

November 22, 2016

Honorable Governor John Hickenlooper  
201 E. Colfax Ave.  
Denver, CO 80203

Dear Governor Hickenlooper and Members of the General Assembly:

Pursuant to C.R.S. §8-45-122, attached please find Pinnacol Assurance's annual report for 2015. Per the statute, the report contains the following information:

- (a) Number of policies held by Pinnacol
- (b) Total assets of Pinnacol
- (c) Amount of reserves
- (d) Amount of surplus
- (e) Number of claims filed
- (f) Number of claims admitted or contested within the twenty-day period pursuant to section 8-43-203, specifying the number of contested claims that are medical only and those that are indemnity claims
- (g) Number of medical procedures denied
- (h) Amount of total compensation each executive officer or staff member receives, including bonuses or deferred compensation
- (i) Amount spent on commissions
- (j) Amount paid to trade associations for marketing fees
- (k) All information relating to bonus programs
- (l) Any other information the CEO deems relevant to the report

All data is as of year-end 2015.

We have included additional information regarding Pinnacol, per subsection (l) in the appendix of this document. The report also highlights Pinnacol's stewardship of our policyholders' premiums, as well as how we're innovating to meet Colorado employers' evolving needs.

If you have any questions concerning the information included in this report, please contact me at 303.361.4891.

Sincerely,

Philip B. Kalin  
President and CEO

cc:

Sen. Bill Cadman, Senate President  
Sen. Lucia Guzman, Senate Minority Leader  
Rep. Dickey Lee Hullinghorst, Speaker of the House  
Rep. Brian DeGrosso, House Minority Leader  
Sen. Chris Holbert, Chair, Senate Business, Labor and Technology  
Sen. Kevin Lundberg, Chair, Senate Health and Human Services  
Rep. Angela Williams, Chair, House Business Affairs and Labor  
Rep. Beth McCann, Chair, House Health, Insurance & Environment

Colorado Legislative Council Library

# 2015 Annual Report from Pinnacol Assurance

To Governor John Hickenlooper  
and the Colorado General Assembly

Nov. 22, 2016



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## Introduction

Pinnacol has deep roots in Colorado. In 1915, the Colorado state legislature created the State Workers' Compensation Fund to ensure that workers injured on the job would receive benefits covering lost wages and medical costs and protect employers from potentially catastrophic losses. That fund was Pinnacol's predecessor, and we now provide workers' compensation insurance to more than 55,000 employers in the state, and protect the lives of nearly 900,000 Colorado workers. We are proud that 2015 marked 100 years of Pinnacol protecting Coloradans on the job.

### Serving and understanding Colorado employers

As Colorado's workers' compensation carrier of last resort we are required to provide coverage to every company that applies to us, regardless of the risk involved. Without Pinnacol, many companies would be unable to secure affordable workers' compensation coverage for their employees.

In order to better meet the needs of our policyholders, we are building on our deep history and understanding of the Colorado economy. In 2015, we restructured our account teams into industry-focused "Centers of Excellence," which enables us to bring expertise and new insights to policyholders in construction, healthcare, natural resources and more.

*Customer satisfaction:* We know Pinnacol policyholders appreciate the service we provide because they stick with us year after year.

- Policyholder satisfaction score was 8.26 out of 10 points for overall service quality
- Policyholder retention rate, based on written premium, was 89 percent

*Safety services:* Every Colorado employee deserves a safe workplace, and Pinnacol is doing its part to make that a reality. We have a staff of **28 safety experts**, the largest, most experienced team in the state, and they invest more than **4,300 workdays every year** helping employers across the state keep their worksites safe. Pinnacol's team includes experts in areas like industrial hygiene and industries like construction, and oil and gas. We also offer hundreds of safety resources to our policyholders at no cost, including webinars, templates, posters and sample documents. Many of these materials are available for download whenever an employer needs them.

### Providing compassionate care to injured workers

Pinnacol covers workers across Colorado, and in 2015 we paid for medical care and provided wage replacement benefits to **more than 45,000 injured workers**. Just three percent of claims were contested (denied) in 2015, most often because the injury was not work related. The first survey of injured workers on their experience with Pinnacol in 2010 resulted in a score of 3.6 out of 5. Our satisfaction score **improved to 3.9 in 2015**, an increase of 8 percent since the initial survey.

Twenty years ago, Pinnacol created SelectNet, a network of accredited occupational medicine providers to treat the injured workers we cover. It was the first of its kind in the nation, and each of its providers is held to a strict standard of training and certification. Now **3,300 strong**, the network includes primary care and specialist physicians, therapists, mental health professionals, dentists and chiropractors. Because every injured worker needs to be able to get to their appointments and receive effective care, SelectNet even includes translators and transportation services.

### Innovating to add value

Keeping Colorado workers safe doesn't just happen on the jobsite. It starts with their own health and wellness. That's why we were the first workers' comp carrier in the country to provide a free wellness program to our policyholders in order to decrease the health risks their employees face on the job and off. Employee participation in the program among our policyholders that offer it is 53 percent, far higher than the national

average of 8-15 percent for wellness programs offered through health plans. And a study by the Colorado School of Public Health found that for every \$1 invested in our program, employers could save \$2 in medical costs and productivity improvements.

We're also looking at how we can better leverage technology and data. Because of the number of Colorado employers we serve, we are in a prime position to use data to provide macro-level insights to employers that no one else can. We can tell a construction company what job site hazards to focus on based on the most common injury in that industry the previous month. Or we can help businesses stay safe and competitive by showing them how they are performing relative to other companies in their industry. Our customers can use these valuable insights to manage risk and thrive in their own increasingly competitive environments.

### **Investing in our community**

Our community investments support our mission: to provide assured protection to Colorado employers and their greatest asset — their employees. Pinnacol focuses on supporting organizations in three main areas:

- Helping injured workers get back to work and stay healthy. Under this heading, we fund organizations such as Craig Hospital, National Jewish, and the Spinal Cord Recovery Project.
- Keeping worksites safe. Our grants and sponsorships here include the Colorado Safety Association and Health Links.
- Ensuring that Colorado has a robust business climate and our policyholders have the workforce they need. Here, we fund workforce development organizations such as the Colorado Innovation Network, as well as numerous chambers of commerce and economic development organizations.

In addition, in 2000 we created the Pinnacol Foundation to help the children of workers who were severely injured or killed in a workplace accident, regardless of the parent's workers' compensation insurance carrier. After a serious workplace accident, families — particularly children — often struggle financially, physically and emotionally. Since its inception, the Foundation has awarded more than \$4 million in scholarships to over 400 students. Many of these are first-generation college students.

### **Maintaining financial stability**

After several years of rebuilding our finances, our board made the decision in 2015 to decrease rates and issue a general dividend to our policyholders. Our efforts paid off when we earned an A- (Excellent) rating from insurance rating agency A.M. Best. A growing Colorado economy helped increase our earned premium by 12 percent, to \$636 million. To maintain our financial stability and guarantee the payment of benefits to injured workers and their dependents that may span years or even decades, we manage expenses, carefully steward our financial resources, apply disciplined underwriting practices, and focus on managing risks to our investment portfolio. We are committed to maintaining the funds required to fulfill our commitment to policyholders and injured workers.

In 2015, Pinnacol received a clean audit of its financial statements, as conducted by independent auditors (KPMG) contracted by the Colorado Office of the State Auditor. The full audit report is attached in Appendix B.

### **Challenges**

Pinnacol's recent success comes despite significant challenges. Our policyholders are increasingly operating in multiple states, and seeking the convenience of bundling multiple insurance products into one payment. But our 100-year-old statute restricts Pinnacol to writing coverage only in Colorado and to offering only one product. Increasingly, other carriers — including nine other state workers' comp funds, and new companies that operate exclusively online — are presenting attractive alternatives to Colorado businesses. While Pinnacol is focused on providing the best product and service possible to our policyholders and injured workers, our statutory constraints do not reflect the reality of 21<sup>st</sup> century business.

**A. Policy Count: 55,903**

Pinnacol's policies-in-force (active) as of Dec. 31, 2015 decreased by slightly less than 1 percent over year-end 2014.

**B. Total (Admitted) Assets: \$2,463,382,952**

Pinnacol's total assets grew by 6.39 percent over year-end 2014. The change was driven primarily by positive net income resulting in an increase in invested assets. Pinnacol's investment portfolio emphasizes high quality, taxable bonds, supplemented by a smaller portfolio of equities, high-yield debt and alternative investments. It is overseen by an investment committee including outside professionals as well as members of Pinnacol's board.

**C. Reserves: \$940,125,000**

Our reserves represent the financial obligations of Pinnacol to pay injured workers' expected future benefits and related claims expenses, as determined by a contracted third-party actuarial firm (Milliman). Pinnacol's total reserves increased by roughly 1 percent over year-end 2014, primarily due to operational improvements that have helped minimize the impact of medical inflation on claims.

**D. Surplus: \$935,298,251**

Our surplus is equity to cover unexpected claims/losses and economic fluctuations, as well as other risks. It is, essentially, our rainy day fund.

Colorado's strong economy helped drive positive net income, which is consistently the biggest driver of surplus growth for Pinnacol, and resulted in a 10.3 percent surplus increase in 2015. Even more significantly, the number of claims decreased in 2015 due to a variety of factors, including improved worksite safety.

**E. Claims filed in 2015: 45,277****F. Claims required by statute to be admitted or denied within 20 days and notice provided to the Colorado Division of Workers' Compensation (DOWC): 5,740**

**Contested claims that are medical-only: 1,292**

**Contested claims that are indemnity claims: 122**

The number of claims Pinnacol admitted or contested (denied) within 20 days decreased by 5.3 percent in 2015 compared to 2014. The percent of claims we provide notice of to the DOWC has held steady at 12-14 percent of total claims filed for a number of years.

The total number of claims Pinnacol contested (denied) and reported to the DOWC dropped in 2015 from 2014 by 2.9 percent. The number of contested indemnity claims was down 23 while the number of contested medical-only claims was down 19. Pinnacol's most common basis for contesting claims in 2015 was due to an injury not being work-related or the need for further investigation.

Here is a more complete picture of key data elements for 2015 with explanations to follow.

1. Claims processed with no filing required with DOWC	= 39,537 (87.3 percent)
2. Claims admitted within 20 days with DOWC	= 4,326 (9.6 percent)
3. Claims contested (denied) within 20 days with DOWC	= <u>1,414</u> (3.1 percent)
Subtotal of items 2 and 3	= 5,740
Total claims in fiscal year 2015	= 45,277 (100 percent)

Item 1: No Filing Required: Claims that are minor in nature; the injured worker has not sustained a permanent disability, disfigurement, or lost time from work in excess of three calendar days/shifts. These claims are processed by Pinnacol and do not require a filing of admission or contest with the DOWC. These claims represent 87.3 percent of all claims received by Pinnacol in 2015.

Items 2 and 3: Admitted or Contested within 20 days: Claims that are more complex in nature require a formal filing with the DOWC of “contested” or “admitted.” It should be noted that not all contested claims are ultimately denied; as many may initially be contested based on the need for more information within the 20 day window, the time in which compensability must be determined.

Claims where the injured worker has sustained one of the following require a formal filing of “contested” or “admitted” with the DOWC:

- The injured employee contracted an occupational disease
- The injured employee was found to have a permanent disability due to the injury
- The injury or occupational disease resulted in lost time from work for the injured employee in excess of three shifts or calendar days

As noted above, the number of claims that fall into these two categories has stayed between 12–14 percent of total claims filed for the last few years.

Item 3: Contested Claims:

The 1,414 contested claims (3.1 percent of total claims in 2015) stemmed from one or more of the following reasons:

- Injury or illness was not work-related – 709 (50 percent)
- Pending further investigation or information – 371 (26 percent)
- Other – 334 (24 percent) This category includes such things as no insurance policy or the injured worker is covered by another carrier.

Pinnacol’s percentage of claims contested remained at 3.1 percent in 2015, the same as in 2014.

**G. Medical procedures denied: 2,552**

Pinnacol’s percentage of medical procedures denied compared to total bills received was .37 percent for 2015. This metric has remained relatively stable over the past few years. The most common reason for denying medical procedures that require prior approval from Pinnacol is the procedure was found not to be medically necessary.

Medical procedures denied are in accordance with Rule 16 of the Colorado Division of Workers’ Compensation’s Rules of Procedure. Some medical procedures require prior approval from the insurance company. Once a request for prior authorization is received, Pinnacol has seven business days to inform the medical provider and the injured worker that we will pay or deny payment for the procedure.

**H. Amount of total compensation each executive officer or staff member receives, including bonuses or deferred compensation**

<b>Title</b>	<b>2015 Total Compensation</b>
President and CEO	\$545,620
Vice President, General Counsel and Corporate Secretary	\$384,928
Vice President, Chief Investment Officer	\$356,160
Vice President, Strategic Development and CIO	\$352,841
Vice President, Insurance Operations	\$350,899
Vice President, Medical Operations and Healthcare Strategy	\$268,955
Chief Financial Officer	\$267,548
Vice President, Agency Relations and Safety Services	\$244,209
Vice President, Human Resources	\$212,448
Vice President, Communications and Public Affairs	\$192,371
Average total compensation for 7 Associate Vice Presidents	\$150,933

- I. Amount spent on commissions: \$81,812,280**
- J. Amount paid to trade associations for marketing fees: \$284,628**
- K. Information related to bonus programs**  
See Appendix A
- L. Other information the CEO deems relevant to the report**  
See Appendix B

Note: Sources for all items except H and the Appendices are the 2015 Pinnacol Annual Statement, the Pinnacol Assurance Key Factor Report, the General Ledger Account (60511-100 — Advertising Expenses — Association Marketing) and other internal reports.

## Appendix A

Information related to bonus programs

## PINNACOL ASSURANCE

### EXECUTIVE PERFORMANCE PLAN (As Amended and Restated January 1, 2016)

#### SUMMARY

The Executive Performance Plan (“Performance Plan”) is hereby amended and restated effective for Plan Years commencing on or after January 1, 2016. The Performance Plan is intended to recognize the achievement of major company objectives and individual objectives, measured on an annual basis.

This Performance Plan appropriately emphasizes individual and group accountability for making specific contributions to Pinnacol Assurance’s overall business results. Based on Board of Directors of Pinnacol Assurance (“Board”) approval, the Performance Plan will be finalized and communicated to Executive Staff. A relatively short decision-result cycle should be attainable (first quarter of the following year) to determine award payout following Board approval.

#### PLAN DESCRIPTION

**Plan Year** – The Plan Year shall be a calendar year.

**Performance Measures** – Awards are paid under this Performance Plan for meeting or exceeding annual performance objectives for pre-established company metrics for the Plan Year, as set forth by the Board.

**Eligibility** – This Performance Plan will only apply to the following positions, each of which will be considered an Eligible Employee: CEO, Vice Presidents, and Associate Vice Presidents. An Eligible Employee who is hired on or after October 1 of a Plan Year is not eligible to participate in the Performance Plan for the year of hire.

**Incentive Award Plans** – Eligible Employees will have incentive award plans based on meeting major company objectives and individual objectives related to Pinnacol Assurance’s annual business plan. For Vice Presidents and Associate Vice Presidents, the amount of an award under this Performance Plan, if any, is subject to the approval of the CEO and then ultimately the Board. For the CEO, the amount of an award under this Performance Plan, if any, is subject to the approval of the Board.

## Determination of Payment

### 1. Eligible Employees Other Than the CEO

The CEO shall make a determination as soon as practicable after the end of the Plan Year as to whether each Eligible Employee (other than the CEO) has met his or her individual objectives and whether the company objectives have been met. The CEO shall make an initial determination as to the award that each such Eligible Employee is eligible for under this Performance Plan for the Plan Year. The Board shall then approve the amount of all awards (the date of such approval being the "Initial Determination Date" with respect to such Eligible Employee). The "Determination" of an award by the Board, as well as the decision as to whether to make any such award, and the amount, if any, of such award, shall be in the sole discretion of the Board. Determination means the Board has passed a resolution approving or denying a bonus award as well as the amount of any such award.

### 2. CEO

The Compensation Committee of the Board (the "Committee") shall make a determination as soon as practicable after the end of the Plan Year as to whether the CEO has met his individual objectives and whether the company objectives have been met. The Committee shall make an initial determination as to the award that the CEO is eligible for under this Performance Plan for the Plan Year. The Board shall then approve the amount of the final award (the date of such approval being the "Initial Determination Date" with respect to the CEO). The Determination of an award by the Board, as well as the decision as to whether to make any such award, and the amount, if any, of such award, shall be in the sole discretion of the Board. Determination means the Board has passed a resolution approving or denying a bonus award as well as the amount of any such award.

### 3. Subsequent Adjustment Due to Error

The Board may increase or decrease the amount of an award subsequent to an Initial Determination Date (a "Subsequent Adjustment Due to Error"), provided, however, that a Subsequent Adjustment Due to Error shall only be made because of a mathematical error, an adjustment to results as described below under "Company Objectives," or upon the determination of the Board that a metric or criterion used to compute an award had been determined in error. The date on which the Board approves a Subsequent Adjustment Due to Error shall be a Subsequent Determination Date with respect to such adjustment.

### 4. Determination Dates

The Initial Determination Date with respect to a Plan Year shall be on or after January 1 of the calendar year immediately following the Plan Year but no later than the May 31 of the calendar year immediately following such Plan Year. Any Subsequent Determination Date with respect to a Plan Year shall be no later than the September 30 of the calendar year immediately following such Plan Year.

**Payment** – Payment of an award, or of a Subsequent Adjustment Due to Error that increases an award, shall be made within 2-1/2 months of the Initial Determination Date (with respect to the award) or within 2-1/2 months of the Subsequent Determination Date (with respect to the Subsequent Adjustment Due to Error). In the event that a Subsequent Adjustment Due to Error reduces an award that has already been paid, Pinnacol Assurance may recoup such Subsequent Adjustment Due to Error from the recipient of an award by reducing the compensation otherwise payable to such recipient within sixty (60) days of the Subsequent Determination Date (including, but not limited to, regular compensation, bonuses, commissions, or severance pay and any amount of such Subsequent Adjustment Due to Error that Pinnacol Assurance has not recouped from such compensation shall be paid by the recipient to Pinnacol Assurance on the sixtieth (60<sup>th</sup>) day following the Subsequent Determination Date. This paragraph applies whether or not such recipient has remained an Eligible Employee.

**Vesting** – An Eligible Employee who is not employed by Pinnacol Assurance on a Determination Date (whether an Initial or Subsequent Determination Date) forfeits all rights to an award (or an increase in an award in the case of a Subsequent Adjustment Due to Error) for the Plan Year to which such Determination Date relates. An Eligible Employee who is employed by Pinnacol Assurance on an Initial or Subsequent Determination Date is fully vested in the award (or an increase in an award, in the case of a Subsequent Adjustment Due to Error) granted on such Initial or Subsequent Determination Date.

**Allocation of Award Under Each Plan** – Incentive awards will be earned as follows once the Board has determined that an Eligible Employee has met the criteria for an individual award, which for all Performance Plan participants shall be based 90% on achievement of company objectives and 10% on Individual Strategic Goals.

**Eligible Employee’s Performance Plan Award Range (% of Base Salary)**

	Threshold	Commendable	Maximum
Associate Vice Presidents	20.0%	32.5%	45.0%
Vice Presidents	22.5%	37.5%	52.5%
CEO	25.0%	42.5%	55.0%

**Award Payout Calculation**

Individual worksheets will be prepared for each Eligible Employee. Pinnacol Assurance will use the following factors in determining the amount of the award once the threshold criteria are met:

1. **Company Objectives**

Annual targets for Operational Efficiency, Risk and Capital Adequacy, Growth (New Business), Client Satisfaction, Strategic Initiatives, and Individual Strategic Goals (each as defined or described below) will be established by the Board. Projected as well as past performance will be factored into the formula for establishing company objectives.

#### A. Operational Efficiency

1. "Combined Ratio Before General Dividends" is the combined ratio results for insurance operations, excluding other income/expense, as determined by the company's financial statements. The numerator of the ratio is total expenses (all losses incurred, loss adjustment expenses, underwriting expenses and safety group dividends). The denominator of the ratio is net underwriting premiums earned (underwriting premiums earned minus program dividends (but not minus association and general dividends)).
2. Cost Advantage (Net Rate) – "Net Rate" is a measure of the workers' compensation premium charged by Pinnacol divided by the loss cost premium set by NCCI. NCCI calculates the net rate for the state of Colorado in a given year. Payout on this measure will be determined by comparing Pinnacol's net rate to the rest of the state of Colorado's net rate.

#### B. Risk and Capital Adequacy

1. Achieve/Maintain AM Best Rating of A-. This rating is determined by A.M. Best, an independent third party.
2. Surplus Management – Pinnacol's surplus target is 300-350 Best Capital Adequacy Ratio (BCAR). BCAR is defined and calculated by A.M. Best. "Surplus management" is any surplus amount above the amount needed to produce a 350 BCAR.

#### C. Growth

1. "New Business" will be based upon the premium generated by policies that are new business to Pinnacol Assurance during the Plan Year.

#### D. Customer Satisfaction

1. "Policy Holder Satisfaction" will be based on the average score, adjusted for selection bias, of the overall service quality question contained in the service quality surveys of customers (policyholders) sent during the Plan Year.
2. "Injured Worker Satisfaction" will be based on the average score of the overall satisfaction question contained in the statutory surveys of injured workers for surveys sent during the Plan Year.
3. "Original Premium Retention" will be based on the average percentage of premium Pinnacol Assurance retains during the Plan Year.

#### E. Strategic Initiatives

1. Geographic Expansion
2. Health and Wellness
3. Product Differentiation (Centers of Excellence) – Agent brand survey, net

promoter score

- F. "Individual Strategic Goals" will be based on the total score of the leadership competencies established by the Board. The Board will evaluate the CEO's performance, the CEO will evaluate the Vice Presidents performance and the Vice Presidents will evaluate the Associate Vice Presidents for this measure.

The weighting of the objectives shall be:

- Operational Efficiency: 45% consisting of the following:
  - Combined Ratio – 40%
  - Net Rate – 5%
- Risk and Capital Adequacy: 10% consisting of the following:
  - Achieve Maintain AM Best Rating of A- - 5%
  - Surplus Management – 5%
- Growth – New Business: 5%
- Customer Satisfaction: 10% consisting of the following:
  - Policy Holder Satisfaction – 2 %
  - Injured Worker Satisfaction – 3%
  - Original Premium Retention – 5%
- Strategic Initiatives: 20% consisting of the following:
  - Geographic Expansion – 5 %
  - Health and Wellness – 5%
  - Product Differentiation – 10%
- Individual Strategic Goals: 10%

## 2. Discretionary Adjustment

The CEO may review additional issues or concerns regarding any award with the Committee prior to final award approval by the full Board.

The final results pertaining to any objective may be adjusted at the discretion of the Board, based on the recommendation of the Committee, to account for unforeseen or uncontrollable events. Such adjustments will be made to assure that the results of this Performance Plan are a fair reflection of the business performance of Pinnacle Assurance. Unforeseen or uncontrollable events may include, without limitation, adverse court rulings, imposed regulatory costs and/or revenue reductions, significantly better than expected performance results, and Board-approved

budget adjustments.

### 3. Calculation of the Award Amount

- A. If the actual result is between two measurements (i.e., threshold and commendable or commendable and maximum) then the award will be linearly interpolated to match the actual result, but not to exceed the maximum award for that performance measure.
- B. If an Eligible Employee has been employed in an eligible position for less than the full twelve calendar months of the Plan Year and was hired prior to October 1 of the Plan Year, the award will be calculated based on the Eligible Employee's base salary on December 31 of the Plan Year or if the Eligible Employee moves from an Eligible Position to a non-eligible position, on the Eligible Employee's base salary on the last day in the eligible position in the Plan Year, in either case prorated based on the number of months in the eligible position.
- C. If an Eligible Employee has been employed in more than one classification eligible for an award under this Performance Plan (e.g., as both an Associate Vice President and a Vice President) during a Plan Year, the award will be calculated based on the Eligible Employee's base salary in each eligible classification, using the base salary on the day prior to any eligible classification change during the year and the base salary on December 31 of the Plan Year in the additional eligible classification, in each case prorated based on the number of months in the eligible classification and multiplied by the Eligible Employee's Performance Plan Award Range for each eligible classification.
- D. The principles of B. and C. above are illustrated by the following examples.

Dakota is hired (or promoted) on July 1 into an AVP position with a base salary of \$100,000 per year. He performs at a commendable level for the Plan Year.

$$\text{Dakota's award} = \$50,000 \times 32.5\% = \$16,250$$

Montana is an AVP on January 1 with a base salary of \$100,000 per year. She is promoted to a VP with a base salary of \$150,000 on July 1. She performs at a commendable level for the Plan Year.

$$\text{Montana's award} = (\$50,000 \times 32.5\%) + (\$75,000 \times 37.5\%) = \$44,375$$

### Section 409A

All payments contemplated by this Plan are intended to qualify as "short-term deferrals" as such term is defined in Treasury Regulation Section 1.409A-1(b)(4) and this Performance Plan shall be administered and construed accordingly. To the extent that any such payment is not a short-term deferral, this Performance Plan is intended to otherwise comply with Section 409A of the Internal Revenue Code of 1986, as amended, the Treasury Regulations promulgated thereunder, and any administrative guidance or judicial decisions with respect thereto ("Section 409A") and shall be administered and construed accordingly. It is the intention of Pinnacle Assurance that payments under this Performance Plan not be subject to the additional tax or interest imposed pursuant to Section 409A. To the extent such potential payments or benefits are or could become subject to Section 409A, Pinnacle Assurance may amend this Performance Plan with the goal of giving Eligible Employees the economic benefits described herein in a manner

that does not result in such additional tax or interest being imposed. It is the intention of Pinnacol Assurance that no person shall be considered to have a legally binding right to any award under this Performance Plan at any time prior to an Initial Determination Date that relates to an award, or, in the case of a Subsequent Adjustment Due to Error that provides for an increase to an award, prior to such Subsequent Determination Date. Each payment described in this Performance Plan shall be a separate payment and a separately identifiable payment to the maximum extent permitted by Section 409A.

***Pinnacol Assurance reserves the right to add, change, end, or suspend this Performance Plan at any time, with or without notice. This document shall not be construed as a contract of employment, nor does it restrict the right of Pinnacol Assurance to discharge the employee or the right of the employee to terminate his or her employment at any time.***

Pinnacol Assurance has evidenced its adoption of the Pinnacol Assurance Executive Performance Plan (As Amended and Restated January 1, 2016) effective January 1, 2016, by the signature of its duly authorized officer.

PINNACOL ASSURANCE

By:



Philip B. Kalin

Title: President and Chief Executive Officer

Date:

12/23/15

## **Appendix B**

### **Other information the CEO deems relevant to the report:**

Annual financial statement audit report

Rule 16 of the Colorado Division of Workers' Compensation  
Rules of Procedure

# DEPARTMENT OF LABOR AND EMPLOYMENT

## Division of Workers' Compensation

7 CCR 1101-3

### WORKERS' COMPENSATION RULES OF PROCEDURE

#### Rule 16 UTILIZATION STANDARDS

##### 16-1 STATEMENT OF PURPOSE

In an effort to comply with its legislative charge to assure appropriate and timely medical care at a reasonable cost, the Director (Director) of the Division of Workers' Compensation (Division) has promulgated these utilization standards, effective January 1, 2014. This Rule defines the standard terminology, administrative procedures and dispute resolution procedures required to implement the Division's Medical Treatment Guidelines and Medical Fee Schedule. With respect to any matter arising under the Colorado Workers' Compensation Act and/or the Workers' Compensation Rules of Procedure and to the extent not otherwise precluded by the laws of this state, all providers and payers shall use and comply with the provisions of the "Medical Treatment Guidelines," Rule 17, and the "Medical Fee Schedule," Rule 18, as incorporated and defined in the Workers' Compensation Rules of Procedure, 7 CCR 1101-3.

##### 16-2 STANDARD TERMINOLOGY FOR RULES 16 AND 18

- (A) Ambulatory Surgical Center (ASC) – licensed as an ambulatory surgery center by the Colorado Department of Public Health and Environment.
- (B) Authorized Treating Provider (ATP) – may be any of the following:
  - (1) The treating physician designated by the employer and selected by the injured worker;
  - (2) A health care provider to whom an authorized treating physician refers the injured worker for treatment, consultation, or impairment rating;
  - (3) A physician selected by the injured worker when the injured worker has the right to select a provider;
  - (4) A physician authorized by the employer when the employer has the right or obligation to make such an authorization;
  - (5) A health care provider determined by the Director or an administrative law judge to be an ATP;
  - (6) A provider who is designated by the agreement of the injured worker and the payer.
- (C) Billed Service(s) – any billed service, procedure, equipment or supply provided to an injured worker by a provider.
- (D) Billing Party – a service provider or an injured worker who has incurred authorized medical costs.

- (E) Certificate of Mailing – a signed and dated statement containing the names and mailing addresses of all persons receiving copies of attached or referenced document(s), certifying the documents were placed in the U.S. Mail, postage pre-paid, to those persons.
- (F) Children’s Hospital – as identified and Medicare certified by the Colorado Department of Public Health and Environment.
- (G) Convalescent Center – as licensed by the Colorado Department of Public Health and Environment.
- (H) Critical Access Hospital (CAH) – as identified and Medicare certified by the Colorado Department of Public Health and Environment.
- (I) Dispute Resolution: Division review of materials for compliance with the Rules prior to any pre-hearing/hearing before an Administrative Law Judge (ALJ) in the Office of Administrative Courts.
- (J) Day – defined as a calendar day unless otherwise noted.
- (K) Hospital – as identified and licensed by the Colorado Department of Public Health and Environment.
- (L) Long-Term Care Facility – as identified and Medicare certified by the Colorado Department of Public Health and Environment
- (M) Medical Fee Schedule – Division's Rule 18, its Exhibits, and the documents incorporated by reference in that Rule.
- (N) Medical Treatment Guidelines – the medical treatment guidelines as incorporated into Rule 17, "Medical Treatment Guidelines."
- (O) Over-the-Counter Drugs – drugs that are safe and effective for use by the general public without a prescription.
- (P) Payer – an insurer, employer, or their designated agent(s) who is responsible for payment of medical expenses.
- (Q) Prior Authorization – assurance that appropriate reimbursement for a specific treatment will be paid in accordance with Rule 18, its’ Exhibits, and the documents incorporated by reference in that Rule.
- (R) Private Psychiatric Facilities – licensed as a psychiatric hospital by the Colorado Department of Public Health and Environment.
- (S) Provider – a person or entity providing authorized health care service, whether involving treatment or not, to a worker in connection with work-related injury or occupational disease.
- (T) Rehabilitation Facilities – licensed as a rehabilitation hospital by the Colorado Department of Public Health and Environment.
- (U) Rural Health Facility – as identified and Medicare certified by the Colorado Department of Public Health and Environment.

- (V) Skilled Nursing Facility (SNF) – licensed as a skilled nursing facility by the Colorado Department of Public Health and Environment
- (W) State Psychiatric Hospitals and State Mental Health Institutions – licensed as a psychiatric facility and operated by the state.
- (X) “Supply et al.” – any single supply, durable medical equipment (DME), orthotic, prosthesis, biologic item, or single drug dose, for which the billed amount exceeds \$500.00 and all implants.
- (Y) Veterans’ Administration Medical Facilities – all medical facilities overseen by the Federal Veterans’ Administration.

16-3 REQUIRED USE OF THE MEDICAL TREATMENT GUIDELINES AND PAYMENT FOR SERVICE

When an injury or occupational disease falls within the purview of Rule 17, Medical Treatment Guidelines and the date of injury occurs on or after July 1, 1991, providers and payers shall use the medical treatment guidelines, in effect at the time of service, to prepare or review their treatment plan(s) for the injured worker. A payer may not dictate the type or duration of medical treatment. Nor may a payer rely solely on its’ own internal guidelines or other standards for medical determination. When treatment exceeds or is outside of the Medical Treatment Guidelines, prior authorization is required. In all instances of contest appropriate processes to deny are required. Refer to applicable sections of 16-9, 16-10 and/or 16-11.

16-4 REQUIRED USE OF THE MEDICAL FEE SCHEDULE

- (A) When services provided to an injured worker fall within the purview of the Medical Fee Schedule, all payers shall use the fee schedule to determine maximum allowable fees.
- (B) All providers are required to report services in accordance with codes, modifiers (both CPT and Level II HCPCS/National Modifiers as listed in RVP Introduction and or in Appendix A of CPT) and standards in Rule 18, Medical Fee Schedule that accurately represent the services provided. The Medical Fee Schedule sets the maximum allowable payment but the fee schedule does not limit the billing charges.
- (C) The provider may be subject to penalties under the Workers’ Compensation Act for inaccurate billing when the provider knew or should have known that the services billed were inaccurate, as determined by the Director or an administrative law judge.

16-5 RECOGNIZED HEALTH CARE PROVIDERS

- (A) Physician and Non-Physician Providers
  - (1) For the purpose of this Rule, recognized health care providers are divided into the major categories of "physician" and "non-physician". Recognized providers are defined as follows:
    - (a) "Physician providers" are those individuals who are licensed by the State of Colorado through one of the following state boards:
      - (1) Colorado State Board of Medical Examiners;
      - (2) Colorado State Board of Chiropractic Examiners;

- (3) Colorado Podiatry Board; or
- (4) Colorado State Board of Dental Examiners.

(b) "Non-physician providers" are those individuals who are registered or licensed by the State of Colorado Department of Regulatory Agencies (DORA), or certified by a national entity recognized by the State of Colorado as follows:

- (1) Acupuncturist (LAc) – licensed by the Office of Acupuncturist Registration, Colorado Department of Regulatory Agencies;
- (2) Advanced Practice Nurse – licensed by the Colorado State Board of Nursing; Advanced Practice Nurse Registry;
- (3) Athletic Trainers (ATC) – certified by the Board of Certification, Inc.;
- (4) Audiologist (AU.D. CCC-A) – certified by the American Speech Language-Hearing Association or board certified in audiology from the American Board of Audiology;
- (5) Clinical Social Worker (LCSW) – licensed by the Colorado State Board of Social Work Examiners;
- (6) Marriage and Family Therapist (LMFT) – licensed by the Colorado State Board of Marriage and Family Therapist Examiners;
- (7) Massage Therapist (RMT) – registered as a massage therapist by the Colorado Department of Regulatory Agencies;
- (8) Occupational Therapist (OTR) – registered by the Colorado Department of Regulatory Agencies as an occupational therapist certified by the National Board for Certification of Occupational Therapy;
- (9) Optometrist (OD) – licensed by the Colorado State Board of Optometric Examiners;
- (10) Orthopedic Technologist (OTC) – certified by the Board for Certification of Orthopedic Technologists, National Association of Orthopedic Technologists;
- (11) Pharmacist – licensed by the Colorado State Board of Pharmacy;
- (12) Physical Therapist (PT) – licensed by the Colorado State Board of Physical Therapy;
- (13) Physical Therapist Assistant (PTA) – certified by the Colorado Board of Physical Therapy.
- (14) Physician Assistant (PA) – licensed by the Colorado State Board of Medical Examiners;

- (15) Practical Nurse (LPN) – licensed by the Colorado State Board of Nursing;
  - (16) Professional Counselor (LPC) – licensed by the Colorado State Board of Professional Counselor Examiners;
  - (17) Psychologist (PsyD, PhD, EdD) – licensed by the Colorado State Board of Psychologist Examiners;
  - (18) Registered Nurse (RN) – licensed by the Colorado State Board of Nursing;
  - (19) Respiratory Therapist (RTL) – certified by the National Board of Respiratory Care and licensed by the Colorado Department of Regulatory Agencies;
  - (20) Speech Language Pathologist (CCC-SLP) – certified by DORA; and
  - (21) Surgical Technologist (CST) – certified under direction of the Association of Surgical Technologists.
- (2) Upon request, health care providers must provide copies of license, registration, certification or evidence of health care training for billed services.
  - (3) Any provider not listed in 16-5(A)(1)(a) or (b) must comply with 16-9, Prior Authorization when providing all services.
  - (4) Referrals:
    - (a) A payer or employer shall not redirect or alter the scope of an authorized treating provider's referral to another provider for treatment or evaluation of a compensable injury. Any party who has concerns regarding a referral or its scope shall advise the other parties and providers involved.
    - (b) All non-physician providers must have a referral from an authorized treating physician. An authorized treating physician making the referral to any listed or unlisted non-physician provider is required to clarify any questions concerning the scope of the referral, prescription, or the reasonableness or necessity of the care.
    - (c) Any listed or non-listed non-physician provider is required to clarify any questions concerning the scope of the referral, prescription, or the reasonableness or necessity of the care with the referring authorized treating physician.
  - (5) Rule 18, Medical Fee Schedule applies to authorized services provided in relation to a specific workers' compensation case.
- (B) Out-of-State Provider
- (1) Injured Worker Relocated
    - (a) Upon receipt of the "Employer's First Report of Injury" or the "Worker's Claim for Compensation" form, the payer shall notify the injured worker

that the procedures for change-of-provider, should s/he relocate out-of-state, can be obtained from the payer.

- (b) A change of provider must be made:
  - (1) Through referral by the injured worker's authorized treating physician; or
  - (2) In accordance with § 8-43-404 (5)(a), C.R.S.

(2) Injured Worker Referred

In the event an injured worker has not relocated out-of-state but is referred to an out-of-state provider for treatment or services not available within Colorado, the referring provider shall obtain prior authorization from the payer as set forth in 16-9, Prior Authorization, and 16-10, Contest of a Request for Prior Authorization. The referring provider's written request for out-of-state treatment shall include the following information:

- (a) Medical justification prepared by the referring provider;
- (b) Written explanation as to why the requested treatment/services cannot be obtained within Colorado;
- (c) Name, complete mailing address and telephone number of the out-of-state provider;
- (d) Description of the treatment/services requested, including the estimated length of time and frequency of the treatment/service, and all associated medical expenses; and
- (e) Out-of-state provider's qualifications to provide the requested treatment or services.

- (3) The Colorado fee schedule should govern reimbursement for out-of-state providers.

16-6 HANDLING, PROCESSING AND PAYMENT OF MEDICAL BILLS

- (A) Use of agents, including but not limited to Preferred Provider Organizations (PPO) networks, bill review companies, third party administrators (TPAs) and case management companies, shall not relieve the employer or insurer from their legal responsibilities for compliance with these Rules.
- (B) Payment for billed services identified in the Medical Fee Schedule shall not exceed those scheduled rates and fees, or the provider's actual billed charges, whichever is less.
- (C) Payment for billed services not identified or identified but without established value, by report (BR) and relativity not established (RNE), in the Medical Fee Schedule shall require prior authorization from the payer as set forth in 16-9 Prior Authorization, except when the billed non-established valued service or procedure is an emergency or a payment mechanism under Rule 18 is identifiable, but not explicit. Examples of the prior authorization request exception(s) include ambulance bills or supply bills that are covered under Rule 18-6(H) with an identified payment mechanism of either CO Medicare HCPCS Level II values or cost of the supply plus 20%.

Similar established code values from the Medical Fee Schedule, recommended by the requesting physician, shall govern the maximum fee value payment.

- (D) Any payer contesting a provider's treatment shall follow the procedures as outlined under 16-10, Contest of a Request for Prior Authorization, or 16-11, Payment of Medical Benefits.
- (E) The payer should note that ICD-9 Supplementary Classification of External Causes of Injury and Poisoning codes (E-codes), when submitted, shall not be used to establish the work relatedness of an injury or treatment.

#### 16-7 REQUIRED BILLING FORMS AND ACCOMPANYING DOCUMENTATION

- (A) Providers may use electronic reproductions of any required form(s) referenced in this section; however, any such reproduction shall be an exact duplication of such form(s) in content and appearance. With the agreement of the payer, identifying information may be placed in the margin of the form.

- (B) Required Billing Forms

All health care providers shall use only the following billing forms or electronically produced formats when billing for services:

- (1) CMS (Centers for Medicare & Medicaid Services) -1500 shall be used by all providers billing for professional services, durable medical equipment (DME) and ambulance services with the exception of those providers billing for dental services or procedures; hospitals are required to use the CMS-1500 when billing for professional services. Health care providers shall provide their name and credentials in an appropriate box of the CMS-1500.
- (2) UB-04 - shall be used by all hospitals, hospital-based ambulance/air services, Children's Hospitals, CAHs, Veterans' Administration Medical Facilities, home health and facilities meeting the definitions found in 16-2 when billing for hospital services or any facility fees billed by any other provider, such as ASCs, except for urgent care which may use the CMS-1500.
- (3) American Dental Association's Dental Claim Form, Version 2006 shall be used by all providers billing for dental services or procedures.
- (4) With the agreement of the payer, the ANSI ASC X12 (American National Standards Institute Accredited Standards Committee) or NCPDP (National Council For Prescription Drug Programs) electronic billing transaction containing the same information as in (1), (2) or (3) in this subsection may be used.

NCPDP Workers' Compensation/Property and Casualty (P&C) Universal Claim Form, version 1.1, for prescription drug billed on paper shall be used by dispensing pharmacies and pharmacy benefits management (PBM). Physicians may use the CMS-1500 billing form as described in Rule 16-7(B)(1).

- (C) Required Billing Codes

All billed services shall be itemized on the appropriate billing form as set forth in 16-7(A) and (B), and shall include applicable billing codes and modifiers from the Medical Fee Schedule. National provider identification (NPI) numbers are required for workers' compensation bills; providers who cannot obtain NPI numbers are exempt from this

requirement. When billing on a CMS-1500, the NPI should be that of the rendering provider and should include the correct place of service codes at the line level whenever possible.

(D) Inaccurate Billing Forms or Codes

Payment for any services not billed on the forms identified and/or not itemized as instructed in 16-7(B) and (C), may be contested until the provider complies. However, when payment is contested, the payer shall comply with the applicable provisions set forth in 16-11, Payment of Medical Benefits.

(E) Accompanying Documentation

- (1) Authorized treating physicians sign (or countersign) and submit to the payer, with their initial and final visit billings, a completed "Physician's Report of Workers' Compensation Injury" (Form WC 164) specifying:
  - (a) The report type as "initial" when the injured worker has their initial visit with the authorized treating physician managing the total workers' compensation claim of the patient. Generally, this will be the designated or selected authorized treating physician. When applicable, the emergency room or urgent care authorized treating physician for this workers' compensation injury may also create a WC 164 initial report. Unless requested or prior authorized by the payer in a specific workers' compensation claim, no other authorized physician should complete and bill for the initial WC 164 form. This form shall include completion of items 1-7 and 10. Note that certain information in item 2 (such as Insurer Claim #) may be omitted if not known by the provider.
  - (b) The report type as "closing" when the authorized treating physician (generally the designated or selected physician) managing the total workers' compensation claim of the patient determines the injured worker has reached maximum medical improvement (MMI) for all injuries or diseases covered under this workers' compensation claim, with or without a permanent impairment. The form requires the completion of items 1-5, 6.B, C, 7, 8 and 10. If the injured worker has sustained a permanent impairment, then item 9 must also be completed and the following additional information shall be attached to the bill at the time MMI is determined:
    - (1) All necessary permanent impairment rating reports when the authorized treating physician (generally the designated or selected physician) managing the total workers' compensation claim of the patient is Level II Accredited; or
    - (2) Referral to a Level II Accredited physician requested to perform the permanent impairment rating when a rating is necessary and the authorized treating physician (generally the designated or selected physician) managing the total workers' compensation claim of the patient is not determining the permanent impairment rating.
  - (c) At no charge, the physician shall supply the injured worker with one legible copy of all completed "Physician's Report of Workers' Compensation Injury" (WC 164) forms at the time the form is completed.

- (d) The provider shall submit to the payer the completed WC 164 form as specified in 16-7(E), no later than 14 days from the date of service.
- (2) Providers, other than hospitals, shall provide the payer with all supporting documentation at the time of submission of the bill unless other agreements have been made between the payer and provider. This shall include copies of the examination, surgical, and/or treatment records.
- (3) Hospital documentation shall be available to the payer upon request. Payers shall specify what portion of a hospital record is being requested. (For example, only the emergency room (ER) chart notes, in-patient physician orders and chart notes, x-rays, pathology reports, etc.)
- (4) In accordance with 16-11, the payer may contest payment for billed services until the provider completes and submits the relevant required accompanying documentation as specified by 16-7(E).
- (F) Providers shall submit their bills for services rendered within 120 days of the date of service or the bill may be denied unless extenuating circumstances exist. Extenuating circumstances may include but are not limited to delays in compensability being decided or the provider has not been informed where to send the bill.

#### 16-8 REQUIRED MEDICAL RECORD DOCUMENTATION

- (A) A treating provider shall maintain medical records for each injured worker when the provider intends to bill for the provided services.
- (B) All medical records shall contain legible documentation substantiating the services billed. The documentation shall itemize each contact with the injured worker and shall detail at least the following information per contact or, at a minimum for cases where contact occurs more than once a week, be summarized once per week:
  - (1) Patient's name;
  - (2) Date of contact, office visit or treatment;
  - (3) Name and professional designation of person providing the billed service;
  - (4) Assessment or diagnosis of current condition with appropriate objective findings;
  - (5) Treatment status or patient's functional response to current treatment;
  - (6) Treatment plan including specific therapy with time limits and measurable goals and detail of referrals;
  - (7) Pain diagrams, where applicable;
  - (8) If being completed by an authorized treating physician, all pertinent changes to work and/or activity restrictions which reflect lifting, standing, stooping, kneeling, hot or cold environment, repetitive motion or other appropriate physical considerations; and
  - (9) All prior authorization(s) for payment received from the payer (i.e., who approved the prior authorization for payment, services authorized, dollar amount, length of time, etc.).

16-9 PRIOR AUTHORIZATION

- (A) Granting of prior authorization is a guarantee of payment in accordance with Rule 18, RVP© and CPT© for those services/procedures requested by the provider per 16-9(F).
- (B) Prior authorization for payment shall be requested by the provider when:
  - (1) A prescribed service exceeds the recommended limitations set forth in the Medical Treatment Guidelines;
  - (2) The Medical Treatment Guidelines otherwise require prior authorization for that specific service;
  - (3) A prescribed service is identified within the Medical Fee Schedule as requiring prior authorization for payment; or
  - (4) A prescribed service is not identified in the Medical Fee Schedule as referenced in 16-6(C).
- (C) Prior authorization for a prescribed service or procedure may be granted immediately and without medical review. However, the payer shall respond to all providers requesting prior authorization within seven (7) business days from receipt of the provider's completed request as defined in 16-9(F). The duty to respond to a provider's written request applies without regard for who transmitted the request.
- (D) The payer, upon receipt of the "Employer's First Report of Injury" or a "Worker's Claim for Compensation," shall give written notice to the injured worker stating that the requirements for obtaining prior authorization for payment are available from the payer.
- (E) The payer, unless they have previously notified said provider, shall give notice to the provider of these procedures for obtaining prior authorization for payment upon receipt of the initial bill from that provider.
- (F) To complete a prior authorization request, the provider shall concurrently explain the reasonableness and the medical necessity of the services requested, and shall provide relevant supporting medical documentation. Supporting medical documentation is defined as documents used in the provider's decision-making process to substantiate the need for the requested service or procedure.
  - (1) When the indicators of the Medical Treatment Guidelines are met, no prior authorization is required. If the provider requests prior authorization for payment the following documentation is recommended:
    - (a) An adequate definition or description of the nature, extent, and necessity for the procedure;
    - (b) Identify the appropriate Medical Treatment Guideline application to the requested service;
    - (c) Document that the indicators in the guidelines have been met; and
    - (d) Final diagnosis.
  - (2) When the service/procedure does not fall within the Medical Treatment Guidelines and/or past treatment failed functional goals or if the requested procedure is not

identified in the Medical Fee Schedule or does not have an established value under the Medical Fee Schedule, such as any unlisted procedure/service with a BR value or an RNE value listed in the RVP© authorization requests may be made using the "Authorized Treating Provider's Request for Prior Authorization" (Form WC 188).

- (G) To contest a request for prior authorization, the payer is required to comply with the provisions outlined in 16-10.
- (H) The Division recommends payers confirm in writing, to providers and all parties, when a request for prior authorization is approved.
- (I) If, after the service was provided, the payer agrees the service provided was reasonable and necessary, lack of prior authorization for payment does not warrant denial of payment. However, the provider is still required to provide with the bill the documentation as required by 16-9(F) for any unlisted valued service or procedure for payment.

#### 16-10 CONTEST OF A REQUEST FOR PRIOR AUTHORIZATION

- (A) If the payer contests a request for prior authorization for non-medical reasons as defined under 16-11(B)(1), the payer shall notify the provider and parties, in writing, of the basis for the contest within seven (7) business days from receipt of the provider's completed request as defined in 16-9(F). A certificate of mailing of the written contest must be sent to the provider and parties.

If an ATP requests prior authorization and indicates in writing, including their reasoning and relevant documentation, that they believe the requested treatment is related to the admitted workers' compensation claim, the insurer cannot deny based solely on relatedness without a medical review as required by 16-10(B).

- (B) If the payer is contesting a request for prior authorization for medical reasons, the payer shall, within seven (7) business days of the completed request:
  - (1) Have all the submitted documentation under 16-9(F) reviewed by a physician or other health care professional, as defined in 16-5(A)(1)(a), who holds a license and is in the same or similar specialty as would typically manage the medical condition, procedures, or treatment under review; and
  - (2) After reviewing all the submitted documentation, the reviewing provider may call the requesting provider to expedite communication and processing of prior authorization requests. However, the written contest or approval still needs to be completed within the specified seven (7) business days under 16-10(B).
  - (3) Furnish the provider and the parties with a written contest that sets forth the following information:
    - (a) An explanation of the specific medical reasons for the contest, including the name and professional credentials of the person performing the medical review and a copy of the medical reviewer's opinion;
    - (b) The specific cite from the Medical Treatment Guidelines exhibits to Rule 17, when applicable;
    - (c) Identification of the information deemed most likely to influence the reconsideration of the contest when applicable; and

(d) A certificate of mailing to the provider and parties.

(C) Prior Authorization Disputes

- (1) The requesting party or provider shall have seven (7) business days from the date of the certificate of mailing on the written contest to provide a written response to the payer, including a certificate of mailing. The response is not considered a "special report" when prepared by the provider of the requested service.
- (2) The payer shall have seven (7) business days from the date of the certificate of mailing of the response to issue a final decision, including a certificate of mailing to the provider and parties.
- (3) In the event of continued disagreement, the parties should follow dispute resolution and adjudication procedures available through the Division or Office of Administrative Courts.

(D) An urgent need for prior authorization of health care services, as recommended in writing by an authorized treating provider, shall be deemed good cause for an expedited hearing.

(E) Failure of the payer to timely comply in full with the requirements of 16-10(A) or (B), shall be deemed authorization for payment of the requested treatment unless:

- (1) A hearing is requested within the time prescribed for responding as set forth in 16-10(A) or (B); and
- (2) The requesting provider is notified that the request is being contested and the matter is going to hearing.

(F) Unreasonable delay or denial of prior authorization, as determined by the Director or an administrative law judge, may subject the payer to penalties under the Workers' Compensation Act.

16-11 PAYMENT OF MEDICAL BENEFITS

(A) Payer Requirements for Processing Medical Service Bills

- (1) For every medical service bill submitted by a provider, the payer shall reply with a written notice or explanation of benefits. In those instances where the payer reimburses the exact billed amount, identification of the patient's name, the payer, the paid bill, the amount paid and the dates of service are required. If any adjustments are made then the payer's written notice shall include:
  - (a) Name of the injured worker or patient;
  - (b) Specific identifying information coordinating the notice with any payment instrument associated with the bill;
  - (c) Date(s) of service(s), if date(s) was (were) submitted on the bill;
  - (d) Payer's claim number and/or Division's workers' compensation claim number, if one has been created;
  - (e) Reference to the bill and each item of the bill;

- (f) Notice that the billing party may resubmit the bill or corrected bill within 60 days;
  - (g) For compensable services for a work-related injury or occupational disease the payer shall notify the billing provider that the injured worker shall not be balance-billed for services related to the work-related injury or occupational disease;
  - (h) Name of insurer with admitted, ordered or contested liability for the workers' compensation claim, when known;
  - (i) Name, address, e-mail (if any), phone number and fax of a person who has responsibility and authority to discuss and resolve disputes on the bill;
  - (j) Name and address of the employer, when known; and
  - (k) Name and address of the Third Party Administrator (TPA) and name and address of the bill reviewer if separate company when known; and
  - (l) If applicable, a statement that the payment is being held in abeyance because a relevant issue is being brought to hearing.
- (2) The payer shall send the billing party written notice that complies with 16-11(A)(1) and (B) or (C) if contesting payment for non-medical or medical reasons within 30 days of receipt of the bill. Any notice that fails to include the required information set forth in 16-11(A)(1) and (B) or (C) if contesting payment for non-medical or medical reasons is defective and does not satisfy the payer's 30-day notice requirements set forth in this section.
- (3) Unless the payer provides timely and proper reasons as set forth by the provisions outlined in 16-11(B) - (D), all bills submitted by a provider are due and payable in accordance with the Medical Fee Schedule within 30 days after receipt of the bill by the payer.
- (4) If the payer discounts a bill and the provider requests clarification in writing, the payer shall furnish to the requester the specifics of the discount within 30 days including a copy of any contract relied on for the discount. If no response is forthcoming within 30 days, the payer must pay the maximum Medical Fee Schedule allowance or the billed charges, whichever is less.
- (5) Date of receipt of the bill may be established by the payer's date stamp or electronic acknowledgement date; otherwise, receipt is presumed to occur three (3) business days after the date the bill was mailed to the payer's correct address.
- (6) Unreasonable delay in processing payment or denial of payment of medical service bills, as determined by the Director or an administrative law judge, may subject the payer to penalties under the Workers' Compensation Act.
- (7) If the payer fails to make timely payment of uncontested billed services, the billing party may report the incident to the Division's Carrier Practices Unit who may use it during an audit.
- (B) Process for Contesting Payment of Billed Services Based on Non-Medical Reasons

- (1) Non-medical reasons are administrative issues. Examples of non-medical reasons for contesting payment include the following: no claim has been filed with the payer; compensability has not been established; the billed services are not related to the admitted injury; the provider is not authorized to treat; the insurance coverage is at issue; typographic, gender or date errors are in the bill; failure to submit any medical documentation at all; unrecognized CPT® code.
- (2) If an ATP bills for medical services and indicates in writing, including their reasoning and relevant documentation that they believe the medical services are related to the admitted WC claim, the payer cannot deny based solely on relatedness without a medical review as required by 16-11(C).
- (3) In all cases where a billed service is contested for non-medical reasons, the payer shall send the billing party written notice of the contest within 30 days of receipt of the bill. The written notice shall include all of the notice requirements set forth in 16-11(A)(1) and shall also include:
  - (a) Date(s) of service(s) being contested, if date(s) was(were) submitted on the bill;
  - (b) If applicable, acknowledgement of specific uncontested and paid items submitted on the same bill as contested services;
  - (c) Reference to the bill and each item of the bill being contested; and
  - (d) Clear and persuasive reasons for contesting the payment of any item specific to that bill including the citing of appropriate statutes, rules and/or documents supporting the payer's reasons for contesting payment.

Any notice that fails to include the required information set forth in this section is defective. Such defective notice shall not satisfy the payer's 30 day notice requirement set forth in this section.

- (4) Prior to modifying a billed code, the payer must contact the billing provider and determine if the modified code is accurate.
  - (a) If the billing provider agrees with the payer, then the payer shall process the service with the agreed upon code and shall document on their explanation of benefits (EOB) the agreement with the provider. The EOB shall include the name of the person at the provider's office who made the agreement.
  - (b) If the provider is in disagreement, then the payer shall proceed according to 16-11(B) or 16-11(C), as appropriate.
- (5) Lack of prior authorization for payment does not warrant denial of liability for payment.
- (6) When no established fee is given in the Medical Fee Schedule and the payer agrees the service or procedure is reasonable and necessary, the payer shall list on their written notice of contest (see 16-11(A)(1)) one of the following payment options:

- (a) A reasonable value based upon the similar established code value recommended by the requesting provider;
- (b) The provider's requested payment based on an established similar code value as required by 16-9(F); or
- (c) The billed charges.

If the payer disagrees with the provider's recommended code value, the payer's notice of contest shall include an explanation of why the requested fee is not reasonable and what their recommendation is, based on the payment options.

If the payer is contesting the medical necessity of any non-valued procedure after a prior authorization was requested, the payer shall follow 16-11(C).

(C) Process for Contesting Payment of Billed Services Based on Medical Reasons

When contesting payment of billed services based on medical reasons, the payer shall:

- (1) Have the bill and all supporting medical documentation under 16-7(E) reviewed by a physician or other health care professional as defined in 16-5(A)(1)(a), who holds a license and is in the same or similar specialty as would typically manage the medical condition, procedures, or treatment under review. After reviewing the supporting medical documentation, the reviewing provider may call the billing provider to expedite communication and timely processing of the contested or paid medical bill.
- (2) In all cases where a billed service is contested for medical reasons, the payer shall send the provider and the parties written notice of the contest within 30 days of receipt of the bill. The written notice shall include all of the notice requirements set forth in 16-11(A)(1) and shall also include:
  - (a) Date(s) of service(s) being contested, if date(s) was (were) submitted on the bill;
  - (b) If applicable, acknowledgement of specific uncontested and paid items submitted on the same bill as contested services;
  - (c) Reference to the bill and each item of the bill being contested;
  - (d) An explanation of the clear and persuasive medical reasons for the decision, including the name and professional credentials of the person performing the medical review and a copy of the medical reviewer's opinion;
  - (e) The specific cite from the Medical Treatment Guidelines exhibits to Rule 17, when applicable; and
  - (f) Identification of the information deemed most likely to influence the reconsideration of the contest, when applicable.
- (3) Any notice that fails to include the required information set forth in this section is defective. Such defective notice shall not satisfy the payer's 30-day notice requirement set forth in this section.

- (4) If the payer is contesting the medical necessity of any non-valued procedure provided without prior authorization, the payer shall follow the procedures given in 16-11(C)(1) and (2).

(D) Process for Ongoing Contest of Billed Services

- (1) The billing party shall have 60 days to respond to the payer's written notice under 16-11(A) – (C). The billing party's timely response must include:
  - (a) A copy of the original or corrected bill;
  - (b) A copy of the written notice or EOB received;
  - (c) A statement of the specific item(s) contested;
  - (d) Clear and persuasive supporting documentation or clear and persuasive reasons for the appeal; and
  - (e) Any available additional information requested in the payer's written notice.
- (2) If the billing party responds timely and in compliance with 16-11(D)(1), the payer shall:
  - (a) When contesting for medical reasons, have the bill and all supporting medical documentation and reasoning under 16-7(E) and, if applicable, 16-11(D)(1) reviewed by a physician or other health care professional as defined in 16-5(A)(1)(a), who holds a license and is in the same or similar specialty as would typically manage the medical condition, procedures, or treatment under review. After reviewing the provider's documentation and response, the reviewing provider may call the billing provider to expedite communication and timely processing of the contested or paid medical bill.
  - (b) When contesting for non-medical reasons, have the bill and all supporting medical documentation and reasoning under 16-7(E) and, if applicable, 16-11(D)(1) reviewed by a person who has knowledge of the bill. After reviewing the provider's documentation and response, the reviewing person may call the billing provider to expedite communication and timely processing of the contested or paid medical bill.
- (3) If before or after conducting a review pursuant to 16-11(D)(2), the payer agrees with the billing party's response, the billed service is due and payable in accordance with the Medical Fee Schedule within 30 days after receipt of the billing party's response. Date of receipt may be established by the payer's date stamp or electronic acknowledgement date; otherwise, receipt is presumed to occur three (3) business days after the date the response was mailed to the payer's correct address.
- (4) After conducting a review pursuant to 16-11(D)(2), if there is still a dispute regarding the billed services, the payer shall send the billing party written notice of contest within 30 days of receipt of the response. The written notice shall include all of the notice requirements set forth in 16-11(A)(1) and shall also include:

- (a) Date(s) of service(s) being contested, if date(s) was(were) submitted by the provider;
  - (b) If applicable, acknowledgement of specific uncontested and paid items submitted on the same bill as contested services;
  - (c) Reference to the bill and each item of the bill being contested;
  - (d) An explanation of the clear and persuasive medical or non-medical reasons for the decision, including the name and professional credentials of the person performing the medical or non-medical review and a copy of the medical reviewer's opinion when the contest is over a medical reason; and
  - (e) The explanation shall include the citing of appropriate statutes, rules and/or documents supporting the payer's reasons for contesting payment.
- (5) Any notice that fails to include the required information set forth in this section is defective. Such defective notice shall not satisfy the payer's 30-day notice requirement set forth in this section.
- (6) In the event of continued disagreement, and within 12 months of the bill being processed in compliance with Rule 16-11, the parties should follow dispute resolution and adjudication procedures available through the Division or Office of Administrative Courts.
- (E) When seeking dispute resolution from the Division's Medical Policy Unit (MPU), the requesting party must complete the Division's "Medical Billing Dispute Resolution Intake Form" (Form WC 181) found on the Division's web page. The items listed on the bottom of the form must be provided at the time of submission. If necessary items are missing or if more information is required, the Division will forward a request for additional information and initiation of the process may be delayed.

When the request is properly made and the supporting documentation submitted, the Division will issue a confirmation of receipt. If after reviewing the materials the Division believes the dispute criteria have not been met, the Division will issue an explanation of those reasons. If the Division determines there is cause for facilitating the disputed items, the other party will be sent a request for a written response, allowing the other party ten (10) business days to respond.

The MPU will facilitate the dispute by reviewing the parties' compliance with Rules 16 and 18 within 30 days of receipt of the complete supporting documentation; or as soon thereafter as possible.

Upon review of all submitted documentation, disputes resulting from violation of Rules 16 and/or 18, as determined by the Director, may result in a Director's Order that cites the specific violation.

Evidence of compliance with the order shall be provided to the Director. If the party does not agree with the findings, it shall state with particularity and in writing its reasons for all disagreements by providing a response with all relevant legal authority, and/or other relevant proof upon which it relies in support of its position(s) concerning disagreements with the order.

Failure to respond or cure violations may result in penalties in accordance with § 8-43-304. Daily fines up to \$1000/day for each such offence will be assessed until the party complies with the Director's Order.

Resolution of disputes not pertaining to Rule violations will be facilitated by the MPU to the extent possible. In the event both parties cannot reach an agreement, the parties will be provided additional information on pursuing resolution and adjudication procedures available through the Office of Administrative Courts. Use of the dispute resolution process does not extend the 12 month application period for hearing.

(F) Retroactive review of Medical Bills

- (1) All medical bills paid by a payer shall be considered final at 12 months after the date of the original explanation of benefits unless the provider is notified that:
  - (a) A hearing is requested within the 12 month period, or
  - (b) A request for utilization review has been filed pursuant to § 8-43-501.
- (2) If the payer conducts a retroactive review to recover overpayments from a provider based on medical reasons, the payer shall have the bill and all supporting documentation reviewed by a physician or other health care professional as defined in 16-5(A)(1)(a), who holds a license and is in the same or similar specialty as would typically manage the medical condition, procedures, or treatment under review. The payer shall send the billing party written notice that shall include all of the notice requirements set forth in 16-11(A)(1) and shall also include:
  - (a) Reference to each item of the bill where payer seeks to recover overpayments;
  - (b) Clear and persuasive medical reason(s) for seeking recovery of overpayment(s). The explanation shall include the citing of appropriate statutes, rules, and/or other documents supporting the payer's reason for seeking to recover overpayment; and
  - (c) Evidence that these payments were in fact made to the provider.
- (3) If the payer conducts a retroactive review to recover overpayments from a provider based on non-medical reasons, the payer shall send the billing party written notice that shall include all of the notice requirements set forth in 16-11(A)(1) and shall also include:
  - (a) Reference to each item of the bill where payer seeks to recover overpayments;
  - (b) Clear and persuasive reason(s) for seeking recovery of overpayment(s). The explanation shall include the citing of appropriate statutes, rules, and/or other documents supporting the payer's reason for seeking to recover overpayment; and
  - (c) Evidence that these payments were in fact made to the provider.

- (4) In the event of continued disagreement, the parties may follow dispute resolution and adjudication procedures available through the Division or Office of Administrative Courts.
- (G) An injured worker shall never be required to directly pay for admitted or ordered medical benefits covered under the Workers' Compensation Act. In the event the injured worker has directly paid for medical services that are then admitted or ordered as covered under the Workers' Compensation Act, the payer shall reimburse the injured worker for the amounts actually paid for authorized services within 30 days after receipt of the bill. If the actual costs exceed the maximum fee allowed by the Medical Fee Schedule, the payer may seek a refund from the medical provider for the difference between the amount charged to the injured worker and the maximum fee. Each request for a refund shall indicate the service provided and the date of service(s) involved.
- (H) To the extent not otherwise precluded by the laws of this state, contracts between providers, payers and any agents acting on behalf of providers or payers shall comply with 16-11.

#### 16-12 ONSITE REVIEW OF HOSPITAL OR OTHER MEDICAL CHARGES

- (A) The payer may conduct a review of billed and non-billed hospital or medical facility charges related to a specific workers' compensation claim.
- (B) The payer shall comply with the following procedures:

Within 30 days of receipt of the bill, notify the hospital or other medical facility of its intent to conduct a review. Notification shall be in writing and shall set forth the following information:

- (1) Name of the injured worker;
  - (2) Claim and/or hospital or other medical facility I.D. number associated with the injured worker's bill;
  - (3) An outline of the items to be reviewed; and
  - (4) If applicable, the name, address and telephone number of any person who has been designated by the payer to conduct the review (reviewer).
- (C) The hospital or other medical facility shall comply with the following procedures:
    - (1) Allow the review to begin within 30 days of the payer's notification;
    - (2) Upon receipt of the patient's signed release of information form, allow the reviewer access to all items identified on the injured worker's signed release of information form;
    - (3) Designate an individual(s) to serve as the primary liaison(s) between the hospital or other medical facility and the reviewer who will acquaint the reviewer with the documentation and charging practices of the hospital or other medical facility;
    - (4) Provide a written response to each of the preliminary review findings within ten (10) business days of receipt of those findings; and
    - (5) Participate in the exit conference in an effort to resolve discrepancies.

- (D) The reviewer shall comply with the following procedures:
- (1) Obtain from the injured worker a signed information release form;
  - (2) Negotiate the starting date for the review;
  - (3) Assign staff members who are familiar with medical terminology, general hospital or other medical facility charging and medical records documentation procedures or have a level of knowledge equivalent at least to that of an LPN;
  - (4) Establish the schedule for the review which shall include, at a minimum, the dates for the delivery of preliminary findings to the hospital or other medical facility, a ten (10) business day response period for the hospital or other medical facility, and the delivery of an itemized listing of discrepancies at an exit conference upon the completion of the review; and
  - (5) Provide the payer and hospital or other medical facility with a written summary of the review within 20 business days of the exit conference.



**PINNACOL ASSURANCE**

Statutory-Basis Financial Statements and  
Supplemental Schedules of Investment Information

December 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

**LIMITATIONS ON DISCLOSURE OF INFORMATION  
CONTAINED IN THIS DOCUMENT**

The enclosed report is being distributed to you at this time for your information in accordance with Colorado Revised Statutes (CRS).

SECTION 2-3-103 (2) states in part:

All reports shall be open to public inspection except for that portion of any report containing recommendations, comments, and any narrative statements, which is released only upon the approval of a majority vote of the committee (emphasis supplied).

SECTION 2-3-103.7 (1) states in part:

Any state employee or other individual acting in an oversight role as a member of a committee, board, or commission who willfully and knowingly discloses the contents of any report prepared by, or at the direction of, the Office of the State Auditor prior to the release of such report by a majority vote of the committee as provided in Section 2-3-103 (2) is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not more than five hundred dollars (emphasis supplied).

COSA – 201 10/2006

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2015 MEMBERS**

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**Chair**

*Representative Su Ryden*  
**Vice Chair**

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*Senator Chris Holbert*  
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*Senator Tim Neville*  
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A bound report may be obtained by calling the  
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**303-869-2800**

Please refer to the report number 1510F when  
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**PINNACOL ASSURANCE  
2016 BOARD OF DIRECTORS**

*Howard L. Carver*  
**Chair**

*Jeffrey L. Cummings*  
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*Joshua L. (Luke) McFarland*  
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**PINNACOL ASSURANCE  
2015 BOARD OF DIRECTORS**

*Blair E. Richardson*  
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*Patricia L. Peterson*

# PINNACOL ASSURANCE

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## PINNACOL ASSURANCE

### Report Summary

#### **Authority and Purpose/Scope of the Audit**

This audit is conducted under the authority of Section 8-45-121(2) of the Colorado Revised Statutes (C.R.S.), which authorizes the State Auditor to conduct an annual financial audit of Pinnacol Assurance (Pinnacol or the Company) and contract with an auditor or firm of auditors, having the specialized knowledge and experience. The primary purpose of our engagement is to audit the statutory-basis financial statements of Pinnacol as of and for the year ended December 31, 2015, 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, and to express an opinion on those statutory-basis financial statements and the supplemental schedules of investment information. The objective of an audit conducted in accordance with such standards is to obtain reasonable, but not absolute, assurance about whether the statutory-basis financial statements are free of material misstatement.

The financial statements of Pinnacol are prepared in accordance with statutory accounting principles prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (hereinafter referred to as statutory-basis financial statements, or financial statements in accordance with statutory accounting principles). Accordingly, they are not designed to present, and do not present, the financial position or results of operations in accordance with accounting principles generally accepted in the United States of America.

In the course of our audit, we examined, on a test basis, evidence supporting the amounts and disclosures in Pinnacol's statutory-basis financial statements as of and for the year ended December 31, 2015.

#### **Required Communications to the Legislative Audit Committee**

In accordance with auditing standards generally accepted in the United States of America (AU Section 260 – *The Auditor's Communication With Those Charged With Governance*), we must communicate to the Legislative Audit Committee certain matters noted during our audit. The following sets forth these required communications:

**Auditor's Responsibility under Professional Standards** – The objective of a financial statement audit conducted in accordance with generally accepted auditing standards (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (GAGAS) is to express an opinion on the fairness of the presentation of the Company's statutory-basis financial statements as of and for the year ended December 31, 2015, in conformity with accounting principles prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado. The audit of the statutory-basis financial statements does not relieve management of its responsibilities.

The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether caused by fraud or error. In making those risk assessments, we considered internal control over financial reporting relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that were 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 do not express an opinion on the effectiveness of the Company's internal control over financial reporting. Our consideration of internal control over financial reporting was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

1. **Accounting Estimates** – Accounting estimates are an integral part of the statutory-basis financial statements prepared by management and are based on management's current judgments. Those judgments are ordinarily

## PINNACOL ASSURANCE

### Report Summary

based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Company's 2015 statutory-basis financial statements include the following:

*Bonds and Common Stocks* – Pinnacol must consider the statutory requirements related to other-than-temporary impairments when determining whether any declines in value are recognized through realized losses in the statutory statement of operations or through change in unrealized losses, which is a direct charge to policyholders' surplus. These statutory requirements for other-than-temporary impairments (OTTI) require management's judgment and consideration of various characteristics of the investments, the underlying causes of the decline in value, as well as management's intent related to future sales of the securities. The Company recorded \$37,834,000 in other-than-temporary impairments on common stocks, mutual funds, and bonds for the year ended December 31, 2015.

*Reserve for Unpaid Losses and Loss Adjustment Expenses* – Estimating the reserve for unpaid losses and loss adjustment expenses (reserves) of an insurance company is a subjective and judgmental process, particularly for workers' compensation insurance, where the ultimate liability to a claimant may not be known with certainty for a number of years. To assist management in estimating the liability for unpaid losses and loss adjustment expenses, Pinnacol retains the assistance of an actuarial consulting firm. At December 31, 2015, Pinnacol has recorded \$940,124,000 as reserves for unpaid losses and loss adjustment expenses as management's best estimate, which management believes to be a reasonable estimate of future amounts to be paid for claims incurred in 2015 and in prior years.

*Structured Settlement Liability* – Pinnacol discounts internal structured settlement liabilities on a tabular basis using a discount rate of 2.5% for 2015. The discount rate is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield.

*Premium Deficiency Reserve* – A premium deficiency reserve is recognized by recording an additional liability for the deficiency, which results when anticipated 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, and anticipated investment income. The change in this reserve is recorded as a component of other underwriting expenses incurred.

Over the past several years Pinnacol increased rates to achieve rate adequacy, which is reflected in the 2014 elimination of the premium deficiency reserve and remains \$0 in 2015. The premium deficiency reserve evaluation was completed on January 21, 2016 by an independent actuary.

*Uncollected Premiums* – The amount of uncollected premiums, which affects the amount of premium revenue recognized, is estimated using statutory requirements, as well as certain management judgments. Management must determine whether an allowance should be established to provide for all reasonably anticipated uncollectible amounts inherent in the uncollected premiums balance. Factors that are considered in establishing reserves for anticipated uncollectible amounts are collection experience and trends, current overall aging of balances, economic conditions and trends, and evaluations of individual accounts. At December 31, 2015, the admitted value of uncollected premiums as reflected in Pinnacol's statutory-basis financial statements is \$79,879,000.

*Earned but Unbilled Premiums* – Earned but unbilled premiums represent a receivable or liability for audit premiums, which are amounts due from or to policyholders after the respective policy period has expired based on audits performed by Pinnacol. A receivable is included as a component of uncollected premiums.

## PINNACOL ASSURANCE

### Report Summary

A liability is included as a component of credit balances due policyholders. Such amounts are estimated by Pinnacol based upon internal calculations using historical premium data. Based on this analysis, Pinnacol recorded an estimated earned but unbilled receivable of approximately \$45,390,000 in 2015.

*Safety Group Dividends Payable to Policyholders* – Pinnacol has a safety group dividend program whereby policyholders who are members of the program are entitled to a dividend based on established criteria. Based on the payment pattern for these dividends, management must estimate the future loss ratio for the eligible policyholders in order to determine the accrual recorded at December 31, 2015. For 2015, safety group dividends payable of \$2,789,000 are included in dividends payable to policyholders.

*Individual Loss Control Dividends Payable to Policyholders* – Pinnacol has an individual loss control dividend (ILCD) program that is designed for policyholders who are committed to effective loss control in their business operations. If the policyholder meets the minimum premium requirements and pays an additional 5% premium charge as a buy-in to the plan, the policyholder may receive a return of premium based on the policy premium and the loss ratio. For 2015, ILCD payable of \$18,571,000 are included in dividends payable to policyholders.

*Agent Loss Control Bonus* – Pinnacol offers an agent contingency commission that is based upon each agency's estimated loss ratio. It is calculated as of June 30th for the preceding accident year. For 2015, an agent loss control bonus accrual of \$24,087,000 is included in commissions payable.

2. **Uncorrected Misstatements** – Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. There are no financial statement misstatements as of and for the year ended December 31, 2015.
3. **Material Corrected Misstatements** – Our audit of the statutory-basis financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. There were no material misstatements that were brought to the attention of management as a result of our audit procedures.
4. **Significant Accounting Policies** – The Company's significant accounting policies are set forth in note 1 to the Company's 2015 statutory-basis financial statements.
5. **Other Information in the Annual Report to Policyholders** – When audited financial statements are included in documents containing other information such as the Company's Annual Report to Policyholders, we read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the statutory-basis financial statements audited by us.
6. **Disagreements with Management** – We have not had any disagreements with management related to matters that are material to the Company's 2015 statutory-basis financial statements.
7. **Our Views about Significant Matters that were the Subject of Consultation with Other Accountants** – We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2015.

## PINNACOL ASSURANCE

### Report Summary

8. **Significant Issues Discussed, or Subject of Correspondence, with Management prior to our Retention** – Throughout the year, routine discussions were held, or were the subject of correspondence, with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.
9. **Other Significant Findings or Issues Arising from the Audit Discussed, or Subject to Correspondence, with Management** – Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant findings or issues requiring communication to the Legislative Audit Committee.
10. **Significant Difficulties Encountered in Performing the Audit** – In our judgment, we received the full cooperation of the Company’s management and staff and had unrestricted access to the Company’s senior management in the performance of our audit.
11. **Management Representations** – We have made specific inquiries of the Company’s management about the representations embodied in the statutory-basis financial statements. Additionally, we have requested that management provide to us the written representations the Company is required to provide to its independent auditors under GAAS.
12. **Other Findings or Issues** – KPMG LLP performed this audit under contract with the Office of the State Auditor and did not discuss accounting or auditing issues with Pinnacol in connection with our retention as auditor.
13. **Modifications to the Opinion in the Independent Auditor’s Report** – As we are issuing an opinion on the statutory-basis financial statements in conformity with accounting principles prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, we have modified our financial statement opinion to include an adverse opinion on accounting principles generally accepted in the United States of America (GAAP).
14. **Independence** – Our professional standards and other regulatory requirements specify that we communicate to you in writing, at least annually, all independence-related relationships between our firm and Pinnacol and provide confirmation that we are independent accountants with respect to Pinnacol.

We hereby confirm that as of May 18, 2016 we are independent accountants with respect to Pinnacol under all relevant professional and regulatory standards.

#### Summary of Audit Findings

No material weaknesses in internal control were discovered during the 2015 audit of the statutory-basis financial statements.

## **PINNACOL ASSURANCE**

### Description of Pinnacol Assurance

December 31, 2015

Pinnacol Assurance (Pinnacol or the Company) was established as a political subdivision of the State of Colorado (the State) under provisions of the Workers' Compensation Act of Colorado (Title 8, Article 45 of the Colorado Revised Statutes, as amended) to operate as a domestic mutual insurance company for the benefit of injured employees and dependents of deceased employees in Colorado. As required under state law, Pinnacol provides an assured source of workers' compensation insurance to Colorado employers. Pinnacol shall not refuse to insure any Colorado employer or cancel any insurance policy due to the risk of loss or amount of premium, except as otherwise provided in Title 8, Article 45, C.R.S., as amended.

Pinnacol is controlled by a nine-member board of directors, which is appointed by the Governor with the consent of the Colorado Senate. The board of directors has control over all monies of Pinnacol and is restricted to use such monies only for the purposes provided in Title 8, Article 45, C.R.S., as amended. The board of directors appoints a chief executive officer who is vested with full power and jurisdiction over the administration of Pinnacol. Pinnacol is not an agency of state government. The State retains no liability on the part of Pinnacol and no State monies are used for Pinnacol operations. All revenue, monies, and assets of Pinnacol belong solely to Pinnacol. The State of Colorado has no claim to, nor any interest in, such revenue, monies, and assets and shall not borrow, appropriate, or direct payments from such revenue, monies, and assets for any purpose.

#### **Policyholders' Surplus**

Pinnacol had policyholders' surplus of \$935,298,000 and \$847,987,000 as of December 31, 2015 and 2014, respectively. The increase in surplus is primarily related to current year net income.



KPMG LLP  
Suite 800  
1225 17th Street  
Denver, CO 80202-5598

## **Independent Auditors' Report**

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Pinnacol Assurance, which comprise the statutory statements of admitted assets, liabilities, and policyholders' surplus as of December 31, 2015, and the related statutory statements of operations and changes in policyholders' surplus, and cash flow for the year then ended, and the related notes to the statutory financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### ***Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles***

As described in note 1 to the financial statements, the 2015 financial statements are prepared by Pinnacol Assurance using statutory accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, which is a basis of accounting other than U.S. generally accepted accounting principles. Accordingly, the 2015 financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.



The effects on the 2015 financial statements of the variances between the statutory accounting practices described in note 1 and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

***Adverse Opinion on U.S. Generally Accepted Accounting Principles***

In our opinion, because of the significance of the variances between statutory accounting principles and U.S. generally accepted accounting principles discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of Pinnacol Assurance as of December 31, 2015, or the results of its operations or its cash flow for the year then ended.

***Opinion on Statutory Basis of Accounting***

In our opinion, the 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, 2015, and the results of its operations and its cash flow for the year then ended, in accordance with statutory accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado described in note 1.

***Other Matters***

***Supplemental Schedule***

Our audit was conducted for the purpose of forming an opinion on the 2015 financial statements as a whole. The supplementary information included in the supplemental schedule of investment risks interrogatories and supplemental summary investment schedule are presented for purposes of additional analysis and are not a required part of the 2015 financial statements but are supplementary information required by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2015 financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2015 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 2015 financial statements or to the 2015 financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 2015 financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated May 18, 2016 on our consideration of Pinnacol Assurance's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Pinnacol Assurance's internal control over financial reporting and compliance.

**KPMG LLP**

Denver, Colorado  
May 18, 2016

**PINNACOL ASSURANCE**  
Statutory-Basis Statements of Admitted Assets, Liabilities, and  
Policyholders' Surplus  
December 31, 2015 and 2014  
(In thousands)

<b>Admitted Assets</b>	<b>2015</b>	<b>2014</b>
Cash and invested assets:		
Bonds at adjusted carrying value, fair value of \$1,849,351 in 2015 and \$1,790,772 in 2014 (note 4)	\$ 1,833,786	1,716,470
Preferred stock at adjusted carrying value, fair value of \$555 in 2015 and \$902 in 2014 (note 4)	553	898
Common stock at fair value, adjusted cost of \$403,458 in 2015 and \$397,928 in 2014 (note 4)	447,763	451,419
Real estate at cost – net of accumulated depreciation of \$13,092 in 2015 and \$11,951 in 2014	16,226	17,098
Cash, cash equivalents, and short-term investments	42,819	39,378
Other invested assets (note 4)	24,417	9,093
Receivables for securities sold	71	4,390
Total cash and invested assets	2,365,635	2,238,746
Uncollected premiums – net of allowance	79,879	58,574
Funds held by or deposited with reinsurers	1,895	1,976
Electronic data processing equipment – at cost – net of accumulated depreciation of \$5,788 in 2015 and \$4,955 in 2014	1,762	1,525
Accrued investment income	14,212	14,554
Total admitted assets	\$ 2,463,383	2,315,375
<b>Liabilities and Policyholders' Surplus</b>		
Reserve for unpaid losses and loss adjustment expenses:		
Reserve for unpaid losses (note 2)	\$ 834,214	822,994
Reserve for unpaid loss adjustment expenses (note 2)	105,910	106,618
Total reserve for unpaid losses and loss adjustment expenses	940,124	929,612
Unearned premiums	83,514	79,439
Advance premiums	9,771	9,276
Dividends payable to policyholders	51,365	15,736
Commissions payable	33,035	25,763
Structured settlement liability (note 3)	373,371	365,772
Credit balances due policyholders	8,406	8,077
Payable for securities purchased	4,751	8,161
Other liabilities	23,748	25,552
Total liabilities	1,528,085	1,467,388
Surplus notes (note 7)	100,000	100,000
Special surplus fund for unfunded pension benefits (notes 1 and 7)	156,767	—
Unassigned policyholders' surplus (note 7)	678,531	747,987
Total liabilities and policyholders' surplus	\$ 2,463,383	2,315,375

See accompanying notes to statutory-basis financial statements.

**PINNACOL ASSURANCE**

Statutory-Basis Statements of Operations and Changes in  
Policyholders' Surplus

Years ended December 31, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Underwriting income:		
Premiums earned	\$ 635,876	569,319
Deductions:		
Losses incurred (note 2)	341,874	379,091
Loss adjustment expenses incurred (note 2)	66,322	61,555
Other underwriting expenses incurred	140,906	122,462
Total underwriting deductions	<u>549,102</u>	<u>563,108</u>
Net underwriting gain	<u>86,774</u>	<u>6,211</u>
Investment income:		
Net investment income earned (note 4)	63,959	70,737
Net realized capital gain (loss) (note 4)	<u>(9,368)</u>	<u>122,644</u>
Total investment income	54,591	193,381
Other income (loss):		
Provision for uncollectible premiums	(4,829)	(3,196)
Structured settlement expense (note 3)	(6,180)	(3,962)
Other income	625	991
Dividends to policyholders	<u>(32,410)</u>	<u>(1,590)</u>
Net income	98,571	191,835
Change in nonadmitted assets	(761)	1,689
Change in surplus notes	—	100,000
Change in net unrealized losses on investments	(13,634)	(71,097)
Correction of an error (note 1)	3,135	—
Policyholders' surplus – beginning of year	<u>847,987</u>	<u>625,560</u>
Policyholders' surplus – end of year	\$ <u><u>935,298</u></u>	\$ <u><u>847,987</u></u>

See accompanying notes to statutory-basis financial statements.

**PINNACOL ASSURANCE**

Statutory-Basis Statements of Cash Flow

Years ended December 31, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Cash flow from operations:		
Premiums collected – net of reinsurance	\$ 615,733	556,569
Losses and loss adjustment expenses paid – net of reinsurance and deductibles	(397,684)	(387,988)
Underwriting expenses paid	(133,733)	(108,187)
Dividends paid to policyholders	3,220	880
Investment income received, net of investment expenses paid	67,546	74,043
Net amount withheld or retained for account of others	625	(6,166)
Net cash provided by operations	<u>155,707</u>	<u>129,151</u>
Cash flow from investments:		
Proceeds from sale, maturity, or redemption of investments:		
Bonds	776,290	799,232
Stocks	32,288	363,451
Other invested assets	1,511	—
Miscellaneous proceeds	4,319	—
Total proceeds from sale or redemption of investments	<u>814,408</u>	<u>1,162,683</u>
Cost of investments acquired:		
Bonds	(889,848)	(1,024,920)
Stocks	(56,644)	(374,529)
Other invested assets	(17,342)	(9,041)
Miscellaneous proceeds (applications)	(3,679)	(22,146)
Total investments acquired	<u>(967,513)</u>	<u>(1,430,636)</u>
Net cash used in investments	<u>(153,105)</u>	<u>(267,953)</u>
Cash flow from financing and miscellaneous sources :		
Surplus notes	—	100,000
Cash used in other miscellaneous sources	839	(8,236)
Net cash provided by financing and miscellaneous sources	<u>839</u>	<u>91,764</u>
Net increase (decrease) in cash, cash equivalents, and short-term investments	3,441	(47,038)
Cash, cash equivalents, and short-term investments – beginning of year	<u>39,378</u>	<u>86,416</u>
Cash, cash equivalents, and short-term investments – end of year	<u>\$ 42,819</u>	<u>39,378</u>

See accompanying notes to statutory-basis financial statements.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

#### (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 statutory-basis 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-basis financial statements, the Company has followed NAIC guidelines and has not utilized any practices 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 debt securities are generally carried at amortized cost, while under GAAP, they would be carried at fair value. For GAAP, changes in fair value in bonds go through net investment income.
- Short-term investments, which include investments with maturities at the time of acquisition of one year or less, are included with cash and cash equivalents in the accompanying statutory-basis financial statements, while under GAAP, only investments with maturities at the time of acquisition of three months or less are included with cash and cash equivalents.

**PINNACOL ASSURANCE**

Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

- Assets are reported under NAIC SAP at “admitted asset” value and “nonadmitted” 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. Nonadmitted assets at December 31, 2015 and 2014 comprised the following (in thousands):

	<b>2015</b>	<b>2014</b>
Receivables	\$ 12,021	7,749
Fixed assets	960	1,480
Prepays	1,677	2,066
Prior year correction of an error adjustment	—	2,602
Total nonadmitted assets	\$ 14,658	13,897

- 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 surplus note is reported as a component of surplus, increasing policyholders’ surplus under NAIC SAP. Under GAAP the surplus note is recorded as long-term debt. The related interest expense may not be accrued under NAIC SAP until approved for payment by the commissioner of the state of domicile while under GAAP, the interest expense is recorded as incurred.
- Governmental Accounting Standards Board (GASB) Statement No. 68 *Accounting and Financial Reporting for Pensions*, which is effective for fiscal years ended June 30, 2014 or later, requires employers that are part of a cost sharing multiple-employer pension fund to record their portion of the unfunded liability, while under NAIC SAP, the employer must only record the cost of the contribution and any liability for any contributions due and unpaid.

The effect of the differences between statutory-basis of accounting and generally accepted accounting principles, although not reasonably determinable, is presumed to be material. Pinnacol is a political subdivision of the State and as such would follow all applicable Governmental Accounting Standards Board (GASB) pronouncements.

**(c) Use of Estimates**

The preparation of statutory-basis 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-basis financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates include internal structured settlement liability, the reserves for unpaid losses and loss adjustment expenses, the earned but unbilled premiums asset, 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.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

**(d) Investments**

Investments are recorded on the trade date. Bonds and preferred stocks are stated at amortized cost or fair value, based on their NAIC designation, and are adjusted for other-than-temporary declines in fair value. Common stocks, mutual funds, and common trust funds are carried at fair value. Other invested assets, which includes partnerships, are recorded at the underlying audited equity value. For those investments in which the audited financial statements are not available in a timely manner, the unaudited equity value is used. Unrealized capital gains on common stocks, preferred stocks, mutual funds, and common trust funds are reported as a direct adjustment to policyholders' surplus. Common stocks, preferred stocks, mutual funds, common trust funds, and structured securities in an unrealized loss position for the years ended December 31, 2015 and 2014 are recorded as other-than-temporarily impaired and are recorded as a realized loss in the statutory-basis 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 widely accepted models with inputs from major third-party data providers. Model assumptions are specific to asset class and collateral type and are regularly evaluated and adjusted where appropriate. The prospective-adjustment method is used to value all loan-backed securities.

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 \$1,140,000 and \$1,127,000 for the years ended December 31, 2015 and 2014, respectively, and is included in net investment income earned in the statutory-basis statements of operations and changes in policyholders' surplus.

**(e) Cash, Cash Equivalents, and Short-Term Investments**

For purposes of the statement of cash flow, 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.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

As of December 31, 2015, cash, cash equivalents, and short-term investments of approximately \$42,819,000 include \$(9,268,000) of book overdrafts, \$4,000,000 of cash equivalents, and \$48,087,000 of short-term investments. As of December 31, 2014, cash, cash equivalents, and short-term investments of approximately \$39,378,000 include \$(7,054,000) of book overdrafts, \$0 of cash equivalents, and \$46,432,000 of short-term investments. In the accompanying statutory-basis 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, 2015, receivables for securities sold were approximately \$71,000. As of December 31, 2014, receivables for securities sold were approximately \$4,390,000. 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 2015 and 2014, Pinnacol recorded a provision of approximately \$4,829,000 and \$3,196,000, 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-basis statements of operations and changes in policyholders' surplus.

A significant portion of Pinnacol's premium receivable balances at December 31, 2015 and 2014 were from companies operating in the construction and services industries in Colorado. The construction industry represents approximately 34% of premiums earned as of December 31, 2015 and 33% as of December 31, 2014. The services industry represents approximately 42% of premiums earned as of December 31, 2015 and 43% as of December 31, 2014, with all other individual industries constituting the remainder of premiums receivable balances.

**(h) *Earned but Unbilled Premiums***

Earned but unbilled premiums represent a receivable or liability for audit premiums, which are amounts due from or to policyholders after the respective policy period has expired based on payroll audits performed by Pinnacol. A receivable is included as a component of uncollected premiums. A liability is included as a component of credit balances due policyholders. Such amounts are estimated by Pinnacol based upon internal calculations using historical premium data. Based on this analysis,

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

Pinnacol recorded an estimated audit premiums receivable in 2015 and 2014 of approximately \$45,390,000 and \$30,260,000, respectively. The increase in the receivable is due to rate increases and increased covered payroll.

**(i) 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 2015 and 2014, such amounts are approximately \$8,406,000 and 8,077,000, respectively.

**(j) 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, 2015 and 2014 was approximately \$1,762,000 and \$1,525,000, respectively. Related depreciation expense of approximately \$833,000 and \$794,000 was incurred during 2015 and 2014, respectively, and is included in LAE and other underwriting expenses incurred in the statutory-basis statements of operations and changes in policyholders' surplus.

**(k) Office Furniture, Equipment, Software, Art, and Leasehold Improvements**

Office furniture, equipment, software, art, automobiles, and leasehold improvements are recorded at cost and depreciated on a straight-line basis. Office furniture, equipment, and software are depreciated over an estimated useful life of three years. Art is depreciated over an estimated useful life of five years. Leasehold improvements are depreciated over the shorter of the term of the lease or the useful life. In accordance with the Manual, these are nonadmitted assets. The net book value of these assets at December 31, 2015 and 2014 was approximately \$960,000 and \$1,480,000, respectively. Related depreciation expense of approximately \$668,000 and \$683,000 was incurred in 2015 and 2014, respectively, and is included in LAE and other underwriting expenses incurred in the statutory-basis statements of operations and changes in policyholders' surplus.

**(l) Other Assets**

At December 31, 2015 and 2014, Pinnacol had prepaid assets and deposits totaling approximately \$3,573,000 and \$4,042,000, respectively. In accordance with the Manual, funds held by or deposited with reinsurance companies of \$1,895,000 and \$1,976,000 in 2015 and 2014, respectively are admitted and the remaining amount is nonadmitted.

**(m) Safety Group Dividend Program**

Pinnacol has a safety group program whereby policyholders who are members of the program are entitled to a dividend based on established criteria. Pinnacol paid out safety group dividends of \$1,941,000 in 2015 and \$1,440,000 in 2014. As of December 31, 2015 and 2014, safety group and association dividends payable of \$2,789,000, and \$2,320,000, respectively, are included in dividends payable to policyholders. These dividends are not declared from surplus nor are they recorded as a direct reduction to policyholders' surplus. The dividends are settled via premium credits and are

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

recorded as dividends to policyholders in the statutory-basis statements of operations and changes in policyholders' surplus.

**(n) Individual Loss Control Dividend Program**

Pinnacol has an individual loss control dividend (ILCD) program that is designed for policyholders who are committed to effective loss control in their business operations. If the policyholder meets the minimum premium requirements and pays an additional 5% premium charge as a buy-in to the plan, the policyholder may receive a return of premium based on the policy premium and the loss ratio. Pinnacol paid out ILCD of \$12,085,000 in 2015 and \$10,758,000 in 2014. As of December 31, 2015 and 2014, ILCD payable of \$18,571,000, and \$13,412,000, respectively, are included in dividends payable to policyholders.

**(o) 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 declared general policyholder dividends to its policyholders in good standing of \$30,000,000 and \$0 in 2015 and 2014, respectively. This is included in dividends payable to policyholders.

**(p) 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.

**(q) 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, 2015 and 2014. 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-basis statements of operations and changes in policyholders' surplus in the period such information becomes known.

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 2015 and 2014.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

**(r) *Unearned Premiums***

Unearned premiums represent amounts either collected or billed and due from policyholders at December 31, 2015 and 2014 but unearned at that date as they pertain to subsequent policy periods. Unearned premiums billed, which relate to policy effective dates subsequent to December 31, 2015 are not included in the unearned premiums balance, but are included as advance premium if the related cash is collected. Unearned premiums are computed on a daily pro rata basis over the 12-month term of the policies.

**(s) *Premium Deficiency Reserve***

A premium deficiency reserve is recognized by recording an additional liability for the deficiency, which results when anticipated future loss, loss adjustment expense, commissions, other acquisition costs and maintenance costs exceed the recorded unearned premium reserve, any future installment premiums on existing policies, and anticipated investment income. The change in this reserve is recorded as a component of other underwriting deductions.

Pinnacol recorded a premium deficiency reserve of \$0 at December 31, 2015 and 2014. Over the past several years, Pinnacol increased rates to achieve rate adequacy, which is reflected in the 2014 elimination of the premium deficiency reserve and remains zero in 2015. Pinnacol considered anticipated investment income at 3.5% when evaluating the premium deficiency reserve for 2015.

**(t) *Multiemployer Pension Plans and Other Postretirement Benefits***

Pinnacol participates in a cost sharing multiemployer defined-benefit pension plan and health care trust fund administered by the Public Employees' Retirement Association (PERA). All employees of Pinnacol are members of the plan and trust fund, and the plan and trust fund provide retirement, disability, health premium subsidies, and death benefits for members or their beneficiaries.

As a participant in a multiemployer pension plan and health care trust fund, Pinnacol recognizes as net pension cost and net postretirement benefit cost the required contribution for the period and as a liability any contributions due and unpaid.

**(u) *Subrogation***

Subrogation claims (claims against third parties) are recognized as a reduction of losses incurred when collections are received. The Company received \$6,584,000 and \$5,463,000 in subrogation as of December 31, 2015 and 2014, respectively.

**(v) *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 (note 5).

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

(w) ***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 by the Colorado Department of Labor and Employment Division of Workers' Compensation annually, approximately 0.63% for 2015 and 1.13% for 2014. Such amounts are included in other underwriting expenses incurred.

(x) ***Surplus Note***

Pinnacol issued a \$100,000,000 surplus note on June 25, 2014. Before issuing this debt, the Company obtained approval from the Commissioner of the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (the Division) for the transaction and approval to classify the debt as a component of policyholders' surplus. Each payment of principal and interest on the surplus note may be made only with the prior approval of the Commissioner and only to the extent the Company has sufficient policyholders' surplus to make such payment. The interest on the unpaid principal amount of this note will be paid in semiannual installments at the rate of 8.625% per annum. In 2015, \$8,625,000 of interest was paid on the note and recorded as investment expense.

(y) ***Special Surplus Fund for Unfunded Pension Benefits***

Pinnacol participates in a cost sharing multiple-employer defined benefit pension plan administered by the Public Employees' Retirement Association of Colorado (PERA). PERA has a net pension liability which represents the unfunded pension benefits. In 2015, Pinnacol established a special surplus fund to record its portion of the unfunded pension benefits in the amount of \$156,767,000. Statutory accounting does not allow Pinnacol's portion of the net pension liability to be recorded as a liability but allows a company to establish a special surplus fund to provide for contingencies. GASB No. 68, *Accounting and Financial Reporting for Pensions* is effective for fiscal years beginning after June 15, 2014. The statement requires cost-sharing employers participating in defined benefit plans to record their proportionate share of the collective net pension liability in their GASB financial statements. PERA provides Pinnacol with the audited schedule of employers' allocations and net pension liability. This estimated liability is calculated based upon actuarial data valued as of December 31, 2013. PERA uses standard roll-forward procedures to then estimate the expected total pension liability as of the measurement date of December 31, 2014. The total pension liability is reduced by the plan's fiduciary net position to obtain the collective net pension liability. A discount rate of 7.5% is being used. PERA also provides the employer allocation percentage for purposes of calculating Pinnacol's proportionate share of the collective net pension liability. The funded portion of PERA's total pension liability as of December 31, 2014 is 60%.

(z) ***Application of Recent Statutory Accounting Pronouncements***

During 2015 there were no substantive revisions to statutory accounting that were applicable to Pinnacol, and therefore, there were no substantive revisions adopted by the Company.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

**(aa) *Immaterial Correction of an Error***

During 2015, the Company discovered an error in the accounting estimate for uncollected premiums receivable. In prior years, the aging for installment premiums was based on transaction date and has been changed to due date in accordance with SSAP No. 6. Additionally, the order in which the calculation for nonadmitted aged receivables greater than 90 days due and the calculation for allowance for uncollected premiums have been reversed so that the nonadmitted adjustments are made first and the impairment analysis is performed on the remaining uncollected premium population. Surplus has been increased by \$3,135,000 in the current year to correct for this error.

**(bb) *SSAP No. 69 Adoption, Statement of Cash Flow***

In March 2015, the NAIC adopted revisions to Statement of Statutory Accounting Principles (SSAP) No. 69, *Statement of Cash Flow*. The revisions clarify that the cash flow statement should be limited to transactions involving “cash”, which is defined to include cash, cash equivalents and short-term investments, and to expand the disclosures to include noncash operating items. The guidance was adopted prospectively by the Company in 2015. The 2014 amounts were not reclassified as of December 31, 2015.

**(2) *Unpaid Losses and Loss Adjustment Expenses***

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-basis 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 currently estimated reserves 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.

**PINNACOL ASSURANCE**

Notes to Statutory-Basis Financial Statements

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***Unpaid Losses and Loss Adjustment Expenses***

Activity in the liability for unpaid losses and loss adjustment expenses in 2015 and 2014 is summarized as follows (in thousands):

	<b>Unpaid losses and loss adjustment expenses</b>	
	<b>2015</b>	<b>2014</b>
Balance at January 1	\$ 929,612	876,954
Additional amounts incurred related to:		
Current year	445,102	480,625
Prior years	(36,906)	(39,979)
Total incurred	<u>408,196</u>	<u>440,646</u>
Reductions relating to payments for:		
Current year	132,407	144,896
Prior years	265,277	243,092
Total paid	<u>397,684</u>	<u>387,988</u>
Balance at December 31	<u>\$ 940,124</u>	<u>929,612</u>

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 \$36,906,000 and \$39,979,000 in 2015 and 2014, respectively. During the year ended December 31, 2015, approximately \$265,277,000 was paid for unpaid losses and loss adjustment expense attributable to insured events of prior years. Reserves for unpaid losses and loss adjustment expense remaining for prior years are now \$627,429,000 as a result of reestimation 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 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 initiatives to improve claims handling practices and reduce claims handling expenses when prudent, a reduction of ultimate claim frequency in Colorado, and consistently favorable emergence of medical losses, indemnity losses and defense and cost containment (DCC) expenses throughout the year. 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. At the end of the current year, the amount of reserve credit recorded for high deductibles on unpaid losses was \$3,597,000. Such reduction is collateralized generally with letters of credit for the benefit of Pinnacol.

**PINNACOL ASSURANCE**

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**(3) Internal Structured Settlements**

Pinnacol 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 market rate. The discount applied to this liability was 2.5% at December 31, 2015 and 2014. The internal structured settlement liability is actuarially valued. The internal structured settlement liability is reported as a financing liability separate from unpaid losses and loss adjustment expenses on the statutory – basis statements of admitted assets, liabilities, and policyholders’ surplus.

Activity in the liability for internal structured settlements in 2015 and 2014 is summarized as follows (in thousands):

	<b>2015</b>	<b>2014</b>
Beginning balance	\$ 365,772	366,084
Amounts incurred:		
Change in valuation	6,180	3,962
Amounts paid	(22,839)	(21,975)
New internal structured settlements	24,258	17,701
Ending balance	\$ 373,371	365,772

Pinnacol 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 market rate. The discount rate applied to internal structured settlement liabilities is 2.5% at December 31, 2015 and 2014.

The amount of the discount for unpaid internal structured settlements as of December 31, 2015 and 2014 is approximately \$156,852,000 and \$157,962,000, respectively. The discount amounts for internal structured settlement reserves at December 31, 2015 and 2014 are distributed over the years in which the losses were incurred as follows (in thousands):

<b>2015</b>		<b>2014</b>	
Loss year	Discount	Loss year	Discount
Prior	\$ 77,600	Prior	\$ 81,885
2005	11,974	2005	12,621
2006	13,928	2006	14,647
2007	9,585	2007	10,318
2008	11,776	2008	12,587
2009	11,704	2009	11,937
2010	6,185	2010	4,943
2011	7,384	2011	6,068
2012	3,167	2012	2,087
2013	2,410	2013	811
2014	1,132	2014	58
2015	7	2015	—
Total	\$ 156,852	Total	\$ 157,962

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

#### (4) Investments

Estimated fair value of investments in bonds is based on quotations provided by widely accepted third-party data providers. In 2015 and 2014, Interactive Data Corporation (IDC), Reuters, and Markit Partners were used to obtain fair market values. Additionally, in 2015 and 2014, the fair value of certain common trust funds and warrants were primarily determined by a widely accepted third-party vendor, followed by a hierarchy using broker/dealer quotes, Bloomberg, Yield Book analytic model, and a benchmark to index model. Prior month price is used only when information is limited or unavailable.

The Securities Valuation Office (SVO) of the NAIC assigns designations of bonds from 1 to 6. Bonds with designations of 1–2 are stated at amortized cost using the interest method. Bonds with designations of 3–6 require the bond to be carried at the lower of amortized cost or fair value, with any related unrealized loss reported in policyholders' surplus.

During 2015 and 2014, Pinnacol had investments in long-term bonds, which the SVO assigned a 3 or higher designation. At December 31, 2015 and 2014, the fair value on long-term bonds was less than amortized cost, which resulted in a cumulative unrealized loss of \$9,015,000 and \$5,094,000, respectively. Carrying values are equal to the lower of amortized cost or fair value for these bonds.

The carrying value and the fair value of investments in long-term bonds in 2015 and 2014 are summarized as follows (in thousands). The carrying value includes investment grade bonds that are reported at amortized cost and low-rated bonds that are reported at the lower of cost or fair value:

	2015			
	Carrying value	Gross unrealized gains	Gross unrealized losses	Fair value
Government obligations:				
Nonloan-backed bonds	\$ 80,868	5,706	(157)	86,417
Loan-backed bonds	31,417	1,947	—	33,364
U.S. political subdivisions:				
Nonloan-backed bonds	11,307	142	(88)	11,361
Loan-backed bonds	—	—	—	—
U.S. special revenue:				
Nonloan-backed bonds	37,571	910	(286)	38,195
Loan-backed bonds	235,660	2,257	(522)	237,395
Industrial and miscellaneous:				
Nonloan-backed bonds	1,191,351	20,458	(17,008)	1,194,801
Loan-backed bonds	245,612	2,206	—	247,818
	\$ 1,833,786	33,626	(18,061)	1,849,351

**PINNACOL ASSURANCE**

Notes to Statutory-Basis Financial Statements

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	<b>2014</b>			
	<u>Carrying value</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
Government obligations:				
Nonloan-backed bonds	\$ 77,565	7,633	(48)	85,150
Loan-backed bonds	47,014	3,072	—	50,086
U.S. special revenue:				
Nonloan-backed bonds	16,010	1,781	—	17,791
Loan-backed bonds	226,213	4,693	(25)	230,881
Industrial and miscellaneous:				
Nonloan-backed bonds	1,151,720	58,133	(3,020)	1,206,833
Loan-backed bonds	197,948	2,383	(300)	200,031
	<u>\$ 1,716,470</u>	<u>77,695</u>	<u>(3,393)</u>	<u>1,790,772</u>

The book/adjusted carrying value and estimated fair value of investments in long-term bonds at December 31, 2015, by contractual maturity, are shown in the following table (in thousands). 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.

	<b>2015</b>	
	<u>Book/adjusted carrying value</u>	<u>Fair value</u>
Due in one year or less	\$ 99,701	101,596
Due after one year through five years	773,080	781,103
Due after five years through ten years	671,250	670,356
Due after ten years	289,755	296,296
	<u>\$ 1,833,786</u>	<u>1,849,351</u>

Proceeds from sales, redemptions, or maturities of investments in long-term bonds during 2015 and 2014 were approximately \$776,290,000 and \$799,232,000, respectively. Realized gains on long-term bonds of approximately \$26,680,000 and \$50,801,000 and realized losses of approximately \$(4,538,000) and \$(4,967,000) were recognized during 2015 and 2014, respectively.

In 2015, investments in joint ventures and partnerships are stated at the underlying audited equity value. For those investments in which the audited financial statements were not available by the March 1, 2016 statutory annual statement filing deadline, the unaudited equity value was used. These assets totaled \$24,417,000 and \$9,093,000 in 2015 and 2014, respectively. The Company has contributed \$24,872,000 in capital calls since the acquisition and may be responsible for up to an additional \$38,528,000.

**PINNACOL ASSURANCE**

Notes to Statutory-Basis Financial Statements

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Unrealized gains on investments in common stocks, mutual funds, and common trust funds are reported as a component of 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. OTTI of common stocks, mutual funds, and common trust 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, mutual funds, and common trust funds are summarized as follows (in thousands):

		<u>Original cost</u>	<u>Adjusted cost</u>	<u>Gross unrealized gains</u>	<u>Fair value</u>
December 31, 2015	\$	447,068	403,458	44,305	447,763
December 31, 2014		419,199	397,928	53,491	451,419

The following table provides the length of impairment for those investments in long-term bonds with an unrealized loss as of December 31, 2015 (in thousands):

<u>Description of securities</u>	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
U.S. government	\$ 23,719	(157)	—	—	23,719	(157)
U.S. political subdivisions	2,429	(88)	—	—	2,429	(88)
U.S. special revenue	98,989	(808)	—	—	98,989	(808)
Industrial and miscellaneous	639,838	(24,044)	13,259	(2,026)	653,097	(26,070)
Total	<u>\$ 764,975</u>	<u>(25,097)</u>	<u>13,259</u>	<u>(2,026)</u>	<u>778,234</u>	<u>(27,123)</u>

The following table provides the length of impairment for those investments in long-term bonds with an unrealized loss as of December 31, 2014 (in thousands):

<u>Description of securities</u>	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
U.S. government	\$ 10,518	(48)	—	—	10,518	(48)
U.S. special revenue	10,099	(25)	—	—	10,099	(25)
Industrial and miscellaneous	411,300	(9,244)	31,754	(1,097)	443,054	(10,341)
Total	<u>\$ 431,917</u>	<u>(9,317)</u>	<u>31,754</u>	<u>(1,097)</u>	<u>463,671</u>	<u>(10,414)</u>

**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.

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### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

The assessment of whether an OTTI 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.
- A change in future expected cash flow has occurred.
- 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, 2015 and 2014, 9.8% and 10.8% of long-term bonds held by the Company were rated noninvestment grade, respectively. At December 31, 2015 and 2014, the Company had approximately \$26,992,000 and \$8,419,000, respectively, of unrealized losses related to its long-term bonds. The Company does not have any significant concentrations by issuer or by sector. The unrealized losses on securities are primarily attributable to fluctuations in market interest rates and changes in credit spreads since the securities were acquired.

**Loan-Backed and Structured Securities** – Loan-backed securities are stated at amortized cost or fair value based on their NAIC designation. 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 widely accepted models with inputs from major third-party data providers. Any loan-backed and structured securities in an unrealized loss position were reviewed to determine whether an OTTI should be recognized at year-end. At December 31, 2015 and 2014, Pinnacol recognized OTTI on loan-backed securities of approximately \$944,000 and \$0, respectively. Loan-backed and structured securities in an

**PINNACOL ASSURANCE**

Notes to Statutory-Basis Financial Statements

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unrealized loss position as of year-end, stratified based on length of time continuously in these unrealized loss positions, are as follows (in thousands):

	<b>2015</b>	
	<b>Aggregate amount of unrealized loss</b>	<b>Aggregate fair value of securities with unrealized loss</b>
Less than twelve months	\$ 522	88,871
Twelve months or longer	—	—
	\$ 522	88,871

**Other-Than-Temporary Impairment** – During 2015 and 2014, the Company recognized \$12,339,000 and \$2,115,000, respectively, in OTTI on long-term bonds, \$7,000 and \$7,000, respectively, in OTTI on preferred stock, and \$25,488,000 and \$12,218,000, respectively, in OTTI on common stocks, mutual funds, and common trust funds.

**Fair Value Measurements** – The Company has categorized its assets and liabilities that are reported on the statutory-basis statements of admitted assets, liabilities, and policyholder’s surplus at fair value into the three-level fair value hierarchy. The three-level fair value hierarchy is based on the degree of subjectivity inherent in the valuation method by which fair value was determined. The three levels are defined as follows.

- **Level 1 – Quoted Prices in Active Markets for Identical Assets and Liabilities:** This category, for items measured at fair value includes exchange-traded preferred and common stocks. The estimated fair value of the equity securities within this category are based on quoted prices in active markets and are thus classified as Level 1.
- **Level 2 – Significant Other Observable Inputs:** This category for items measured at fair value includes bonds and common stocks which are not exchange-traded. The estimated fair values of some of these items were determined by independent pricing services using observable inputs. Others were based on quotes from markets which were not considered actively traded.
- **Level 3 – Significant Unobservable Inputs:** This category for items measured at fair value includes common stock warrants. The estimated fair value of common stock warrants was determined by internal ratings in the absence of observable inputs.

At the end of each reporting period, the Company evaluates whether or not any event has occurred or circumstances have changed that would cause an instrument to be transferred between Levels 1 and 2. This policy also applies to transfers into or out of Level 3 as stated below. During the current year, no transfers between Level 1 and 2 were required.

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Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

The following table represents (in thousands) information about the Company's financial assets measured at fair value in Level 3 as of December 31, 2015.

Assets	Fair value measurements – Level 3 December 31, 2015				Ending balance December 31, 2015
	Beginning balance January 1, 2015	Current realized net income	Change in unrealized surplus	Purchases	
Common stock	\$ 10	(21)	54	124	167
Total assets	\$ 10	(21)	54	124	167

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, 2015 and 2014, respectively, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

Assets	Fair value measurements – recurring basis December 31, 2015			Total
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Common stocks, mutual funds, and common trust funds	\$ 389,529	58,067	167	447,763
Preferred stocks	476	—	—	476
Total assets	\$ 390,005	58,067	167	448,239

Assets	Fair value measurements – recurring basis December 31, 2014			Total
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Common stocks, mutual funds, and common trust funds	\$ 407,262	44,147	10	451,419
Preferred stocks	344	—	—	344
Total assets	\$ 407,606	44,147	10	451,763

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

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Certain assets are measured at fair value on a nonrecurring 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 designation of 3–6 and redeemable preferred stocks held at fair value with an NAIC designation of RP3-RP6. There were bonds with these designations where the fair value was less than carrying value, which resulted in an unrealized loss of \$9,015,000 at December 31, 2015 and \$5,094,000 at December 31, 2014.

The Company did not have any significant concentrations by industry or by issuer as of December 31, 2015 or 2014.

The following table reflects (in thousands) the fair values and admitted values of all admitted assets and liabilities that are financial instruments excluding those accounted for under the equity method as of December 31, 2015 and 2014, respectively. The fair values are also categorized into the three-level fair value hierarchy as described above.

<b>December 31, 2015</b>					
<b>Type of financial instrument</b>	<b>Fair value</b>	<b>Admitted value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Financial instruments-assets:					
Long-term bonds	\$ 1,849,351	1,833,786	—	1,849,351	—
Preferred stocks	555	553	555	—	—
Common stocks, mutual funds, and common trust funds	447,763	447,763	389,529	58,067	167
Cash equivalents and short-term investments	42,820	42,819	33,818	9,002	—
Total assets	<u>\$ 2,340,489</u>	<u>2,324,921</u>	<u>423,902</u>	<u>1,916,420</u>	<u>167</u>
<b>December 31, 2014</b>					
<b>Type of financial instrument</b>	<b>Fair value</b>	<b>Admitted value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Financial instruments-assets:					
Long-term bonds	\$ 1,790,771	1,716,470	—	1,790,771	—
Preferred stocks	902	898	902	—	—
Common stocks, mutual funds, and common trust funds	451,419	451,419	407,262	44,147	10
Cash equivalents and short-term investments	39,378	39,378	39,378	—	—
Total assets	<u>\$ 2,282,470</u>	<u>2,208,165</u>	<u>447,542</u>	<u>1,834,918</u>	<u>10</u>

**PINNACOL ASSURANCE**

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**Investment Income** – Major categories of net investment income for the years ended December 31, 2015 and 2014 are summarized as follows (in thousands):

	<b>2015</b>	<b>2014</b>
Investment income:		
Corporate and miscellaneous bonds	\$ 60,691	54,429
U.S. government bonds	5,074	9,127
Cash and other investments	2	3
Real estate	5,083	4,932
Other invested assets	905	—
Equity securities	9,197	12,943
Surplus note interest expense	(8,625)	(3,019)
Investment expenses	(8,368)	(7,678)
	<u>63,959</u>	<u>70,737</u>
Net investment income earned		
Net realized capital gain (loss):		
Corporate and miscellaneous bonds	9,803	23,510
U.S. government bonds	—	20,209
Cash and other investments	—	1
Equity securities	(19,171)	78,924
	<u>(9,368)</u>	<u>122,644</u>
Net realized capital gains		
Net investment income	<u>\$ 54,591</u>	<u>193,381</u>

**(5) Reinsurance**

**Ceded Reinsurance** – Pinnacol purchases excess of loss reinsurance with two layers and terrorism coverage. 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
- Terrorism Only – Limit of \$50,000,000 in excess of retention of \$80,000,000 per occurrence

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 prior policy periods.

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.

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Pinnacol uses Lloyd's Syndicates as part of its ceded reinsurer program. The Syndicates are generally not rated by AM Best. The remaining reinsurers had the following AM Best ratings at December 31, 2015:

Reinsurer	AM Best Rating
Arch Reinsurance Company	A+
Partner Reinsurance Company of the U.S.	A
IOA Re, Inc. for and on behalf of Montpelier Rd Ltd (Bermuda)	A
Endurance Specialty Insurance Limited	A
Lloyd's Syndicate 2003 (Catlin Underwriting Agencies Limited)	A
Lloyd's Syndicate 3000 (Markel Syndicate Management 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 canceled in 2010; however, 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. This agreement was still in effect as of December 31, 2015. 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 \$1,046,000 and \$970,000 for the years ended December 31, 2015 and 2014, respectively. Pinnacol had loss and loss adjustment expense reserves related to assumed business of \$29,213,000 and \$27,436,000 for the years ended December 31, 2015 and 2014, respectively.

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

	<u>2015</u>	<u>2014</u>
Direct premiums written	\$ 633,021	571,694
Premiums ceded	(1,495)	(1,274)
Premiums assumed	<u>8,425</u>	<u>7,477</u>
Net premiums written	\$ <u>639,951</u>	<u>577,897</u>
Direct premiums earned	\$ 629,023	562,521
Premiums ceded	(1,495)	(1,274)
Premiums assumed	<u>8,348</u>	<u>8,072</u>
Net premiums earned	\$ <u>635,876</u>	<u>569,319</u>
Direct losses incurred	\$ 334,828	370,743
Losses ceded	—	—
Losses assumed	<u>7,046</u>	<u>8,348</u>
Net losses incurred	\$ <u>341,874</u>	<u>379,091</u>
Direct loss adjustment expenses incurred	\$ 64,931	60,412
Loss adjustment expenses ceded	—	—
Loss adjustment expenses assumed	<u>1,391</u>	<u>1,143</u>
Net loss adjustment expenses incurred	\$ <u>66,322</u>	<u>61,555</u>

**(6) Employee Benefits**

**(a) *Defined-Benefit Pension Plan through the State of Colorado***

*Plan Description* – All of Pinnacol’s employees are provided with pensions through the State Division Trust Fund (SDTF), a cost sharing multiple-employer defined benefit pension plan administered by PERA. Plan benefits are specified in Title 24, Article 51 of the Colorado Revised Statutes (C.R.S.), administrative rules set forth at 8 C.C.R. 1502-1, and applicable provisions of the federal Internal Revenue Code. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. PERA issues a publicly available comprehensive annual financial report that can be obtained at [www.copera.org/investments/pera-financial-reports](http://www.copera.org/investments/pera-financial-reports).

The plan’s purpose is to provide retirement, disability, and survivor benefits. Responsibility for the organization and administration of the plan is placed with the PERA Board of Trustees. Changes to the plan require an actuarial assessment and legislation by the General Assembly. Retirement benefits are determined by the amount of service credit earned and/or purchased, highest average salary, the benefit structure(s) under which the member retires, the benefit option selected at retirement, and age at retirement. Retirement eligibility is specified in tables set forth at C.R.S. § 24-51-602, 604, 1713, and 1714.

## **PINNACOL ASSURANCE**

### Notes to Statutory-Basis Financial Statements

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The lifetime retirement benefit for all eligible retiring employees under the PERA Benefit Structure is the greater of the:

- Highest average salary multiplied by 2.5% and then multiplied by years of service credit.
- The value of the retiring employee's member contribution account plus a 100% match on eligible amounts as of the retirement date. This amount is then annuitized into a monthly benefit based on life expectancy and other actuarial factors.

In all cases the service retirement benefit is limited to 100% of highest average salary and also cannot exceed the maximum benefit allowed by federal Internal Revenue Code.

Members may elect to withdraw their member contribution accounts upon termination of employment with all PERA employers; waiving rights to any lifetime retirement benefits earned. If eligible, the member may receive a match of either 50% or 100% on eligible amounts depending on when contributions were remitted to PERA, the date employment was terminated, whether 5 years of service credit has been obtained and the benefit structure under which contributions were made.

Benefit recipients who elect to receive a lifetime retirement benefit are generally eligible to receive post-retirement cost-of-living adjustments (COLAs), referred to as annual increases in the C.R.S. Benefit recipients under the PERA benefit structure who began eligible employment before January 1, 2007 receive an annual increase of 2%, unless PERA has a negative investment year, in which case the annual increase for the next three years is the lesser of 2% or the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the prior calendar year. Benefit recipients under the PERA benefit structure who began eligible employment after January 1, 2007 receive an annual increase of the lesser of 2% or the average CPI-W for the prior calendar year, not to exceed 10% of PERA's Annual Increase Reserve for the SDTF.

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. The disability benefit amount is based on the retirement benefit formula shown above considering a minimum 20 years of service credit, if deemed disabled.

Survivor benefits are determined by several factors, which include the amount of earned service credit, highest average salary of the deceased, the benefit structure(s) under which service credit was obtained, and the qualified survivor(s) who will receive the benefits.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

*Contributions* – Eligible employees and Pinnacol are required to contribute to the SDTF at a rate set by Colorado statute. The contribution requirements are established under C.R.S. § 24-51-401, *et seq.* Eligible employees with the exception of State Troopers are required to contribute 8% of their PERA-includable salary. The employer contribution requirements for Pinnacol are summarized in the table below:

	CY14	CY15	CY16	CY17	CY18
Employer contribution rate (includes 1.02% allocation to the Health Care Trust Fund – see note 6c)	10.15%	10.15%	10.15%	10.15%	10.15%
Amortization Equalization Disbursement (AED) as specified in C.R.S. Section 24-51-411	3.80	4.20	4.60	5.00	5.00
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S., Section 24-51-411	3.50	4.00	4.50	5.00	5.00
Total employer contribution rate	17.45%	18.35%	19.25%	20.15%	20.15%

Rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42)

Employer contributions are recognized in the period in which the compensation becomes payable to the member and Pinnacol is statutorily committed to pay the contributions. Employer contributions to PERA for the years ending December 31, 2015 and 2014 were \$8,732,000 and \$7,830,000, respectively. These contributions met the contribution requirement for each year.

**(b) Voluntary Tax-Deferred Retirement Plans**

Employees of Pinnacol that are also members of the SDTF may voluntarily contribute to the Voluntary Investment Program, an Internal Revenue Code Section 401(k) defined contribution plan administered by PERA. Title 24, Article 51, Part 14 of the C.R.S., as amended, assigns the authority to establish the plan provisions to the PERA Board of Trustees. PERA issues a publicly available comprehensive annual financial report for the Program. That report can be obtained at [www.copera.org/investments/pera-financial-reports](http://www.copera.org/investments/pera-financial-reports).

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 years ended December 31, 2015 and 2014, Pinnacol contributed approximately \$1,191,000 and \$1,137,000, respectively, in matching contributions to the 401(k) plan. Pinnacol also offers a 457 deferred compensation plan.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

(c) ***Postretirement Health Care and Life Insurance Benefits through the State of Colorado***

*Health Care Program* – Pinnacol contributed to the Health Care Trust Funds (HCTF), a cost-sharing multiple-employer healthcare trust administered by PERA. The HCTF benefit provides a health care premium subsidy and health care programs (known as PERACare) to PERA participating benefit recipients and their eligible beneficiaries. Title 24, Article 51, Part 12 of the C.R.S., as amended, establishes the HCTF and sets forth a framework that grants authority to the PERA Board to contact, self-insure and authorize disbursements necessary in order to carry out the purposes of the PERACare program, including the administration of health care subsidies. PERA issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for the HCTF. That report can be obtained at [www.copera.org/investments/pera-financial-reports](http://www.copera.org/investments/pera-financial-reports).

*Funding Policy* – Pinnacol is required to contribute at a rate of 1.02% of PERA-includable salary for all PERA members as set by statute. No member contributions are required. The contribution requirements for Pinnacol are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The apportionment of the contributions to the HCTF is established under Title 24, Article 51, Section 208(1)(f) of the C.R.S., as amended. For the years ending December 31, 2015 and 2014, Pinnacol contributed approximately \$485,000 and \$458,000, respectively, equal to the required contributions for each year.

(d) ***Other***

*Health and Welfare Trust* – Effective January 1, 2010, Pinnacol entered into certain self-funded benefit programs with its vendors for healthcare, dental care, and vision care and established a separate legal trust for administrative purposes. Pinnacol withholds monthly premium from its employee participants' payroll checks and uses these premiums and the employer contribution amounts to fund the trust account. Medical claims are processed and paid by the third-party vendors and subsequently reimbursed by the funds held in the trust. Employer contributions in 2015 and 2014 were \$5,733,000 and \$5,561,000, respectively.

*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 \$1,932,000 and \$1,717,000 at December 31, 2015 and 2014, respectively, is included in other liabilities in the statutory-basis statements of admitted assets, liabilities, and policyholders' surplus.

(7) **Policyholders' Surplus**

There were no general policyholder dividends paid in 2015 or 2014. Pinnacol declared general policyholder dividends of \$30,000,000 in 2015 and subsequently paid them in March 2016.

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 \$168,924,000 for 2015.

## PINNACOL ASSURANCE

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

A surplus note in the amount of \$100,000,000 was issued on June 25, 2014, to an unaffiliated third party in exchange for cash. Each payment of principal and interest on the surplus note may be made only with the prior approval of the Commissioner of the Colorado Division of Insurance and only to the extent Pinnacol has sufficient policyholders' surplus to make such payment. The interest on the unpaid principal amount of this note will be paid in semiannual installments at the rate of 8.625% per annum. In 2015, \$8,625,000 of interest was paid on the note and recorded as investment expense. The note, which is subordinate to the prior payment of all other liabilities of the Company, will be due and payable twenty years from the issuance date, with an optional pre-payment date in whole or part in fifteen years with no penalty. The surplus note was issued to partially cover Pinnacol's estimated proportionate share of PERA's unfunded liability for vested service of Pinnacol employees and retirees. This liability is not required to be recorded in the statutory-basis financial statements as of December 31, 2015. In accordance with the note agreement, Pinnacol may apply the proceeds for general corporate purposes.

Pinnacol participates in a cost sharing multiple-employer defined benefit pension plan administered by the Public Employees' Retirement Association of Colorado (PERA). PERA has a net pension liability which represents the unfunded pension benefits. In 2015, Pinnacol established a special surplus fund to record its portion of the unfunded pension benefits in the amount of \$156,767,000. Statutory accounting does not allow Pinnacol's portion of the net pension liability to be recorded as a liability but allows a company to establish a special surplus fund to provide for contingencies. GASB No. 68, *Accounting and Financial Reporting for Pensions* is effective for fiscal years beginning after June 15, 2014. The statement requires cost-sharing employers participating in defined benefit plans to record their proportionate share of the collective net pension liability in their GASB financial statements. PERA provides Pinnacol with the audited schedule of employers' allocations and net pension liability. This estimated liability is calculated based upon actuarial data valued as of December 31, 2013. PERA uses standard roll-forward procedures to then estimate the expected total pension liability as of the measurement date of December 31, 2014. The total pension liability is reduced by the plan's fiduciary net position to obtain the collective net pension liability. A discount rate of 7.5% is being used. PERA also provides the employer allocation percentage for purposes of calculating Pinnacol's proportionate share of the collective net pension liability. The funded portion of PERA's total pension liability as of December 31, 2014 is 60%.

#### **(8) Commitments and Contingencies**

The Company has made total commitments of \$38,528,000 to provide additional funds as needed to the following partnerships: GCM Grosvenor Opportunistic Credit Fund IV, Ltd \$5,066,000, Kayne Credit Opportunities Fund LP \$4,290,000, North Haven Credit Partners LP \$6,840,000, Blackstone Tactical Opportunities Fund II LP \$7,012,000, Entrust Special Opportunities Fund III Ltd \$7,050,000, and Warburg Pincus Private Equity XII LP \$8,270,000.

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.

## **PINNACOL ASSURANCE**

### Notes to Statutory-Basis Financial Statements

December 31, 2015 and 2014

At December 31, 2015 and 2014, Pinnacol had a letter of credit for the benefit of Argonaut Insurance Company under an assumed reinsurance agreement for approximately \$12,532,000 and \$14,024,000, respectively. In addition, Pinnacol had a letter of credit for the benefit of Zurich American Insurance Company under an assumed reinsurance agreement for approximately \$37,000,000 as of December 31, 2015 and 2014, respectively. 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 long-term bonds and money market securities are amounts held as collateral for the letter of credit of approximately \$68,606,000 and \$68,006,000, compared to a requirement of \$49,532,000 and \$51,024,000, as of December 31, 2015 and 2014, respectively.

Pinnacol is contingently liable for approximately \$52,782,000 of claims closed by the purchase of annuities from life insurers for structured settlements. Pinnacol has not purchased annuities from life insurers under which the Company is payee, and therefore, no balances are due from such annuity insurers.

Pinnacol is aware of an unfunded net pension liability. If Pinnacol were to partially or fully leave the PERA program, the unfunded net pension liability for the vested service of Pinnacol employees and retirees would become immediately due to PERA. Title 24, Article 51, Section 316 of the Colorado Revised Statutes (C.R.S.) requires a company to calculate the reserve transfer necessary when an employer disaffiliates from PERA. The formula to calculate the termination liability differs significantly from the formula used to calculate Pinnacol's share of the unfunded pension obligation under GASB 68. Therefore, the amount of a possible termination liability is unknown but is expected to exceed \$100,000,000. Currently, the possibility of the Company partially or fully leaving the PERA program is remote and would require legislative action.

#### **(9) Subsequent Events**

The Board of Directors declared general dividends on November 4, 2015 in an amount to be approximately \$30,000,000. The final dividend amount of \$30,000,000 was confirmed in February 2016 and subsequently paid at the end of March 2016.

Subsequent events have been evaluated through May 18, 2016, the date these statutory-basis financial statements were available to be issued.

**SUPPLEMENTAL SCHEDULES OF INVESTMENT INFORMATION**  
(See Independent Auditors' Report)

**PINNACOL ASSURANCE**  
Supplemental Schedule of Investment Information  
Investment Risks Interrogatories  
Year ended December 31, 2015  
(In thousands)

1. Pinnacol's total admitted assets as reported on page 2 of its annual statement are: \$ 2,463,383
2. The following are the ten largest exposures to a single issuer/borrower/investment by investment category, excluding: (i) U.S. government securities, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the *Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO)* as exempt, (ii) property occupied by Pinnacol, (iii) policy loans, and (iv) asset types that are investment companies (mutual funds) and common trust funds that are diversified within the meaning of the Investment Company Act of 1940 (Section 5(b) (1)).

Issuer	Description of exposure	Amount	Percentage of total admitted assets
2.01 FNMA POOLS	LONG-TERM BONDS	\$ 117,180	4.757%
2.02 FREDDIE MAC GOLD POOLS	LONG-TERM BONDS	50,179	2.037
2.03 FANNIE MAE POOLS	LONG-TERM BONDS	31,415	1.275
2.04 FGLMC POOLS	LONG-TERM BONDS	24,513	0.995
2.05 CITIBANK CREDIT CARD ISSUANCE SERIES 201	LONG-TERM BONDS	13,887	0.564
2.06 FHLMC POOLS	LONG-TERM BONDS	12,372	0.502
2.07 CITIGROUP INC	LONG-TERM BOND, COMMON STOCK, PREFERRED STOCK	11,524	0.468
2.08 JPMORGAN CHASE & CO	LONG-TERM BOND AND COMMON STOCK	10,848	0.440
2.09 VERIZON COMMUNICATIONS INC	LONG-TERM BOND AND COMMON STOCK	10,832	0.440
2.10 PETROLEOS MEXICANOS	LONG-TERM BOND AND COMMON STOCK	10,776	0.437

3. Pinnacol's total admitted assets held in bonds and preferred stocks by NAIC designation are:

NAIC Designation	Amount	Percentage of total admitted assets
Bonds:		
NAIC-1	\$ 1,364,418	55.388%
NAIC-2	340,540	13.824
NAIC-3	63,451	2.576
NAIC-4	101,752	4.131
NAIC-5	15,223	0.618
NAIC-6	490	0.020
Preferred stocks:		
P/RP-1	—	—
P/RP-2	—	—
P/RP-3	499	0.020
P/RP-4	54	0.002
P/RP-5	—	—
P/RP-6	—	—
	<u>\$ 1,886,427</u>	

4. Assets held in foreign investments are \$230,827,195 and assets held in foreign-currency-denominated investments are \$0, which is approximately 9.370% and 0.000% of Pinnacol's total admitted assets, respectively.

5. The following represents aggregate foreign investment exposure categorized by NAIC sovereign designation:

Foreign investment assets		Amount	Percentage of total admitted assets
NAIC Designation			
Countries designated NAIC-1		\$ 163,442	6.635%
Countries designated NAIC-2		47,765	1.939
Countries designated NAIC-3 or below		19,620	0.796
		<u>\$ 230,827</u>	

**PINNACOL ASSURANCE**  
Supplemental Schedule of Investment Information  
Investment Risks Interrogatories  
Year ended December 31, 2015  
(In thousands)

6. The following represents the largest foreign investment exposures by country, categorized by the country's NAIC sovereign designation:

<b>Foreign investment assets</b>				
NAIC Designation	Country	Amount	Percentage of total admitted assets	
Countries designated NAIC-1:				
Country 1:	UNITED KINGDOM	\$ 32,297	1.311%	
Country 2:	AUSTRALIA	25,024	1.016	
Countries designated NAIC-2:				
Country 1:	MEXICO	23,390	0.950	
Country 2:	IRELAND	11,164	0.453	
Countries designated NAIC-3 or below:				
Country 1:	VIRGIN ISLANDS-BRITISH	12,024	0.488	
Country 2:	SOUTH KOREA	6,941	0.282	
		<u>\$ 110,840</u>		

7. Aggregate unhedged foreign currency exposure is \$0, which is approximately 0.000% of Pinnacol's total admitted assets.

8. The following represents aggregate unhedged foreign currency exposure categorized by NAIC sovereign designation:

<b>Foreign-Currency-Denominated investment assets</b>			
NAIC Designation	Amount	Percentage of total admitted assets	
Countries designated NAIC-1	\$ —	—%	
Countries designated NAIC-2	—	—	
Countries designated NAIC-3 or below	—	—	
	<u>\$ —</u>		

9. The following represents the largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign designation:

<b>Foreign-Currency-Denominated investment assets</b>				
NAIC Designation	Country	Amount	Percentage of total admitted assets	
Countries designated NAIC-1:				
Country 1:		\$ —	—%	
Country 2:		—	—	
Countries designated NAIC-2:				
Country 1:		—	—	
Country 2:		—	—	
Countries designated NAIC-3 or below:				
Country 1:		—	—	
Country 2:		—	—	
		<u>\$ —</u>		

10 The following represents the ten largest nonsovereign (i.e., nongovernmental) foreign issues:

Issuer	NAIC Designation	Amount	Percentage of total admitted assets	
10 PETROELOS MEXICANOS	2FE	\$ 10,770	0.437%	
10 BARCLAYS BANK PLC	1FE	10,555	0.428	
10 ACTAVIS FUNDING SCS	2FE	10,095	0.410	
10 LLOYDS BANK PLC	1FE	10,026	0.407	
10.1 MACQUARIE BANK LTD	1FE	9,998	0.406	
10.1 UBS AG STAMFORD CT	1FE	9,998	0.406	
10.1 ING BANK NV	1FE	9,995	0.406	
10.1 BNP PARIBAS SAS	1FE	9,987	0.405	
10.1 STATOIL ASA-SPON ADR	1FE	7,888	0.320	
10.10 GE CAPITAL INTL FUNDING	1FE	7,212	0.293	

**PINNACOL ASSURANCE**  
Supplemental Schedule of Investment Information  
Investment Risks Interrogatories  
Year ended December 31, 2015  
(In thousands)

11. Assets held in Canadian investments are less than 2.5% of Pinnacol's total admitted assets.  
12. Pinnacol does not hold any investments with contractual sales restrictions.  
13. The following are the ten 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 Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO) as exempt or Class 1):

Issuer	Amount	Percentage of total admitted assets
13.01 WESTWOOD INCOME OPPORTUNITY FUND	\$ 43,166	1.752%
13.02 HARDING LOEVNER INTL EQ & EMERGING MKTS FUND	39,947	1.622
13.03 BLACKROCK EQUITY INDEX FUND B CTF	37,211	1.511
13.04 VANGUARD INTL STOCK FUND	31,162	1.265
13.05 DODGE & COX INTL STOCK FUND	27,564	1.119
13.06 FRANKLIN INTL GROWTH FUND	25,913	1.052
13.07 T. ROWE PRICE INSTITUTIONAL SMALL CAP STOCK FUND	23,803	0.966
13.08 GMO BENCHMARK-FREE ALLOCATION FUND-III	23,104	0.938
13.09 WELLINGTON INTERNATIONAL SMALL CAP OPPORTUNITIES CTF	20,856	0.847
13.10 FIRST EAGLE OVERSEAS FUND	20,049	0.814

14. Assets held in nonaffiliated, privately placed equities is LESS THAN 2.5% of Pinnacol's total admitted assets.  
Items 15 through 23 are not applicable.

See accompanying independent auditors' report.

**PINNACOL ASSURANCE**  
Supplemental Schedule of Investment Information  
Summary Investment Schedule  
December 31, 2015  
(In thousands)

<b>Investment categories</b>	<b>Gross investment holdings*</b>		<b>Admitted assets as reported in the annual statement</b>	
	<b>Amount</b>	<b>Percentage of gross investment holdings</b>	<b>Amount</b>	<b>Percentage of total admitted assets</b>
Bonds:				
U.S. Treasury securities	\$ 78,246	3.3%	\$ 78,246	3.3%
U.S. government agency obligations (excluding mortgage-backed securities):				
– Issued by U.S. government agencies	—	—	—	—
– Issued by U.S. government-sponsored agencies	—	—	—	—
Non U.S. government (including Canada, excluding mortgage-backed securities)	2,022	0.1	2,022	0.1
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
– States, territories, and possessions general obligations	600	—	600	—
– Political subdivisions of states, territories, and possessions and political general obligations	11,307	0.5	11,307	0.5
– Revenue and assessment obligations	37,571	1.6	37,571	1.6
– Industrial development and similar obligations	—	—	—	—
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
– Issued or guaranteed by GNMA	5,040	0.2	5,040	0.2
– Issued or guaranteed by FNMA and FHLMC	229,755	9.7	229,755	9.7
– All other	—	—	—	—
CMOs and REMICs:				
– Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	32,281	1.4	32,281	1.4
– Issued by non-U.S. government issuers and collateralized by mortgage-based securities issued by above	—	—	—	—
– All other	118,750	5.0	118,750	5.0
Other debt and other fixed income securities (excluding short term):				
– Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	1,090,063	46.1	1,090,063	46.1
– Unaffiliated non-U.S. securities (including Canada)	228,151	9.6	228,151	9.6
– Affiliated securities	—	—	—	—
Equity interests:				
– Investments in mutual funds	280,924	11.9	280,924	11.9
Preferred stocks:				
– Affiliated	—	—	—	—
– Unaffiliated	553	—	553	—
Publicly traded equity securities (excluding preferred stocks):				
– Affiliated	—	—	—	—
– Unaffiliated	108,772	4.6	108,772	4.6
Other equity securities:				
– Affiliated	—	—	—	—
– Unaffiliated	58,067	2.5	58,067	2.5
Other equity interests including tangible personal property under lease:				
– Affiliated	—	—	—	—
– Unaffiliated	—	—	—	—

PINNACOL ASSURANCE

Supplemental Schedule of Investment Information  
Summary Investment Schedule

December 31, 2015

(In thousands)

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
Mortgage loans:				
– Construction and land development	\$ —	—%	\$ —	—%
– Agricultural	—	—	—	—
– Single-family residential properties	—	—	—	—
– Multifamily residential properties	—	—	—	—
– Commercial loans	—	—	—	—
– Mezzanine real estate loans	—	—	—	—
Real estate investments:				
– Property occupied by Company	16,226	0.7	16,226	0.7
– Property held for production of income	—	—	—	—
– Property held for sale	—	—	—	—
Contract loans	—	—	—	—
Derivatives	—	—	—	—
Receivables for securities	71	—	71	—
Securities lending	—	—	—	—
Cash, cash equivalents, and short-term investments	42,819	1.8	42,819	1.8
Other invested assets	24,417	1.0	24,417	1.0
Total invested assets	\$ 2,365,635	100.0%	\$ 2,365,635	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.

See accompanying independent auditors' report.



KPMG LLP  
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Denver, CO 80202-5598

## **Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards***

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

We have audited, in accordance with the 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, the financial statements of Pinnacol Assurance, which comprise the statutory statements of admitted assets, liabilities, and policyholders' surplus as of December 31, 2015, and the related statutory statements of operations and changes in policyholders' surplus, and cash flow for the year then ended, and the related notes to the statutory financial statements, and have issued our report thereon dated May 18, 2016. Our report on the financial statements includes an adverse opinion on U.S. generally accepted accounting principles because the financial statements are prepared using statutory accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, which is a basis of accounting other than U.S. generally accepted accounting principles. Our report on the financial statements also includes an unmodified opinion on the financial statements in accordance with statutory accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, which is a basis of accounting other than U.S. generally accepted accounting principles.

### **Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Pinnacol Assurance's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Pinnacol Assurance's internal control. Accordingly, we do not express an opinion on the effectiveness of Pinnacol Assurance's internal control.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Pinnacol Assurance's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Pinnacol Assurance's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Pinnacol Assurance's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

Denver, Colorado  
May 18, 2016