondary education scholarships to the children of Colorado workers seriously injured or killed on the job—regardless of which insurer handled the parent's claim. In 2010, **96 scholarships** were awarded, totaling **$290,250**. Since its inception 10 years ago, the Foundation has distributed **well over $1 million** in scholarships, helping hundreds achieve their dream of a postsecondary education.

**Educational Partnerships:** This new area of focus allows Pinnacol to develop curriculum in higher education for risk management and insurance studies (which can be hard to find in the western U.S.). Several years ago, we pioneered the Rocky Mountain region's first insurance classes at **Colorado Mesa University** (formerly Mesa State College) and the **University of Northern Colorado**, and later expanded our efforts with classroom and faculty sponsorships at **Colorado State University**. In 2010 we made a commitment to donate **$5 million, over seven years**, to help establish **the Pinnacol Assurance Center for Risk Management and Insurance Studies at the University of Colorado Denver Business School**. Our goal is to make insurance a direct and desirable career path for the next generation of business leaders.

In addition to these three main programs, in 2010, we raised funds for the Mile High United Way through our annual **employee-giving** campaign, which included a **100-percent corporate match**. We provided **sponsorships** to multiple nonprofits, and our executives **served on the boards of directors** for various community organizations. We donated 1,000 turkeys to the **Denver Rescue Mission** Annual Turkey Drive. To do our part for the **environment**, Pinnacol's Green Team recycled 99 tons of paper throughout the year.

In 2010, our community efforts reached unimagined heights—thanks to the grassroots passion and commitment of our employees. They supply the fuel that has kept our corporate citizenship programs burning with greater intensity each year.

## *Pinnacol in Action*

Pinnacol employees prepare for a volunteer event, picking up trash for "Adopt-a-Spot."

*Pinnacol in Action* is our corporate volunteer program, which makes it possible for Pinnacol Assurance employees to get out and make a difference in the community. Our employees receive **12 hours of paid time** off each year to volunteer, and the overwhelming majority embrace this opportunity.

In 2010, we set two records for volunteerism:

- **98 percent** of Pinnacol employees volunteered
- **5,852 hours** of employee time were donated in the community

This level of participation **far surpasses the national norm** of about 30 percent involvement in corporate volunteer programs. It's also one of the reasons why Pinnacol has been **recognized locally and nationally** for corporate citizenship. In 2009, The Points of Light Institute awarded Pinnacol its Corporate Engagement Award of Excellence, one of the oldest and most prestigious awards in the industry.

Since its inception in 2003, *Pinnacol in Action* has been **staffed and managed entirely by employees**. These volunteers do everything from coordinating events to building partnerships with community nonprofits, such as:

- 9Health Fair
- Adopt-a-Spot
- Big Brothers Big Sisters of Colorado
- Bonfils Blood Center
- Junior Achievement
- National Sports Center for the Disabled
- Volunteers of America

"Volunteering is important to me because it gives me the ability to give back and do something for someone else," says Cora Burris, underwriter, Pinnacol Assurance. "There's a sense of pride and accomplishment in that."

## The Pinnacol Foundation

Pinnacol Foundation scholarship recipients and their families.

The Pinnacol Foundation provides postsecondary education scholarships to the children of Colorado workers seriously injured or killed on the job—regardless of insurance carrier.

Scholarships are awarded based on financial need, the severity of the parent's injury, the student's grade point average, a written essay, and social responsibility.

In 2010, the Foundation awarded **$290,250** in scholarships to **96 young adults**. **That brings the Foundation's cumulative impact over the past decade to approximately $1 million**.

Back in 2000, Pinnacol Assurance didn't have to search far to identify a cause we believed in. We knew that injured workers face a tough future—emotionally, physically and financially— even with supportive employers and the best medical care. We also understood that an injury can shatter the college dreams of an injured worker's child.

So with **$50,000** in seed money from Pinnacol Assurance, the Pinnacol Foundation was established in 2001. Each year since then, the number of applicants has grown, as has the need for scholarship money. Loyal partners, who have helped fund and grow the program, include:

- Independent insurance agents
- Workers' compensation attorneys
- Medical providers
- Policyholders
- Financial services companies
- Vendors
- Consultants
- Pinnacol's own employees

For all who support the Pinnacol Foundation, there's a deep sense of satisfaction in knowing we're **changing the course of young lives and helping to relieve some of the financial burden** borne by families of injured workers.

"It's a huge blessing, knowing that this scholarship was created for people just like me," says Sarah Curley, scholarship recipient and student at Colorado Christian University. "It's difficult to scrape up the money for college, especially when one of your parents is disabled. We really need and appreciate the Foundation's help."

## Educational Partnerships

Children are the entrepreneurs, corporate leaders and insurance executives of tomorrow. That's why **Pinnacol Assurance has long supported Colorado youth** through our volunteer efforts and the Pinnacol Foundation scholarship program.

Recently, **we've turned our attention to gaps in higher education**—particularly the lack of risk management and insurance programs in the western U.S.

Along the East Coast, given close proximity to the nation's financial capitals, insurance programs are plentiful at both the graduate and undergraduate levels. By contrast, there are no insurance programs in the Rocky Mountain region and few west of the Mississippi River.

That's what prompted us to partner with **Colorado Mesa University** and the **University of Northern Colorado**. Expanding on those early efforts, we next partnered with **Colorado State University**—funding classroom space for insurance studies and even sponsoring a faculty position. Business students embraced the classes with such enthusiasm that we knew the time was right to develop a full-scale program.

So in 2010, Pinnacol began collaborating with the **University of Colorado Denver Business School** to develop curriculum for a new undergraduate program in risk management and insurance. **The Pinnacol Assurance Center for Risk Management and Insurance Studies** was established with a **$5 million** gift to help:

- Hire faculty members
- Offer scholarships
- Develop undergraduate and graduate-level curriculum
- Provide internships
- Expose all business students to insurance principles through elective classes
- Offer online courses, accessible to students of all ages and at colleges across the state
- Deliver continuing education to agents and other industry professionals

We believe this program is crucial because **almost every commercial transaction—from construction projects to corporate mergers—involves some form of risk or insurance**, and often both. It's imperative that our future business leaders have a firm grasp on these critical concepts.

"Programs in this field tend to be quite traditional," says Suann Ambron, dean, University of Colorado Denver Business School. "The West is wide-open. This is where the new ideas are going to come from."

Along with our partner, the University of Colorado Denver Business School, Pinnacol's goal is to make insurance **a direct and desirable career path for the next generation** of business leaders.

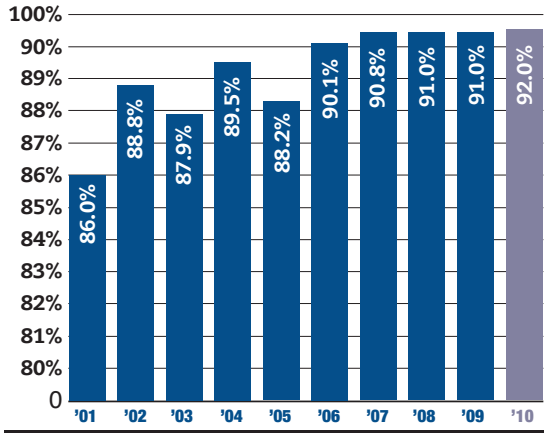
# GOOD MAKES GOOD

## 2010 STATISTICS



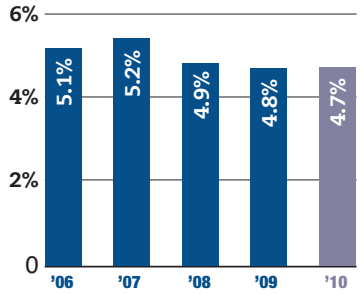
### POLICYHOLDER RETENTION RATE

92.0%




### INVESTMENT PORTFOLIO YIELD

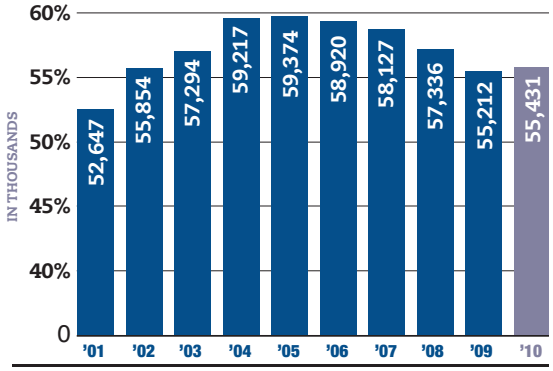
4.7%




### NUMBER OF ACTIVE POLICIES

as of December 31

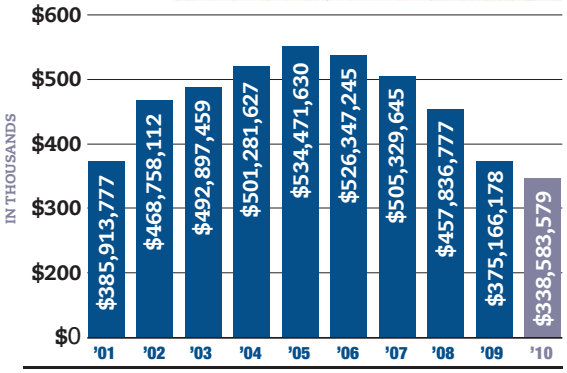
55,431




### TOTAL PREMIUM VALUE

as of December 31

$338,583,579




## TOP 10 INDUSTRIES INSURED BY PREMIUM

| | | |
|---|---|---|
| 1 | Carpentry Work | $9,375,568 |
| 2 | Plumbing, Heating, Air Conditioning | $7,448,442 |
| 3 | Eating Places | $7,041,598 |
| 4 | Roofing, Siding, and Sheet Metal Work | $6,899,704 |
| 5 | Concrete Work | $6,845,198 |
| 6 | Excavation Work | $5,576,576 |
| 7 | Building Maintenance Services, NEC | $5,479,121 |
| 8 | Elementary and Secondary Schools | $5,292,715 |
| 9 | Trucking, Except Local | $4,708,636 |
| 10 | Local Trucking, Without Storage | $4,418,784 |

## TOP 5 INJURY TYPES

| | | |
|---|---|---|
| 1 | Contusion | 10,581 |
| 2 | Strain | 9,647 |
| 3 | Laceration | 5,723 |
| 4 | Sprain | 5,232 |
| 5 | Puncture | 1,954 |

## TOP 5 INJURY CAUSES

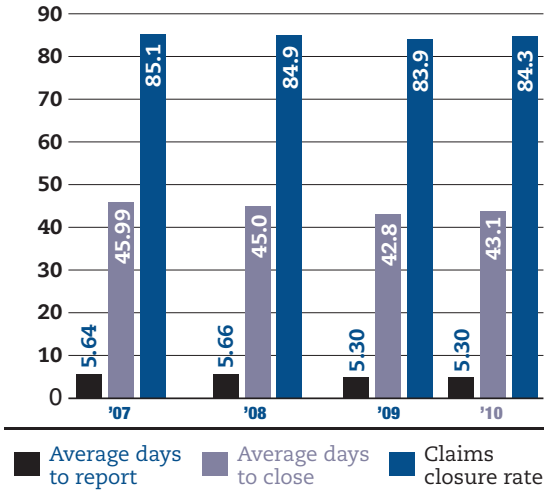
| | | |
|---|---|---|
| 1 | Strain-Lifting | 3,547 |
| 2 | Strain or Injury – Misc. | 2,456 |
| 3 | Strain or Injury by Twisting | 2,200 |
| 4 | Fall – Same Level | 2,125 |
| 5 | Cut – Misc. | 2,051 |

## TOP 10 COUNTIES INSURED BY PREMIUM

| | | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| 1 | Adams | $43,726,595 | $24,564,978 | $29,991,749 | $31,460,810 |
| 2 | Denver | $37,001,788 | $51,778,317 | $60,380,295 | $70,937,807 |
| 3 | Arapahoe | $35,578,997 | $34,087,707 | $41,709,185 | $47,358,001 |
| 4 | El Paso | $28,648,522 | $30,862,224 | $36,496,742 | $40,688,338 |
| 5 | Boulder | $23,256,293 | $17,300,987 | $20,076,140 | $22,733,394 |
| 6 | Larimer | $18,501,550 | $20,214,295 | $24,205,272 | $26,378,412 |
| 7 | Weld | $14,449,542 | $21,626,691 | $26,245,720 | $28,022,092 |
| 8 | Mesa | $14,414,362 | $15,033,143 | $18,636,883 | $19,176,536 |
| 9 | Jefferson | $12,643,779 | $26,025,663 | $32,229,628 | $36,453,774 |
| 10 | Eagle | $9,934,761 | $7,936,209 | $10,517,865 | $11,165,368 |

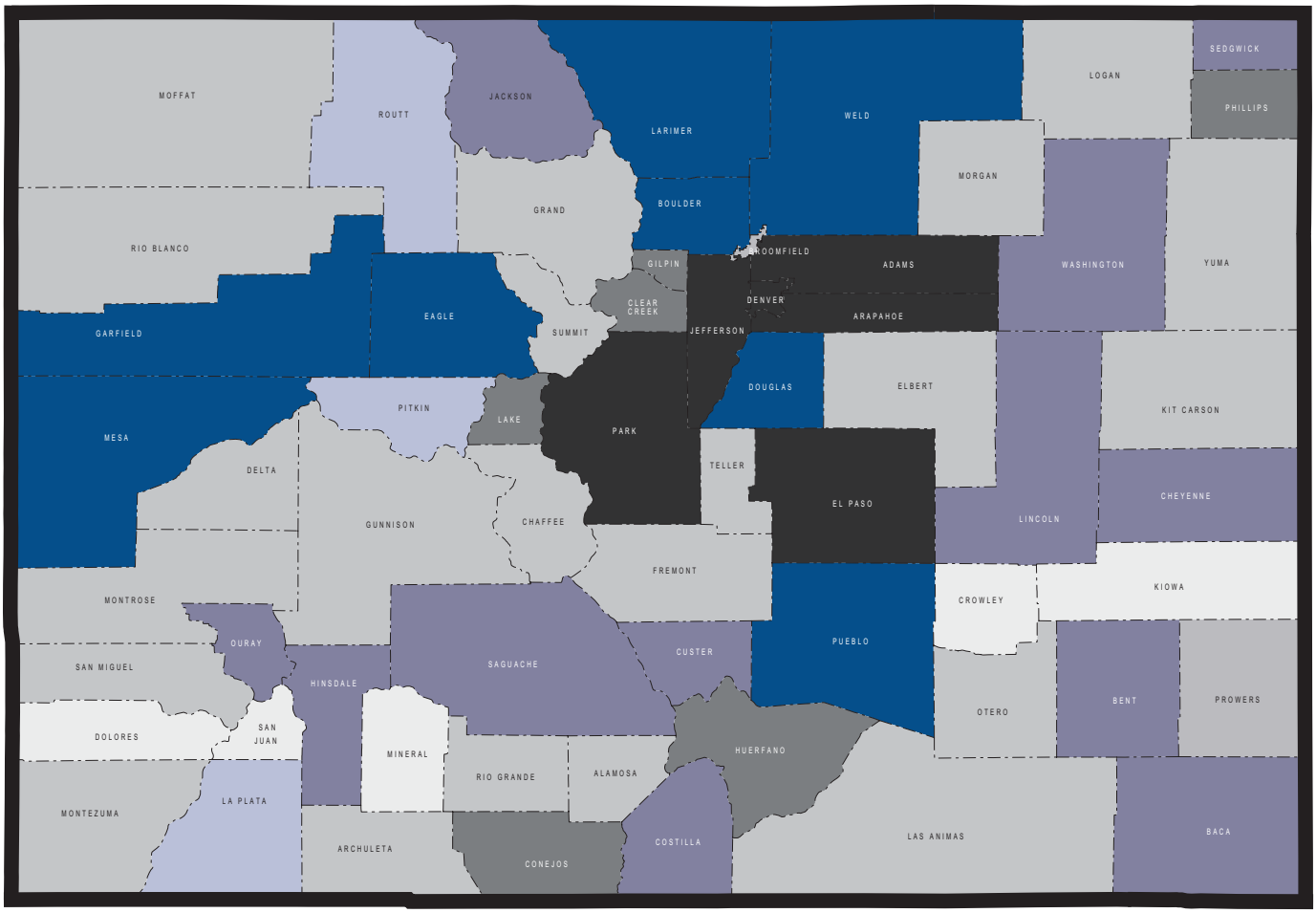
## CLAIMS

| | |
|---|---|
| Total New Claims Reported | 42,427 |
| Total Claims Closed | 44,015 |



# GENERAL DIVIDEND BY COUNTY 2005-2011

Total Dividend Distribution Over the Past Seven Years **$435.25M**




| $50,000-$200,000 | $200,000-$500,000 | $500,000-$1,000,000 | $1,000,000-$5,000,000 | $5,000,000-$10,000,000 | $10,000,000-$30,000,000 | $30,000,000-$70,000,000 |
|---|---|---|---|---|---|---|

# Independent Auditors' Report

**THE MEMBERS OF THE LEGISLATIVE AUDIT COMMITTEE AND PINNACOL ASSURANCE BOARD OF DIRECTORS:**

We have audited the accompanying statutory-basis statements of admitted assets, liabilities, and policyholders' surplus of Pinnacol Assurance (the "Company") as of December 31, 2010 and 2009, and the related statutory-basis statements of operations, changes in policyholders' surplus, and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note 1 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, and such practices differ from accounting principles generally accepted in the United States of America. The effects on such financial statements of the differences between the statutory basis of accounting 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 matters discussed in the preceding paragraph, the 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 Pinnacol Assurance as of December 31, 2010 and 2009, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and policyholders' surplus of Pinnacol Assurance as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the year then ended, on the basis of accounting described in Note 1.

In accordance with Government Auditing Standards, we have also issued our report dated July 28, 2011, on our consideration of the Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our 2010 audit.

Our 2010 audit was conducted for the purpose of forming an opinion on the basic 2010 statutory-basis financial statements taken as a whole. The supplemental schedules of investment information as of and for the year ended December 31, 2010 are presented for purposes of additional analysis and are not a required part of the basic 2010 statutory-basis financial statements. These schedules are the responsibility of the Company's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic 2010 statutory-basis financial statements. The effects on these schedules of the differences between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. Accordingly, in our opinion, such schedules do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the information shown therein. However, in our opinion, such schedules are fairly stated in all material respects when considered in relation to the basic 2010 statutory-basis financial statements taken as a whole.

Deloitte + Touche LLP

Denver, Colorado
July 28, 2011

| STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND POLICYHOLDERS' SURPLUS | AS OF DECEMBER 31, 2010 AND 2009 (IN THOUSANDS) | |
|---|---|---|
| | 2010 | 2009 |
| **ADMITTED ASSETS** | | |
| Cash And Invested Assets: | | |
| Bonds at adjusted carrying value, fair value of $1,696,381 in 2010 and $1,706,783 in 2009 (Note 3) | $ 1,563,182 | $ 1,615,972 |
| Common stock at fair value, adjusted cost of $209,196 in 2010 and $212,205 in 2009 (Note 3) | 295,352 | 268,236 |
| Real estate at cost—net of accumulated depreciation of $7,429 in 2010 and $6,332 in 2009 | 21,116 | 21,589 |
| Cash, cash equivalents and short-term investments | 52,809 | 63,556 |
| Receivables for securities sold | 532 | – |
| Total cash and invested assets | 1,932,991 | 1,969,353 |
| Uncollected Premiums—Net of Allowance | 26,618 | 27,088 |
| Electronic data processing equipment—at cost—net of accumulated depreciation of $3,007 in 2010 and $4,503 in 2009 | 1,197 | 1,898 |
| Accrued investment income | 17,958 | 18,328 |
| Total admitted assets | **$ 1,978,764** | **$ 2,016,667** |
| **LIABILITIES AND POLICYHOLDERS' SURPLUS** | | |
| Reserve for unpaid losses and loss | | |
| Adjustment Expenses: | | |
| Reserve for unpaid losses (Note 2) | $ 1,029,128 | $ 954,394 |
| Reserve for unpaid loss adjustment expenses (Note 2) | 152,727 | 194,744 |
| Total reserve for unpaid losses and loss adjustment expenses | 1,181,855 | 1,149,138 |
| Other liabilities | 42,688 | 34,663 |
| Unearned premiums | 59,746 | 57,596 |
| Advance premiums | 8,821 | 14,242 |
| Dividends payable to policyholders | 14,572 | 20,276 |
| Premium deficiency reserve | 35,344 | - |
| Credit balances due policyholders | 17,612 | 8,225 |
| Total liabilities | 1,360,638 | 1,284,140 |
| Commitments and contingencies (notes 2, 7, 8, and 10) | | |
| Policyholders' surplus (note 7) | 618,126 | 732,527 |
| Total liabilities and policyholders' surplus | **$ 1,978,764** | **$ 2,016,667** |

*See notes to statutory financial statements.*

| STATUTORY STATEMENTS OF OPERATIONS AND CHANGES IN POLICYHOLDERS' SURPLUS | FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (IN THOUSANDS) | |
|---|---|---|
| | 2010 | 2009 |
| Underwriting income: | | |
| Premiums earned (note 5) | $ 344,612 | $ 398,502 |
| Deductions: | | |
| Losses incurred (note 2 and 5) | 373,201 | 255,523 |
| Loss adjustment expenses incurred (note 2 and 5) | 16,136 | 34,543 |
| Other underwriting expenses incurred | 145,518 | 113,957 |
| Total underwriting deductions | 534,855 | 404,023 |
| Net underwriting loss | (190,243) | (5,521) |
| Investment income: | | |
| Net investment income earned | 89,496 | 94,402 |
| Net realized capital gain | 21,187 | 4,773 |
| Total investment income | 110,683 | 99,175 |
| Other income (loss): | | |
| Provision for uncollectible premiums | (2,330) | (1,252) |
| Other income | 1,134 | 1,480 |
| Dividends to policyholders | (46,956) | (116,841) |
| Net loss | (127,712) | (22,959) |
| Change in nonadmitted assets | (1,814) | 2,601 |
| Change in net unrealized gains on investments | 30,125 | 54,884 |
| Other changes in policyholders' surplus (note 1) | (15,000) | - |
| Policyholders' surplus—beginning of year | 732,527 | 698,001 |
| Policyholders' surplus—end of year | **$ 618,126** | **$ 732,527** |

*See notes to statutory financial statements.*

| STATUTORY STATEMENTS OF CASH FLOWS | FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (IN THOUSANDS) | |
|---|---|---|
| | 2010 | 2009 |
| Cash flows from operations: | | |
| Premiums collected—net of reinsurance | $ 339,337 | $ 415,990 |
| Losses and loss adjustment expenses paid—net of reinsurance and deductibles | (380,075) | (364,088) |
| Underwriting expenses paid | (133,570) | (124,652) |
| Dividends paid to policyholders | (52,659) | (126,523) |
| Investment income received, net of investment expenses paid | 89,377 | 95,199 |
| Net amount withheld or retained for account of others | (1,196) | 228 |
| Net cash used in operations | (138,786) | (103,846) |
| Cash flows from investments: | | |
| Proceeds from sale or redemption of investments | 298,728 | 311,023 |
| Purchase of investments | (221,311) | (253,375) |
| Net cash provided from investments | 77,417 | 57,648 |
| Cash flows from financing and miscellaneous Sources—cash provided from (used in) other miscellaneous sources | 50,622 | (1,920) |
| Net decrease in cash, cash equivalents And short-term investments | (10,747) | (48,118) |
| Cash, cash equivalents and short-term Investments—beginning of year | 63,556 | 111,674 |
| Cash, cash equivalents and short-term Investments—end of year | **$ 52,809** | **$ 63,556** |

*See notes to statutory financial statements.*

# Notes To Statutory Financial Statements

## DECEMBER 31, 2010 AND 2009

### 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

**(a) Organization–**Pinnacol Assurance (Pinnacol or the Company) was established under provisions of the Workers' Compensation Act of Colorado (Title 8, Article 45 of the Colorado Revised Statutes (C.R.S.), as amended), as a political subdivision of the state of Colorado, to operate as a domestic mutual insurance company for the benefit of injured employees and dependents of deceased employees. Pinnacol provides insurance to employers operating within the State of Colorado (the State) not otherwise insured through private carriers or self-insurance.

Pinnacol is controlled by a nine-member board of directors, which is appointed by the Governor with the consent of the Senate. In accordance with the applicable statutes of the State, the administration of Pinnacol is under the direction of a chief executive officer, appointed by the board of directors. Pinnacol is not an agency of the State and the State retains no liability on behalf of Pinnacol and no State monies are used for Pinnacol operations.

**(b) Basis of Presentation–**The accompanying financial statements of Pinnacol have been prepared in accordance with accounting practices prescribed or permitted by The Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (the Division). Prescribed statutory accounting practices (SAP) are those practices that are incorporated directly or by reference to state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Colorado has adopted the National Association of Insurance Commissioners' (NAIC) statutory accounting practices, which are codified in the NAIC's *Accounting Practices and Procedures Manual* (the Manual). Therefore, compliance with the Manual is a prescribed accounting practice. In the preparation of the accompanying statutory financial statements, the Company has followed NAIC guidelines and has not utilized any practices which are considered to be permitted practices.

Statutory accounting practices contained in the Manual vary in some respects from accounting principles generally accepted in the United States of America (GAAP). The more significant differences between SAP and GAAP are as follows:

- Policy acquisition costs, such as commissions, premium taxes, and other expenses directly related to the cost of acquiring new business are expensed as incurred, while under GAAP, they are deferred and amortized over the policy term to provide for proper matching of revenue and expense;

- Investments in bonds and preferred stocks are generally carried at amortized cost, while under GAAP, they would be classified as available for sale and are carried at fair value;
- Assets are reported under NAIC SAP at "admitted-asset" value and "non-admitted" assets are excluded through a charge against policyholders' surplus, while under GAAP, all assets are reported on the balance sheet, net of any required valuation allowance;
- The reserve for losses and loss adjustment expenses ("LAE") is reported net of reinsurance, while under GAAP, the balance sheet reports reinsurance recoverable, including amounts related to losses incurred but not reported, as assets.

The effect of the differences between statutory basis of accounting and generally accepted accounting principles, although not reasonably determinable, is presumed to be material.

**(c) Use of Estimates–**The preparation of statutory financial statements in accordance with accounting practices prescribed by the Division 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates include the reserves for unpaid losses and loss adjustment expenses, association dividends, the earned but unbilled premiums liability, as well as the allowance for uncollectible premiums, among others. Reserve for unpaid losses and loss adjustment expenses represent estimates of the ultimate unpaid cost, net of reinsurance, of all losses incurred including losses incurred but not reported. This liability is an estimate and, as such, the ultimate actual liability may vary from the recorded amounts. These liabilities are reviewed periodically and adjustments to the reserve are included in operations in the period such determination is made. Actual results could differ from those estimates and such differences could be significant.

**(d) Investments–**Investments are recorded on the trade date. Bonds are stated at amortized cost or market value based on their NAIC rating and are adjusted for other-than-temporary declines in fair value. Common stocks and mutual funds are carried at fair value. Unrealized capital gains on common stocks and mutual funds are reported as a direct adjustment to policyholders' surplus. Common stocks and mutual funds in an unrealized loss position for the years ended December 31, 2010 and 2009 are recorded as other-than-temporarily impaired and are recorded as a realized loss in the statutory statement of operations in the period in which they occur.

Amortization of bond premium or discount is calculated using the effective interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions are amortized to the call or maturity value or date that produces the lowest asset value.

Gains and losses on investments sold are realized in operations and are computed using the specific identification method.

Prepayment assumptions for purposes of recognition of income and valuing of loan-backed bonds and structured securities were obtained from external broker dealer survey values. These assumptions are consistent with the current interest rate and economic environment. The prospective method is used to value mortgage-backed securities. Prepayment assumptions for single class and multiclass mortgage-backed/asset-backed securities were obtained from Yield Book and Bloomberg.

Real estate includes land, the building on the land, and capitalized building improvements used in conducting the Company's business. Land is carried at cost. Building and capitalized building improvements are carried at cost less accumulated depreciation. The cost of the building and capitalized improvements is depreciated over an estimated useful life of 30 years using the straight-line method. Depreciation expense was approximately $1,096,000 and $1,043,000 for the years ended December 31, 2010 and 2009 respectively, and is included in other underwriting expenses incurred in the Statutory Statements of Operations and Changes in Policyholders' Surplus.

(e) **Cash, Cash Equivalents and Short-Term Investments and Other Invested Assets–**For purposes of the statement of cash flows, cash, cash equivalents and short-term investments include cash on deposit, money market funds, and other investments with maturities of one year or less at the date of acquisition.

As of December 31, 2010, cash, cash equivalents and short-term investments of approximately $52,809,000 include $(12,309,000) of book overdrafts, $0 of cash equivalents, and $65,118,000 of short-term investments. As of December 31, 2009, cash, cash equivalents and short-term investments of approximately $63,556,000 include $(11,687,000) of book overdrafts, $0 of cash equivalents, and $75,243,000 of short-term investments. In the accompanying statutory statements of admitted assets, liabilities, and policyholders' surplus, Pinnacol has recorded checks that have been issued, but not presented for payment, as a reduction of cash and cash equivalents.

(f) **Receivables for Securities Sold–**As of December 31, 2010, receivables for securities sold were approximately $532,000. As of December 31, 2009, receivables for securities sold were $0. Receivables for securities arise when sales of securities are recorded as of the trade date. A receivable due from the broker is established when a security has been sold, but the proceeds from the sale have not yet been received. Receivables for securities not received within 15 days from the settlement date are nonadmitted.

(g) **Uncollected Premiums–**Uncollected premiums are reported net of allowances for uncollectible and nonadmitted balances. Certain receivables are not admissible for statutory accounting purposes.

Receivables for canceled policies and billed receivables that have been outstanding for a period exceeding 90 days are not admissible according to the Manual. Pinnacol independently estimates the realizable amounts of premiums receivable and nonadmits uncollectible premiums for the difference between the gross receivable amount and the estimate of the amount to be ultimately realized. Pinnacol also nonadmits receivables for the amount by which nonadmissible receivables, as defined above, exceed the estimate of uncollectible receivables.

During 2010 and 2009, Pinnacol recorded a provision of approximately $2,330,000 and $1,252,000, respectively, for premiums receivable due to the unlikelihood of ultimate collection thereof. These amounts are reflected as provision for uncollectible premiums in the accompanying statutory statements of operations and changes in policyholders' surplus.

A significant portion of Pinnacol's premium receivable balances at December 31, 2010 and 2009 were from companies operating in the construction and services industries in Colorado. The construction industry represents 32% and 33% of premiums written as of December 31, 2010 and 2009, respectively. The services industry represents 44% and 41% of premiums written as of December 31, 2010 and 2009, respectively, with all other individual industries constituting the remainder of premiums receivable balances.

(h) **Credit Balances Due Policyholders–**Credit balances due policyholders represent excess premiums or are amounts due to policyholders. Generally, credit balances due policyholders are applied to future premium obligations of policyholders. For 2010 and 2009, such amounts are approximately $7,612,000 and $8,225,000, respectively.

Pinnacol also recorded a liability for final audit premiums, which are amounts due to policyholders after the respective policy period has expired based on audits performed by Pinnacol. Such amounts are estimated by Pinnacol based upon internal calculations using historical premium data. Based on this analysis, Pinnacol recorded an estimated audit return premium liability of approximately $10,000,000 and $0 in 2010 and 2009, respectively. The establishment of the liability was due to the downturn in the economy and covered payroll being less than originally anticipated which has resulted in premium refunds during 2010.

(i) **Electronic Data Processing Equipment–**Electronic data processing equipment is recorded at cost, less accumulated depreciation, and depreciated on a straight-line basis over an estimated useful life of three years. Net book value of these assets at December 31, 2010 and 2009 was approximately $1,197,000 and $1,898,000, respectively. Related depreciation expense of approximately $1,043,000 and $927,000 was incurred during 2010 and 2009, respectively, and is included in other underwriting expenses incurred in the statements of operations and changes in policyholders' surplus.

(j) **Art, Office Furniture and Equipment, and Software–**Art, office furniture and equipment, and software are recorded at cost and depreciated on a straight-line basis. Art, office furniture and equipment are depreciated over an estimated useful life of five years. Software is depreciated over an estimated useful life of three years. In accordance with the Manual, these are nonadmitted assets. The net book value of these assets at December 31, 2010 and 2009 was approximately $2,184,000 and $2,986,000, respectively. Related depreciation expense of approximately $1,422,000 and $1,327,000 was incurred in 2010 and 2009, respectively and is included in other underwriting expenses incurred in the statements of operations and changes in policyholders' surplus.

(k) **Other Assets–**At December 31, 2010 and 2009, Pinnacol had prepaid assets and deposits totaling approximately $7,224,000 and $3,890,000, respectively. In accordance with the Manual, these are nonadmitted assets.

(l) **General Policyholder Dividends–**The board of directors, at its discretion, determines the amount of general policyholder dividends to be declared based on Pinnacol's overall experience and financial condition. Pinnacol has paid general policyholder dividends to its policyholders in good standing of approximately $48,226,000 and $122,600,000 in May of 2010 and 2009, respectively. This is included in dividends to policyholders in the statutory statements of operations and changes in policyholders' surplus and reduces net operations for the years ended December 31, 2010 and 2009.

(m) **Association Dividend Program–**Pinnacol has an association dividend program whereby policyholders who are members of the program are entitled to a dividend based on established criteria. In 2010 Pinnacol reduced the estimate of the future liability for association dividends by $4,000,000 resulting in a credit of approximately $4,000,000 in incurred dividend expense. In 2009, Pinnacol reduced the estimate of the future liability for association dividends by $10,000,000 resulting in a credit of approximately $5,759,000 in incurred dividend expense. For 2010 and 2009, association dividends payable of $4,000,000 and $8,000,000, respectively, are included in dividends payable to policyholders. These dividends are not declared from surplus nor are they recorded as a direct reduction to surplus. The dividends are settled via premium credits and are recorded as dividends to policyholders in the statutory statements of operations and changes in policyholders' surplus.

(n) **Revenue Recognition–**For certain policies, earned premium is recorded on an installment basis to match the billing frequency stated in the policyholder contract with a provision for amounts earned but unbilled. Earned premium for all other contracts is recognized using the daily pro rata method over the period the policy is effective.

(o) **Reserve for Unpaid Losses and Loss Adjustment Expenses–**The reserve for unpaid losses and loss adjustment expenses represents management's best estimate of ultimate net cost of all reported and unreported losses incurred through December 31, 2010 and 2009. The reserve for unpaid losses and loss adjustment expenses is estimated by management, which uses an independent third-party actuary to provide estimates based on individual case basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserve for unpaid losses and loss adjustment expenses is adequate. These estimates are continually reviewed and adjusted, as necessary, as experience develops or new information becomes known; such adjustments are included in losses incurred or loss adjustment expenses incurred within the statutory statements of operations and changes in policyholders' surplus in the period such information becomes known.

Workers' Compensation case unpaid losses have been discounted on a tabular basis using a discount rate of 2.5% in 2010 and 3.5% in 2009.

Internal structured settlement liabilities represent obligations to claimants and dependents on cases that have been closed by contract. These obligations are discounted at 2.5% in 2010 and 3.5% in 2009.

(p) **Unearned Premiums–**Unearned premiums represent amounts either collected or billed and due from policyholders at December 31, 2010 and 2009 but unearned at that date as they pertain to subsequent policy periods. Unearned premiums are computed on a daily pro rata basis over the 12-month term of the policies.

(q) **Premium Deficiency Reserve–**A premium deficiency reserve is recognized by recording an additional liability for the deficiency which results when anticipated future losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve and any future installment premiums on existing policies. The change in this reserve is recorded as a component of underwriting deductions.

As of December 31, 2010, Pinnacol recorded a premium deficiency reserve of $35,344,000 as a result of rate reductions driven by a competitive market and the downturn in the economy. This evaluation was completed on January 25, 2011 by an independent actuary. Pinnacol considered anticipated investment income at 3.5% when evaluating the premium deficiency reserve for 2010. In 2009, management determined that a premium deficiency reserve was not necessary based upon its evaluation.

(r) **Division of Insurance Stipulation–**In 2010, the Colorado Division of Insurance and Pinnacol entered into a stipulation where, among other things, Pinnacol agreed to pay $15 million from surplus to policyholders as a premium credit during 2011. This amount was established as a liability in 2010 and is a direct reduction of policyholders' surplus.

(s) **Subrogation–**Subrogation claims (claims against third parties) are recognized as a reduction of losses incurred when collections are received. The Company received $5,392,000 and $5,746,000 in subrogation as of December 31, 2010 and December 31, 2009, respectively.

(t) **Reinsurance–**Ceded reinsurance transactions are accounted for based on estimates of their ultimate cost. Losses incurred, loss adjustment expenses incurred, and the reserve for loss adjustment expenses are reported net of reinsured amounts in accordance with the Manual. Reinsurance premiums are reflected as a reduction of premiums earned (see Note 5).

(u) **Taxes–**As a political subdivision of the State of Colorado, Pinnacol is not subject to Federal or State income taxes under a specific exemption granted under Section 501(c) of the Internal Revenue Code; nor is Pinnacol subject to property tax or sales and use taxes. Additionally, Pinnacol is not subject to a premium tax pursuant to Section 8-45-117(3), C.R.S. However, Pinnacol is subject to a surcharge on premiums pursuant to Section 8-44-112(1 )(s), C.R.S. The surcharge is based on a rate established annually, approximately 1.63% for 2010 and 3.62% for 2009. Such amounts are included in other underwriting expenses incurred.

### (v) Application of Recent Statutory Accounting Pronouncements

In December 2009, the NAIC issued Statement on Statutory Accounting Principle No. 62R, "Property and Casualty Reinsurance—Revised" (SSAP No. 62R.). This SSAP expands the exceptions for retroactive reinsurance to include property/casualty reinsurance run-off agreements that meet specified criteria. There are several additional criteria, including commissioner approval, financial strength of the nonaffiliated assuming entity, and unlimited transfer of risk, without the ability to cancel the contract. SSAP No. 62R is effective January 31, 2010. The Company adopted SSAP 62R for its fiscal year ended December 31, 2010. The adoption of SSAP 62R did not have an impact on the Company's financial position or the results of its operations as it did not enter into any of these agreements in 2010.

In October 2010, the NAIC issued Statement on Statutory Accounting Principle No. 5R, "Liabilities, Contingencies and Impairments of Assets" (SSAP No. 5R) and modified SSAP No. 25, "Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties" (SSAP No. 25). SSAP No. 5R adopts, with modification, Financial Accounting Standards Board Interpretation No. (FIN) 45: Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, and interpretation of Financial Accounting Standards Board (FASB) Statement No. 5, 57 and 107 and rescission of FASB Interpretation No. 34. The substantive revisions require reporting entities to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee, even if the likelihood of having to make payments under the guarantee is remote. Revisions to SSAP No. 25 are nonsubstantive and update the disclosure requirements to complement the revisions made to SSAP No. 5R. The Company adopted SSAP 5R for its fiscal year ended December 31, 2010. The adoption of SSAP 5R did not have an impact on the Company's financial position or the results of its operations as it has not issued any guarantees.

In October 2010, the NAIC issued Statement on Statutory Accounting Principle No. 16R, "Electronic Data Processing Equipment and Accounting for Software" (SSAP No. 16R). SSAP No. 16R incorporates guidance regarding software that was previously included within other SSAPs. It also adopts, with modification, a nonsubstantive change to ASU 2010-04, "Certain Revenue Arrangements That Include Software Elements". Although the revisions are primarily considered placement changes, this item is considered a substantive change, as the adoption resulted in the following SSAPs being superseded: SSAP No. 79, "Depreciation of Nonoperating System Software—an Amendment to SSAP No. 16"; SSAP No. 81, "Software Revenue Recognition"; and SSAP No. 82, "Accounting for the Costs

of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs". The Company adopted SSAP 16R for its fiscal year ended December 31, 2010. The adoption of SSAP 16R did not have a material impact on the Company's financial position or the results of its operations.

## 2. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES & INTERNAL STRUCTURED SETTLEMENT RESERVES

Unpaid losses and loss adjustment expenses (both allocated and unallocated) represent management's best estimate of the ultimate medical and indemnity net cost of all losses and loss adjustment expenses that are incurred but unpaid at year-end. Such estimates are based on individual case estimates for reported claims and actuarial estimates for losses that have been incurred but not reported. Any change in probable ultimate liabilities is reflected in losses incurred or loss adjustment expenses incurred within the statutory statements of operations and changes in policyholders' surplus in the period such determination is made.

The estimated ultimate cost of losses is based on historical patterns and the expected impact of current socioeconomic trends. The ultimate settlement of claims will not be known in many cases for years after the time a policy expires. Court decisions and federal and state legislation between the time a policy is written and the time associated claims are ultimately settled, among other factors, may dramatically impact the ultimate cost. Due to these factors, among others, the process to estimate loss and loss adjustment reserves at a point in time cannot provide an exact forecast of future payments. Rather, it produces a best estimate of liability as of a certain date. Management believes the reserves currently estimated to be adequate. While the ultimate liability may differ from the current estimate, management does not believe the difference will have a material effect, either adverse or favorable, on Pinnacol's financial position or results of operations.

The Company also has an internal structured settlement program in which it retains the liability for settlements to claimants rather than purchasing annuities from third parties. This liability has mortality risk and is discounted using a reasonable market rate. The discount applied to this liability was 2.5% and 3.5% at December 31, 2010 and 2009, respectively. The internal structured settlement liability is actuarially valued on a quarterly basis. The internal structured settlement liability is included in unpaid losses and loss adjustment expenses on the Statements of Admitted Assets, Liabilities, and Policyholders' Surplus.

**(a) Discount of Liabilities for Unpaid Losses:**

Pinnacol discounts its liabilities on unpaid losses for certain long-term scheduled workers' compensation payments. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. Such losses have been discounted at a rate of 2.5% in 2010 and 3.5% in 2009. The decrease was primarily driven by the change in estimated future yields on the investment portfolio, including consideration of decreasing US Treasury rates in the current market. Pinnacol recorded the effect of the change in accounting estimate in accordance with SSAP No. 3, "Accounting Changes and Corrections of Errors". The change in discount rate increased losses incurred by $17,852,000 in the current year.

The amount of tabular discount for case unpaid losses as of December 31, 2010 and December 31, 2009 was $70,006,000 and $76,151,000, respectively. The discount on internal structured settlement liabilities is presented in Note 2(c). The amount of discount for case reserves at December 31, 2010 is distributed as follows over the years in which the losses were incurred:

| LOSS YEAR | DISCOUNT |
|---|---|
| 2010 | $ 5,968 |
| 2009 | 9,654 |
| 2008 | 15,397 |
| 2007 | 9,631 |
| 2006 | 6,786 |
| 2005 | 4,107 |
| 2004 | 2,736 |
| 2003 | 985 |
| 2002 | 1,766 |
| 2001 | 1,800 |
| Prior | 11,176 |
| Total | **$ 70,006** |

### (b) Unpaid Loss and Loss Adjustment Expenses:

Activity in the liability for unpaid losses and loss adjustment expenses in 2010 and 2009 is summarized as follows (in thousands). Beginning in 2010, Internal Structured Settlement Reserves are no longer included in the roll-forward and are discussed separately under (c) Internal Structured Settlements below. See reconciliation below.

| | UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES | |
|---|---|---|
| | 2010 | 2009 |
| Balance - January 1 | $ 968,542* | $ 1,223,160 |
| Additional amounts incurred related to: | | |
| Current year | 378,871 | 390,369 |
| Prior years | (119,093) | (100,303) |
| Total Incurred | 259,778 | 290,066 |
| Reductions relating to payments for: | | |
| Current year | 115,773 | 115,058 |
| Prior years | 246,473 | 249,030 |
| Total Paid | 362,246 | 364,088 |
| Balance at December 31 | **$ 866,074** | **$ 1,149,138** |

| | |
|---|---|
| * Reconciliation of Year End 2009 to Beginning Balance 2010: | |
| Balance at December 31, 2009 | $ 1,149,138 |
| Remove Internal Structured Settlements presented in Note 2c | (180,596) |
| Beginning Balance January 1, 2010 | **$ 968,542*** |

As a result of changes in estimates of insured events in prior years, the provision for unpaid losses and loss adjustment expenses decreased by approximately $119,093,000 and $100,303,000 in 2010 and 2009, respectively, which is net of a change in discount of approximately ($6,144,000) and $3,657,000, respectively. Had the discount rate not been changed, 2010 reserves would have been $17,852,000 lower and the net change in discount would have been $11,708,000. During the year ended December 31, 2010, approximately $246,473,000 was paid for unpaid loss and loss adjustment expense attributable to insured events of prior years. Reserves for unpaid loss and loss adjustment expense remaining for prior years are now $602,977,000 as a result of re-estimation of unpaid losses and loss adjustment expenses. This decrease is generally the result of ongoing analysis of recent loss development trends and better than expected development. Pinnacol's claims, for all accident years, continue the trend of favorable development that has been evident for a number of calendar years. When the actual selected ultimate cost of an accident year's claims is less than the original estimate, favorable development is recorded. This favorable development resulted from aggressive claim closure, a reduction of ultimate claim frequency in Colorado, and a reduction of catastrophic losses. Pinnacol management continually evaluates the estimated ultimate cost of all accident years and on a calendar year basis adjusts to the best estimate available, favorable or unfavorable, in the current period.

**(c) Internal Structured Settlements:**

In 2010 Pinnacol changed the mortality table used to estimate liabilities for the internal structured settlements as of December 31, 2010. Mortality risk is the most significant variable in the determination of settlement payments and is evaluated regularly by actuaries. In prior years, the mortality table was based upon lives of disabled people; however, actuarial results show that internal structured settlement recipients often outlive the disabled lives table. As of December 31, 2010, the liabilities of internal structured settlements were valued based upon the US Lives mortality table. The change in accounting estimate impacts the current year operations statement in accordance with SSAP No. 3, "Accounting Changes and Corrections of Errors". The effect of the change in the discount rate increases the liability and increases loss incurred in the amount of approximately $87,280,000.

In 2010, Pinnacol evaluated the discount rate used for internal structured settlement liabilities and determined the need to adjust the rate to an acceptable current market rate. The Company uses an annuity quote that is based upon an estimated discount rate as a basis for the paid claim amount. As such, the liability should be discounted at a reasonable market rate. As of December 31, 2010, the Company decreased the discount rate applied to internal structured settlement liabilities from 3.5% to 2.5%. The decrease was primarily driven by the change in estimated future yields on the investment portfolio, including consideration of decreasing US Treasury rates

in the current market. Pinnacol recorded the effect of the change of an accounting estimate in accordance with SSAP No. 3, "Accounting Changes and Corrections of Errors". The change in estimate resulted in an increase to the liability and an increase in loss incurred in the amount of approximately $37,953,000.

During 2010 and 2009, respectively, the total change in the internal structured settlements liability was as follows (in thousands):

| | 2010 | 2009* |
|---|---|---|
| Beginning Balance | $ 180,596 | $ 167,455 |
| Amounts Incurred: | | |
| Change in Valuation | 4,326 | 5,571 |
| Change in Discount Rate | 37,953 | - |
| Change in Mortality Table | 87,280 | - |
| Amounts Paid | (17,829) | (16,744) |
| New Internal Structured Settlements | 23,455 | 24,314 |
| Ending Balance | **$ 315,781** | **$ 180,596** |

* *The 2009 rollforward for the internal structured settlement liability is also included in the unpaid loss and loss adjustment expense rollforward as of December 31, 2009.*

The amount of the discount for unpaid internal structured settlements as of December 31, 2010 and 2009, respectively, is approximately $152,743,000 and $75,688,000. The amount of discount for internal structured settlement reserves at December 31, 2010 is distributed as follows over the years in which the losses were incurred (in thousands):

| LOSS YEAR | DISCOUNT |
|---|---|
| 2010 | $ 151 |
| 2009 | 5,704 |
| 2008 | 5,461 |
| 2007 | 7,155 |
| 2006 | 16,795 |
| 2005 | 12,445 |
| 2004 | 9,155 |
| 2003 | 13,239 |
| 2002 | 11,347 |
| 2001 | 16,279 |
| Prior | 55,012 |
| Total | **$ 152,743** |

## 3. INVESTMENTS

Estimated fair value of investments in bonds is based on quotations provided by accepted external pricing vendors. In both 2010 and 2009, Interactive Data Corporation (IDC) and Standard and Poor's Security Evaluations (SPSE) were used to obtain fair market values.

The SVO of the NAIC designates ratings of bonds from 1 to 6. Bonds with ratings of 1–2 are stated at amortized cost using the effective interest method. Bonds with ratings of 3–6 require the bond to be carried at the lower of amortized cost or market, with any related unrealized loss reported in policyholders' surplus.

During 2010 and 2009, Pinnacol had investments in bonds where the SVO designated the bonds at a 3 or higher rating. At December 31, 2010 and 2009, the fair market value on these bonds was greater than, or equal to, amortized cost, which resulted in a cumulative unrealized loss of $0 and $0, respectively, and carrying values equal to amortized cost for these bonds.

The book/adjusted carrying value and the fair value of investments in bonds in 2010 and 2009 are summarized as follows (in thousands):

| | 2010 | | | |
|---|---|---|---|---|
| | BOOK/ ADJUSTED CARRYING VALUE | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
| U.S. government obligations: | | | | |
| Non-loan-backed bonds | $ 285,476 | $ 22,383 | $ (928) | $ 306,931 |
| Loan-backed bonds | 21,493 | 1,561 | - | 23,054 |
| Special revenue: | | | | |
| Loan-backed bonds | 338,755 | 23,829 | - | 362,584 |
| Industrial and miscellaneous: | | | | |
| Non-loan-backed bonds | 917,458 | 87,854 | (1,500) | 1,003,812 |
| | $ 1,563,182 | $ 135,627 | $ (2,428) | $ 1,696,381 |

| | 2009 | | | |
|---|---|---|---|---|
| | BOOK/ ADJUSTED CARRYING VALUE | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
| U.S. government obligations: | | | | |
| Non-loan-backed bonds | $ 265,854 | $ 14,120 | $ (4,270) | $ 275,704 |
| Loan-backed bonds | 29,440 | 1,125 | - | 30,565 |
| Special revenue: | | | | |
| Non-loan-backed bonds | 4,987 | 372 | - | 5,359 |
| Loan-backed bonds | 394,885 | 17,599 | (52) | 412,432 |
| Industrial and miscellaneous: | | | | |
| Non-loan-backed bonds | 920,806 | 62,821 | (904) | 982,723 |
| | $ 1,615,972 | $ 96,037 | $ (5,226) | $ 1,706,783 |

The book/adjusted carrying value and estimated fair value of investments in bonds at December 31, 2010, by contractual maturity, are shown in the following table. Investments such as mortgage backed securities have been allocated based on the original maturity date at issuance. Contractual maturities may differ from actual maturities because the borrower may have the right to call or prepay obligations with or without call or prepayment penalties.

| | BOOK/ADJUSTED CARRYING VALUE | FAIR VALUE |
|---|---|---|
| | (IN THOUSANDS) | |
| | $ 57,165 | $ 57,795 |
| Due after one year through five years | 415,733 | 451,964 |
| Due after five years through ten years | 555,111 | 611,672 |
| Due after ten years | 535,173 | 574,950 |
| Due in one year or less | $ 1,563,182 | $ 1,696,381 |

Proceeds from sales of investments in bonds during 2010 and 2009 were approximately $217,110,000 and $296,143,000, respectively. Realized gains on bonds of approximately $3,086,000 and $10,384,000 and realized losses of approximately $252,000 and $4,871,000 were recognized during 2010 and 2009, respectively. Realized losses on bonds include approximately $252,000 and $106,000 in other-than-temporary losses recognized during the years ended December 31, 2010 and 2009, respectively.

Unrealized gains on investments in common stocks and mutual funds are reported directly in policyholders' surplus. Equities in an unrealized loss position are deemed to be other-than-temporarily impaired, with the resulting loss recognized in the statement of operations. Other-than-temporary impairments of common stocks and mutual funds result in the establishment of a new, adjusted cost basis for such investments. The original cost, adjusted cost, gross unrealized gains (measured against adjusted cost), and fair value of common stocks and mutual funds are summarized as follows (in thousands):

| | ORIGINAL COST | ADJUSTED COST | UNREALIZED GAINS | FAIR VALUE |
|---|---|---|---|---|
| December 31, 2010 | $ 259,324 | $ 209,196 | $ 86,156 | $ 295,352 |
| December 31, 2009 | $ 273,750 | $ 212,205 | $ 56,031 | $ 268,236 |

The following table provides the length of impairment for those investments in bonds with an unrealized loss as of December 31, 2010 (in thousands):

| DESCRIPTION OF SECURITIES | LESS THAN 12 MONTHS | | GREATER THAN 12 MONTHS | | TOTAL | |
|---|---|---|---|---|---|---|
| | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| Industrial and miscellaneous | $ 35,266 | $ (1,263) | $ 11,700 | $ (237) | $ 46,966 | $ (1,500) |
| Government obligations | 2,459 | (30) | 57,259 | (898) | 59,718 | (928) |
| Total | **$ 37,725** | **$ (1,293)** | **$ 68,959** | **$ (1,135)** | **$ 106,684** | **$ (2,428)** |

The following table provides the length of impairment for those investments in bonds with an unrealized loss as of December 31, 2009 (in thousands):

| DESCRIPTION OF SECURITIES | LESS THAN 12 MONTHS | | GREATER THAN 12 MONTHS | | TOTAL | |
|---|---|---|---|---|---|---|
| | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| Industrial and miscellaneous | $ 7,923 | $ (51) | $ 11,077 | $ (853) | $ 19,000 | $ (904) |
| Public utilities | 53,894 | (4,270) | - | - | 53,894 | (4,270) |
| Mortgage-backed securities | 12,156 | (52) | - | - | 12,156 | (52) |
| | $ 73,973 | $ (4,373) | $ 11,077 | $ (853) | $ 85,050 | $ (5,226) |

There were 16 and 6 bonds in an unrealized loss position as of December 31, 2010 and 2009, respectively.

**Impairment of Bonds–**The Company writes securities down to fair value that it deems to be other than temporarily impaired in the period the securities are deemed to be so impaired. The Company records write downs as realized capital losses and adjusts the cost basis of the securities accordingly. The Company does not adjust the revised cost basis for subsequent recoveries in value.

The assessment of whether an other-than-temporary impairment has occurred is based upon management's case-by-case evaluation of the underlying reasons for the decline in fair value. Management considers a wide range of factors, as described below, regarding the security issuer and uses its best judgment in evaluating the cause of the decline in its estimated fair value and in assessing the prospects for near-term recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations and future earnings potential of the issuer.

Considerations used by the Company in the impairment evaluation process include, but are not limited to, the following:

- Fair value is significantly below cost.
- The decline in fair value is attributable to specific adverse conditions affecting a particular instrument, its issuer, an industry or geographic area.
- The decline in fair value has existed for an extended period of time.
- A debt security has been downgraded by a credit rating agency.
- The financial condition of the issuer has deteriorated.

- Dividends have been reduced or eliminated or scheduled interest payments have not been made.
- The ability and intent to hold investments until recovery, including consideration of the investment manager's discretion to sell securities.

While all available information is taken into account, it is difficult to predict the ultimate recoverable amount from a distressed or impaired security.

**Bonds–**At December 31, 2010 and 2009, less than 1% and 1%, respectively, of bonds held by the Company were rated non investment grade. At December 31, 2010 and 2009, the Company had approximately $1,500,000 and $904,000, respectively, of unrealized losses related to its industrial and miscellaneous bonds. The Company does not have any significant concentrations by issuer or by sector. The unrealized losses on the securities are primarily attributable to fluctuations in market interest rates and changes in credit spreads since the securities were acquired.

**Loan-Backed-Securities–**Loan-backed securities are stated at amortized cost or market value based on their NAIC designation. The prospective method is used to value mortgage-backed securities. Prepayment assumptions for single class and multi-class mortgage-backed/asset-backed securities were obtained from Yield Book and Bloomberg. All loan-backed and structured securities in an unrealized loss position were reviewed to determine whether an other-than-temporary impairment should be recognized. Pinnacol recognized other-than-temporary impairments on loan-backed securities during the year ended December 31, 2010 for approximately $252,000. Pinnacol did not recognize any other-than-temporary impairments on loan-backed securities during the year ended December 31, 2009.

**Other-Than-Temporary Impairment–**During 2010 and 2009, Pinnacol recognized approximately $252,000 and $106,000, respectively, in other-than-temporary impairments on bonds. During the years ended December 31, 2010 and 2009, the Company recorded other-than-temporary impairments on common stocks and mutual funds in the amounts of approximately $231,000 and $900,000, respectively. These impairments relate to market declines in value as of the last day of the year.

**Fair Value Measurements–**The Company's assets recorded at fair value have been categorized based upon a fair value hierarchy. The levels of the fair value hierarchy are described below.

- Level 1 inputs utilize observable, quoted prices (unadjusted) in active markets for identical assets that the Company has the ability to access. Financial assets utilizing Level 1 inputs include actively exchange-traded equity securities.

- Level 2 inputs utilize other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3 inputs are unobservable and include situations where there is little, if any, market activity for the asset.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The following table presents (in thousands) information about the Company's financial assets measured at fair value on a recurring basis for accounting purposes as of December 31, 2010 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

| | FAIR VALUE MEASUREMENTS - RECURRING BASIS DECEMBER 31, 2010 | | | |
|---|---|---|---|---|
| | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) | TOTAL |
| Common stocks and mutual funds | $ 295,352 | $ - | $ - | $ 295,352 |
| Total assets | **$ 295,352** | **$ -** | **$ -** | **$ 295,352** |

Certain assets are measured at fair value on a non-recurring basis quarterly or more frequently if events dictate that the carrying value of the asset may not be recovered. These assets include bonds held at fair value with an NAIC rating of 3–6. There were no bonds with these ratings where the carrying value was less than market value at December 31, 2010.

**Investment Income–**Major categories of net investment income for the years ended December 31, 2010 and 2009 are summarized as follows (in thousands):

| | 2010 | 2009 |
|---|---|---|
| Investment income: | | |
| Corporate and miscellaneous bonds | $ 72,387 | $ 76,735 |
| U.S. government bonds | 12,866 | 13,180 |
| Cash and other investments | 24 | 367 |
| Real estate | 3,864 | 3,866 |
| Equity securities | 4,573 | 4,569 |
| Investment expenses | (4,218) | (4,315) |
| Net investment income earned | 89,496 | 94,402 |
| Net realized capital (losses) gains | 21,187 | 4,773 |
| Net investment income | **$ 110,683** | **$ 99,175** |

The company did not have any significant concentrations by industry or by issuer as of December 31, 2010 or 2009.

## 4. UNINSURED PLANS AND UNINSURED PORTION OF PARTIALLY INSURED PLANS

Pinnacol offers Administrative Services Contract Plans whereby Pinnacol acts as a third party administer for all workers' compensation claims under these contracts. All loss and loss adjustment expenses related to claims under these contracts are reimbursed to Pinnacol. Pinnacol does not record premium revenue nor loss and loss adjustment expenses on these plans, but does show the related receivables for these costs. Claims processed and reimbursed under these contracts were approximately $37,080,000 and $34,294,000 in 2010 and 2009, respectively. Included in these contracts are transactions with the State.

## 5. REINSURANCE

**Ceded Reinsurance–**Pinnacol purchases excess of loss reinsurance with two layers. The reinsurance coverage for individual workers' compensation accidents was as follows:

- Layer 1–Limit of $20,000,000 in excess of retention of $20,000,000 per occurrence
- Layer 2–Limit of $40,000,000 in excess of retention of $40,000,000 per occurrence

This coverage was in effect at December 31, 2010 and 2009. Management is not aware of any loss nor did the Company record any loss great enough to attach to these layers during any of the aforementioned policy periods.

Should the reinsurers be unable to meet their obligations under the reinsurance contracts, Pinnacol would remain liable for amounts ceded to its reinsurers. Reinsurance contracts do not relieve Pinnacol of its obligations, and a failure of the reinsurer to honor its obligations could result in losses unreimbursed to Pinnacol. Pinnacol evaluates and monitors the financial condition of its reinsurers to minimize its exposure to loss from reinsurer insolvency. Management of Pinnacol believes its reinsurers are financially sound and will continue to meet their contractual obligations.

Pinnacol uses Lloyd's Syndicates as part of its ceded reinsurer program and are generally not rated by AM Best. The remaining reinsurers had the following AM Best ratings at December 31, 2010:

| REINSURER | AM BEST RATING |
|---|---|
| Aspen Insurance UK Limited | A |
| AXIS Specialty Limited | A |
| Endurance Specialty Insurance Limited | A |
| Flagstone Reassurance Suisse SA | A- |
| Validus Reinsurance Limited | A- |

**Assumed Reinsurance–**Pinnacol has entered into assumed reinsurance contracts that allow the Company to provide insurance coverage under the workers' compensation provisions of other states for the employees of Colorado companies who work outside of Colorado ("Other States Coverage"). Effective March 1, 2004, Pinnacol executed a reinsurance contract with Argonaut Insurance Company (a California corporation) for Other States Coverage. The contract was cancelled in 2010. Pinnacol will continue to pay existing claims in accordance with this reinsurance agreement until these claims are closed or these risks are transferred. As the company entered into a reinsurance agreement in 2010 with Zurich American Insurance Company, there were no gaps in coverage during the year. This agreement was in effect as of December 31, 2010. The Other States Coverage contracts are designed as 100% quota share arrangements with Pinnacol acting as the assuming company. Premium revenue is recognized pro rata over the period the policy is effective.

Pinnacol held unearned premium reserves related to assumed business of $1,661,000 and $1,546,000 for the years ended December 31, 2010 and 2009 respectively. Pinnacol had loss and loss adjustment expense reserves related to assumed business of $26,300,000 and $28,834,000 for the years ended December 31, 2010 and 2009, respectively.

The following reinsurance activity has been recorded in the accompanying statutory financial statements (in thousands):

| | 2010 | 2009 |
|---|---|---|
| Direct premiums written | $ 330,531 | $ 353,824 |
| Premiums ceded | (1,016) | (1,041) |
| Premiums assumed | 17,247 | 17,247 |
| Net premiums written | **$ 346,762** | **$ 370,030** |
| Direct premiums earned | $ 328,495 | $ 381,693 |
| Premiums ceded | (1,016) | (1,041) |
| Premiums assumed | 17,133 | 17,850 |
| Net premiums earned | **$ 344,612** | **$ 398,502** |
| Direct losses incurred | $ 234,488 | $ 248,298 |
| Losses ceded | - | - |
| Losses assumed | 9,154 | 7,225 |
| Net losses incurred * | **$ 243,642** | **$ 255,523** |
| Direct loss adjustment expenses incurred | $ 15,704 | $ 31,312 |
| Loss adjustment expenses ceded | - | - |
| Loss adjustment expenses assumed | 432 | 3,231 |
| Net loss adjustment expenses incurred | **$ 16,136** | **$ 34,543** |

** Net losses incurred for 2010 excludes activity related to the internal structured settlement liability.*

## 6. EMPLOYEE BENEFITS

### DEFINED BENEFIT PENSION PLAN THROUGH THE STATE OF COLORADO

***Plan Description–***All of Pinnacol's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require an actuarial assessment and legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting www.copera.org.

Defined benefit plan members vest after five years of service and are eligible for full retirement based on their original hire date as follows:

- Hired before July 1, 2005—age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.
- Hired on or after July 1, 2005 but before January 1, 2007—any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.
- Hired on or after January 1, 2007 but before January 1, 2011—any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service.
- Hired on or after January 1, 2011—any age with 35 years of service, age 58 with 30 years of service, age 65 with 5 years of service.

Members are also eligible for retirement benefits without a reduction for early retirement based on their original hire date as follows:

- Hired before January 1, 2007—age 55 with a minimum of 5 years of service credit and age plus years of service equals 80 or more.
- Hired on or after January 1, 2007 but before January 1, 2011—age 55 with a minimum of 5 years of service credit and age plus years of service equals 85 or more.
- Hired on or after January 1, 2011—age 58 with a minimum of 5 years of service credit and age plus years of service equals 88 or more.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5% times the number of years of service times the highest average salary (HAS). For members eligible to retire as of January 1, 2011, HAS is determined by the highest annual salaries associated with four periods of 12 consecutive months. The lowest of the four periods becomes the base year used as a starting point for a 15% cap on annual salary increases. For members not eligible to retire as of January 1, 2011, more restrictive limits of 8% are placed on salary increases between periods used in calculating HAS.

Prior to January 1, 2010, retiree benefits were increased annually based on their original hire date as follows:

- Hired before July 1, 2005—3.5%, compounded annually.
- Hired between July 1, 2005 and December 31, 2006—the lesser of 3% or the actual increase in the national Consumer Price Index (CPI).
- Hired on or after January 1, 2007—the lesser of 3% or the actual increase in the national Consumer Price Index, limited to a 10% reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1 percentage point of salaries contributed by employers for employees hired on or after January 1, 2007.)

In the 2010 legislative session, the general assembly set the current increase as the lesser of 2% or the average of the monthly CPI amounts for the prior calendar year. The 2009 CPI was negative resulting in a calendar year 2010 increase of 0 %. The 2010 legislation moved the payment date of all increases to July. New rules governing the annual increase amount will be in effect beginning January 1, 2011.

For January 1, 2011 and beyond, retiree benefits are increased annually based upon the following:

- Hired before January 1, 2007 whose benefit is paid based on retirement prior to January 1, 2011—2% per year unless PERA has a negative investment year in which the lessor of 2% or the average monthly CPI of the prior year for the next three years if the recipient has been receiving benefits for the last seven months.
- Hired before January 1, 2007 whose benefit is paid based on retirement on or after January 1, 2011—2% per year unless PERA has a negative investment year in which the lessor of 2% or the average monthly CPI of the prior year for the next three years if the recipient has been receiving benefits for the last twelve months.
- Hired on or after January 1, 2007—the lessor of 2% or the average monthly CPI of the prior year for the next three years if the recipient has been receiving benefits for the last twelve months.

Members who are disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their eligible children under the age of 18 (23 if a full time student) or their spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse, then financially dependent parents, beneficiaries, or the member's estate, may be entitled to a survivor's benefit.

***Funding Policy–***The contribution requirements of plan members and their employers are established, and may be amended, by the General Assembly. Salary subject to PERA contribution is gross earnings less any reduction in pay to offset employer contributions to the state sponsored IRC 125 plan established under Section 125 of the Internal Revenue Code.

All employees contribute 10.50% of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. From January 1, 2009, to December 31, 2009, Pinnacol contributed 12.95% of the employee's salary. From January 1, 2010, through June 30, 2010, Pinnacol contributed 13.85%. From July 1, 2010 through December 31, 2010, Pinnacol contributed 11.35%. During all of 2010, 1.02% of the employees' total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2009, the division of PERA in which Pinnacol participates was underfunded with an infinite amortization period, which means that the unfunded actuarially accrued liability would never be fully funded at the current contribution rate.

In the 2004 legislative session, the general assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional .5% of salary beginning January 1, 2006, another .5% of salary in 2007, and subsequent year increases of .4% of salary until the additional payment reaches 3.0% in 2012.

In the 2006 legislative session, the general assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one half percentage point of total salaries paid beginning January 1, 2008. The SAED is scheduled to increase by one-half percentage point through 2013 resulting in a cumulative increase of three percentage points. For state employers, each year's one half percentage point increase in the SAED will be deducted from the amount of changes to state employees' salaries, and used by the employer to pay the SAED. Both the AED and SAED will terminate when funding levels reach 100%.

In the 2010 legislative session, the general assembly extended both the AED and SAED. The AED will continue to increase at a rate of .4% of salary from calendar years 2013 through 2017. The SAED will continue to increase by one-half percentage point from calendar years 2014 through 2017. If the funding ratio reaches 103%, both the AED and the SAED will be reduced by one-half percentage point. Neither the AED nor the SAED may exceed 5%.

Pinnacol expects the annual contribution rate, including AED and SAED, to increase as follows from 2011 to 2018:

| YEAR | EMPLOYER CONTRIBUTION | AED | SAED | TOTAL PINNACOL CONTRIBUTION |
|---|---|---|---|---|
| 2011 | 7.65% | 2.60% | 2.00% | 12.25% |
| 2012 | 10.15% | 3.00% | 2.50% | 15.65% |
| 2013 | 10.15% | 3.40% | 3.00% | 16.55% |
| 2014 | 10.15% | 3.80% | 3.50% | 17.45% |
| 2015 | 10.15% | 4.20% | 4.00% | 18.35% |
| 2016 | 10.15% | 4.60% | 4.50% | 19.25% |
| 2017 | 10.15% | 5.00% | 5.00% | 20.15% |
| 2018 | 10.15% | 5.00% | 5.00% | 20.15% |

Historically members have been allowed to purchase service credit at reduced rates. However, legislation passed in the 2006 session required that future agreements to purchase service credit be sufficient to fund the related actuarial liability.

Pinnacol's contributions to PERA for the years ending December 31, 2010 and 2009 were $5,118,000 and $5,259,000 respectively. These contributions met the contribution requirement for each year.

In 2010, Pinnacol became aware of an unfunded liability to PERA of approximately $75-$80 million which relates to the vested service of Pinnacol employees whose future benefits relate to that service. The variables that impact the determination of the liability are the number of active and inactive members, annual payroll, required contribution rates and the investment returns of PERA. Pinnacol believes the obligation exists if Pinnacol remains part of PERA as these funds will be collected through increased assessments on current and future salaries. (Refer to Note 8 for further discussion.)

## VOLUNTARY TAX-DEFERRED RETIREMENT PLANS

PERA offers a voluntary 401(k) plan entirely separate from the defined benefit pension plan. Pinnacol offers a 457 deferred compensation plan. Pinnacol matches employee's elective contributions into the PERA 401(k) plan at 50% up to the first 6% of employees' elected deferrals. The matching contribution is immediately vested and available to the employees. During the year ended December 31, 2010 and 2009, Pinnacol contributed approximately $970,000 and $907,000, respectively, in matching contributions to the 401(k) plan.

## POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

***Health Care Program–***The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the program and the Health Care Fund; the program was converted to a trust fund in 1999. The plan is a cost-sharing multiple-employer plan under which PERA subsidizes a portion of the monthly premium for health care coverage. The benefits and employer contributions are established in statute and may be amended by the General Assembly. PERA includes the Health Care Trust Fund in its Comprehensive Annual Financial Report, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting www.copera.org.

After the PERA subsidy, the benefit recipient pays the balance of the premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the health care plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is $230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare and $115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction of 5% for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above. Beginning July 1, 2004, employers are required to contribute 1.02% of gross covered wages to the Health Care Trust Fund. Pinnacol contributed approximately $414,000 and $414,000 as required by statute in the years ended December 31, 2010 and 2009, respectively. In each year the amount contributed was 100% of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully-insured plans offered through health care organizations and self-insured plans administered for PERA by third-party vendors. As of December 31, 2010, there were 46,455 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2010, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.40 billion, a funded ratio of 17.5%, and a 42-year amortization period.

**Accrued Paid Leave–**Pinnacol employees may accrue paid time off based on their length of service subject to certain limitations on the amount that will be paid upon termination or taken in future periods. Paid time off is recorded as an expense and a liability at the time the paid time off is earned. The estimated liability for cumulative accrued paid time off of approximately $1,786,000 and $1,574,000 at December 31, 2010 and 2009, respectively, is included in other liabilities in the statutory statements of admitted assets, liabilities and policyholders' surplus.

## 7. POLICYHOLDERS' SURPLUS

Pinnacol paid approximately $48,226,000 and $122,600,000 in general policyholder dividends to its policyholders in good standing in 2010 and 2009, respectively. This is included in dividends to policyholders on the statutory statements of operations and changes in policyholders' surplus and reduces net operations for the year ended December 31, 2010.

The Division monitors a company's "risk based capital" in assessing the financial strength of an insurance company. Pinnacol's level of surplus exceeds the "company action level" of risk-based capital, which is approximately $106,067,000 for 2010.

## 8. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2010 and 2009, Pinnacol had a letter of credit for the benefit of Argonaut Insurance Company under the assumptive reinsurance agreement for approximately $39,964,000 and $46,169,000, respectively. In addition, Pinnacol had a letter of credit for the benefit of Zurich American Insurance Company under an assumptive reinsurance agreement for approximately $10,800,000 as of December 31, 2010. These reinsurance agreements allow each reinsurer to draw upon the letter of credit, which is 100% collateralized, at any time to secure any of Pinnacol's obligations under the agreement. Included in fixed maturities are amounts held as collateral for the letter of credit of approximately $79,718,000 and $77,433,000, compared to a requirement of $50,764,000 and $46,169,000, as of December 31, 2010 and 2009, respectively.

Pinnacol is contingently liable for approximately $55,135,000 of claims closed by the purchase of annuities from life insurers for structured settlements. Pinnacol purchased annuities that aggregated more than one percent of surplus from Genworth Life and Annuity Insurance Company of Virginia and Symetra Life Insurance Company of Washington for reserves that approximated $32,392,000 and $15,756,000 as of December 31, 2010. These insurance companies are authorized insurers in the state of Colorado. No provision has been made for this contingency as management believes that any payments related to this contingency are remote.

In 2010, Pinnacol became aware of an unfunded liability to PERA of approximately $75-$80 million which relates to the vested service of Pinnacol employees whose future benefits relate to that service. The variables that impact the determination of the liability are the number of active and inactive members, annual payroll, required contribution rates and the investment returns of PERA. The obligation exists if Pinnacol were to partially or fully leave the PERA program and the funding would become immediately due to PERA. Currently, the possibility of the Company partially or fully leaving the PERA program is remote. In accordance with SSAP No. 5R, "Liabilities, Contingencies and Impairments of Assets", the Company has not recorded this estimated contingency as of December 31, 2010.

## 9. RECONCILIATION OF ANNUAL STATEMENT TO AUDITED FINANCIAL STATEMENTS

The accompanying statutory financial statements reflect certain adjustments to amounts previously reported in the annual statement filed with the Colorado Division of Insurance. The following reconciles admitted assets, capital and surplus and net income included in the annual statement to the accompanying statutory financial statements as of December 31, 2009 (in thousands):

| 2009 | ADMITTED ASSETS | CAPITAL AND SURPLUS | NET INCOME |
|---|---|---|---|
| Total per annual statement | $ 2,016,667 | $ 732,527 | $ (91,231) |
| Other-than-temporary impairment adjustment | - | - | 68,272 |
| Total per statutory financial statements | **$ 2,016,667** | **$ 732,527** | **$ (22,959)** |

There are no differences in the admitted assets, capital and surplus and net loss as presented in the accompanying statutory-basis financial statements and the amounts as presented in the Company's annual statement (as amended) filed with the Colorado Division of Insurance as of December 31, 2010.

## 10. SUBSEQUENT EVENTS

**General Dividend Declared–**The board of directors held a meeting on April 13, 2011 in which it declared a general dividend of approximately $41,250,000 to its policyholders with policies in good standing. This general dividend was paid in May 2011. The board of directors, at its discretion, determines the amount of policyholder dividends to be declared based on Pinnacol's overall experience and financial condition.

**Third Party Administration Program–**Pinnacol made a decision to terminate its Third Party Administration (TPA) program in 2011. The Administrative Services Contract (ASC) Plan provides an administrative service in which claims are paid on the employer's behalf and subsequently reimbursed by the employer. The Company will honor any contracts in force in 2011 but will not renew these contracts, effectively eliminating the program by December, 31, 2011. The Company does not believe this event will have a material impact on its financial condition.

**New Board Members–**Three members of the Company's board were replaced after December 31, 2010. It was determined that one board member no longer met the qualifications in the statute to act as a board member and voluntarily resigned. The remaining members were replaced after their terms had expired.

These events have been evaluated through July 28, 2011, the date these statutory financial statements were available to be issued.

# Supplemental Schedules Of Investment Information

## Pinnacol Assurance

### SUPPLEMENTAL SCHEDULE OF INVESTMENT INFORMATION— INVESTMENT RISKS INTERROGATORIES FOR THE YEARS ENDED DECEMBER 31, 2010

1. Pinnacol's total admitted assets as reported on page two of its Annual Statement are $1,978,764,000.

2. The following are the 10 largest exposures to a single issuer/borrower/investment by investment category, excluding: (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt, (ii) property occupied by Pinnacol, and (iii) policy loans:

| ISSUER | DESCRIPTION OF EXPOSURE | AMOUNT | PERCENTAGE OF TOTAL ADMITTED ASSETS |
|---|---|---|---|
| a. Vanguard | Mutual fund | $ 115,393,392 | 5.8 % |
| b. General Electric Co | Bonds & Common stock | 46,086,855 | 2.3 |
| c. Verizon New Jersey Inc | Bonds & Common stock | 43,237,328 | 2.2 |
| d. Rainier | Mutual fund | 41,204,384 | 2.1 |
| e. Anheuser-Busch | Bonds | 40,505,096 | 2.0 |
| f. Bellsouth Corporation | Bonds & Common stock | 35,686,842 | 1.8 |
| g. IBM | Bonds | 34,787,155 | 1.8 |
| h. PacifiCorp | Bonds | 34,100,796 | 1.7 |
| i. Emerson Electric Co | Bonds & Common stock | 30,681,708 | 1.6 |
| j. Proctor & Gamble | Bonds & Common stock | 28,593,935 | 1.4 |

3. Pinnacol's total admitted assets held in bonds by NAIC rating are:

| BONDS | | |
|---|---|---|
| NAIC RATING | AMOUNT | PERCENTAGE OF TOTAL ADMITTED ASSETS |
| NAIC-1 | $ 1,393,599,907 | 70.4 % |
| NAIC-2 | 222,821,755 | 11.3 |
| NAIC-3 | 5,623,540 | 0.3 |
| NAIC-4 | 6,254,984 | 0.3 |
| NAIC-5 | - | 0.0 |
| NAIC-6 | - | 0.0 |
| | $ 1,628,300,186 | |

4. Assets held in foreign investments are less than 2.5% of Pinnacol's total admitted assets.

*Items 5 through 10 are not applicable.*

11. Assets held in Canadian investments are less than 2.5% of Pinnacol's total admitted assets.

*Item 12 is not applicable.*

13. The following are the largest equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other securities and excluding money market and bond mutual funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt or Class 1):

| ISSUER | AMOUNT | PERCENTAGE OF TOTAL ADMITTED ASSETS |
|---|---|---|
| a. Vanguard | $ 115,393,392 | 5.8 % |
| b. Rainer | 41,204,384 | 2.1 |
| c. T Rowe Price | 27,032,082 | 1.4 |
| d. Matthews Asian | 20,300,233 | 1.0 |
| e. First Eagle Overseas | 12,237,501 | 0.6 |
| f. Scout International | 11,691,052 | 0.6 |
| g. Managers Cadence | 11,397,274 | 0.6 |
| h. Exxon Mobil Corporation | 2,222,848 | 0.1 |
| i. Emerson Electric Co. | 2,214,194 | 0.1 |
| j. 3M Co. | 2,071,200 | 0.1 |

*Items 14 through 23 are not applicable.*

| SUPPLEMENTAL SCHEDULE OF INVESTMENT INFORMATION — SUMMARY INVESTMENT SCHEDULE | | | AS OF DECEMBER 31, 2010 | |
|---|---|---|---|---|
| INVESTMENT CATEGORIES | GROSS INVESTMENT HOLDINGS* | | ADMITTED ASSETS AS REPORTED IN THE ANNUAL STATEMENT | |
| | AMOUNT | PERCENTAGE OF GROSS INVESTMENT HOLDINGS | AMOUNT | PERCENTAGE OF TOTAL ADMITTED ASSETS |
| Bonds: | | | | |
| U.S. Treasury securities | $ 267,374,093 | 13.8% | $ 267,374,093 | 13.8% |
| U.S. government agency and corporate obligations (excluding mortgage-backed securities): | | | | |
| - Issued by U.S. government agencies | | | | |
| - Issued by U.S. government-sponsored agencies | 12,513,329 | 0.6% | 12,513,329 | 0.6% |
| Foreign government (including Canada, excluding mortgage-backed securities) | 4,988,606 | 0.3% | 4,988,606 | 0.3% |
| Securities issued by states, territories, and possessions and their political subdivisions in the U.S.: | | | | |
| - State, territory, and possessions — general obligations | 600,000 | 0.0% | 600,000 | 0.0% |
| - Political subdivisions of states, territories, and possessions — general obligations | | | | |
| - Revenue and assessment obligations | | | | |
| - Industrial development and similar obligations | | | | |
| Mortgage-backed securities (includes residential and commercial MBS): | | | | |
| Pass-through securities: | | | | |
| - Guaranteed by GNMA | 21,492,537 | 1.1% | 21,492,537 | 1.1% |
| - Issued by FNMA and FHLMC | 43,356,136 | 2.2% | 43,356,136 | 2.2% |
| - All others | | | | |
| CMOs and REMICs: | | | | |
| - Issued or guaranteed by GNMA, FNMA, FHLMC or VA | 295,399,263 | 15.3% | 295,399,263 | 15.3% |
| - Issued by non-US Govt issuers and collateralized by mortgage-backed securities issued by above | | | | |
| - All other | | | | |
| Other debt and other fixed income securities (excluding short term): | | | | |
| - Unaffiliated domestic securities (includes credit tenant loans rated by the SVO) | 871,577,414 | 45.1% | 871,577,414 | 45.1% |
| - Unaffiliated foreign securities | 45,880,890 | 2.4% | 45,880,890 | 2.4% |
| - Affiliated securities | | | | |

| SUPPLEMENTAL SCHEDULE OF INVESTMENT INFORMATION — SUMMARY INVESTMENT SCHEDULE (Cont.) | | | AS OF DECEMBER 31, 2010 | |
|---|---|---|---|---|
| INVESTMENT CATEGORIES | GROSS INVESTMENT HOLDINGS* | | ADMITTED ASSETS AS REPORTED IN THE ANNUAL STATEMENT | |
| | AMOUNT | PERCENTAGE OF GROSS INVESTMENT HOLDINGS | AMOUNT | PERCENTAGE OF TOTAL ADMITTED ASSETS |
| Equity interests: | | | | |
| - Investments in mutual funds | $ 239,255,918 | 12.4% | $ 239,255,918 | 12.4% |
| Preferred stocks: | | | | |
| - Affiliated | | | | |
| - Unaffiliated | | | | |
| Publicly traded equity securities (excluding preferred stocks): | | | | |
| - Affiliated | | | | |
| - Unaffiliated | 56,096,517 | 2.9% | 56,096,517 | 2.9% |
| Other equity securities: | | | | |
| - Affiliated | | | | |
| - Unaffiliated | | | | |
| Other equity interests including tangible personal property under lease: | | | | |
| - Affiliated | | | | |
| - Unaffiliated | | | | |
| Mortgage loans: | | | | |
| - Construction and land development | | | | |
| - Agricultural | | | | |
| - Single-family residential properties | | | | |
| - Multifamily residential properties | | | | |
| - Commercial loans | | | | |
| Real estate investments: | | | | |
| - Property occupied by Company | 21,115,875 | 1.1% | 21,115,875 | 1.1% |
| - Property held for production of income | | | | |
| - Property issued or guaranteed by GNMA, FNMA | | | | |
| Collateral loans | | | | |
| Policy loans | | | | |
| Receivables for securities | 530,716 | 0.0% | 530,716 | 0.0% |
| Cash, cash equivalents and short-term investments | 52,809,441 | 2.7% | 52,809,441 | 2.7% |
| Write-ins for invested assets | | | | |
| Total Invested Assets | $1,932,990,735 | 100.0% | $1,932,990,735 | 100.0% |

** Gross investment holdings as valued in compliance with NAIC Accounting Practices and Procedures Manual.*

***Note**: Reinsurance Interrogatories are excluded as they are not applicable.*

## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

*To the Members of the Legislative Audit Committee*
*and Pinnacol Assurance Board of Directors:*

We have audited the statutory-basis financial statements of Pinnacol Assurance (Pinnacol) as of and for the year ended December 31, 2010, and have issued our report thereon dated July 28, 2011. Our report is modified for statutory basis of accounting presentation. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States of America.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered Pinnacol's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Company's statutory-basis financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether Pinnacol's statutory-basis financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Although we have included management's written response to our comments in the Findings and Recommendations section above, such responses have not been subjected to the auditing procedures applied in the audit of the statutory-basis financial statements and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

This report is intended solely for the information and the use of the members of the Legislative Audit Committee, the board of directors and management of Pinnacol, and state insurance departments to whose jurisdiction Pinnacol is subject, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

Denver, Colorado
July 28, 2011

# Pinnacol Assurance

**DISTRIBUTION DECEMBER 31, 2010**

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of the Office of the State Auditor
**www.state.co.us/auditor**

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