PINNACOL ASSURANCE

Statutory–Basis Financial Statements and
Supplemental Schedules of Investment Information

December 31, 2014 and 2013

(With Independent Auditors' Report Thereon)

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PINNACOL ASSURANCE
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PINNACOL ASSURANCE

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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 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, 2014, 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, 2014.

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, 2014, 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 based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Company's 2014 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 $14,340,000 in other-than-temporary impairments on common stocks, mutual funds, and bonds for the year ended December 31, 2014.

   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, 2014, Pinnacol has recorded $929,612,000 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 2014 and in prior years.

   Pinnacol discounts internal structured settlement liabilities on a tabular basis using a discount rate of 2.5% for 2014. 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.

   Pinnacol evaluated the need to record a premium deficiency reserve as of the end of the current year and recorded a reserve of $0. Pinnacol increased rates from 2011 through 2014, which is reflected in the 2014 elimination of the premium deficiency reserve. The premium deficiency reserve evaluation was completed on January 22, 2015 by an independent actuary. Pinnacol considered anticipated investment income at 3.5% when evaluating the premium deficiency reserve for 2014.

Other accounting estimates are as follows:

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, 2014, the admitted value of uncollected premiums as reflected in Pinnacol's statutory-basis financial statements is $58,574,000.

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. 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 $30,260,000 in 2014.

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, 2014. For 2014, safety group dividends payable of $2,320,000 are included in dividends payable to policyholders.

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. We have discussed with management certain financial statement misstatements that have not been corrected in the Company's books and records as of and for the year ended December 31, 2014, which would decrease the Company's change in net unrealized losses on investments and net income by $1,200,000. Additionally we have discussed the reversing effect on the Company's books and records as of and for the year ended December 31, 2014, of uncorrected misstatements identified during the 2013 audit, which would increase other underwriting expenses incurred by $1,100,000 and correspondingly decrease the Company's net income by $1,100,000 as of and for the year ended December 31, 2014. The total impact of the uncorrected financial statement misstatements would decrease net income by $2,300,000 and has no impact on policyholders' surplus in the Company's books and records as of and for the year ended December 31, 2014. We have reported such misstatements to management on a Summary of Uncorrected Financial Statement Misstatements and have received representations from management that management believes, and concur, that the effects of the uncorrected financial statement misstatements are immaterial, both individually and in the aggregate, to the statutory financial statements taken as a whole.

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.

(Continued)

4. **Significant Accounting Policies –** The Company's significant accounting policies are set forth in note 1 to the Company's 2014 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 2014 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 2014.

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 15, 2015 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 2014 audit of the statutory-basis financial statements.

PINNACOL ASSURANCE

Description of Pinnacol Assurance

December 31, 2014

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 $847,987,000 and $625,560,000 as of December 31, 2014 and 2013, respectively. The increase in surplus is primarily related to current year net income and the issuance of a surplus note.

Pinnacol issued a $100,000,000 surplus note to cover Pinnacol's estimated proportionate share of PERA's (Public Employees' Retirement Association of Colorado) unfunded liability for vested service of Pinnacol employees and retirees that has not been recorded in the statutory-basis financial statements as of December 31, 2014. Pinnacol estimates the liability to exceed $100,000,000. Each payment of principal and interest on the surplus note may be made only with the prior approval of the Colorado Division of Insurance 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 semi-annual installments at the rate of 8.625% per annum.

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, 2014, and the related statutory statements of operations and changes in policyholders' surplus, and cash flows 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 2014 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 2014 financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.

The effects on the 2014 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, 2014, or the results of its operations or its cash flows 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, 2014, 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 2014 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 2014 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 2014 financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2014 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 2014 financial statements or to the 2014 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 2014 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 15, 2015 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 15, 2015

PINNACOL ASSURANCE

Statutory-Basis Statements of Admitted Assets, Liabilities, and Policyholders' Surplus

December 31, 2014 and 2013

(In thousands)

Admitted Assets		**2014**	**2013**
Cash and invested assets:			
Bonds at adjusted carrying value, fair value of $1,790,772 in 2014 and $1,536,939 in 2013 (note 4)	$	1,716,470	1,454,706
Preferred stock at adjusted carrying value, fair value of $902 in 2014 and $0 in 2013 (note 4)		898	—
Common stock at fair value, adjusted cost of $397,928 in 2014 and $308,824 in 2013 (note 4)		451,419	428,430
Real estate at cost – net of accumulated depreciation of $11,951 in 2014 and $10,824 in 2013		17,098	18,138
Cash, cash equivalents, and short-term investments		39,378	86,416
Other invested assets (note 4)		9,093	—
Receivables for securities sold		4,390	699
Total cash and invested assets		2,238,746	1,988,389
Uncollected premiums – net of allowance		58,574	40,527
Funds held by or deposited with reinsurers		1,976	—
Electronic data processing equipment – at cost – net of accumulated depreciation of $4,955 in 2014 and $4,161 in 2013		1,525	514
Accrued investment income		14,554	14,123
Total admitted assets	$	2,315,375	2,043,553
Liabilities and Policyholders' Surplus			
Reserve for unpaid losses and loss adjustment expenses:			
Reserve for unpaid losses (note 2)	$	822,994	768,516
Reserve for unpaid loss adjustment expenses (note 2)		106,618	108,438
Total reserve for unpaid losses and loss adjustment expenses		929,612	876,954
Unearned premiums		79,439	70,861
Advance premiums		9,276	10,433
Dividends payable to policyholders		15,736	13,265
Structured settlement liability (notes 1 and 3)		365,772	366,084
Premium deficiency reserve		—	7,600
Credit balances due policyholders		8,077	6,686
Payable for securities purchased		8,161	26,529
Other liabilities		51,315	39,581
Total liabilities		1,467,388	1,417,993
Commitments and contingencies (note 8)		—	—
Surplus notes (note 7)		100,000	—
Policyholders' surplus (note 7)		747,987	625,560
Total liabilities and policyholders' surplus	$	2,315,375	2,043,553

See accompanying notes to statutory-basis financial statements.

PINNACOL ASSURANCE

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

Years ended December 31, 2014 and 2013

(In thousands)

		2014	2013
Underwriting income:			
Premiums earned	$	569,319	479,719
Deductions:			
Losses incurred (note 2)		379,091	361,711
Loss adjustment expenses incurred (note 2)		61,555	62,695
Other underwriting expenses incurred		122,462	110,022
Total underwriting deductions		563,108	534,428
Net underwriting gain (loss)		6,211	(54,709)
Investment income:			
Net investment income earned (note 4)		70,737	71,848
Net realized capital gain (note 4)		122,644	22,356
Total investment income		193,381	94,204
Other income (loss):			
Provision for uncollectible premiums		(3,196)	(2,480)
Structured settlement expense (notes 1 and 3)		(3,962)	(9,546)
Other income		991	346
Dividends to policyholders		(1,590)	(1,720)
Net income		191,835	26,095
Change in nonadmitted assets		1,689	(2,055)
Change in surplus notes		100,000	—
Change in net unrealized (losses) gains on investments		(71,097)	57,011
Change in method of accounting (note 2)		—	(71,593)
Policyholders' surplus – beginning of year		625,560	616,102
Policyholders' surplus – end of year	$	847,987	625,560

See accompanying notes to statutory-basis financial statements.

PINNACOL ASSURANCE

Statutory-Basis Statements of Cash Flows

Years ended December 31, 2014 and 2013

(In thousands)

		2014	2013
Cash flows from operations:			
Premiums collected – net of reinsurance	$	556,569	477,934
Losses and loss adjustment expenses paid – net of reinsurance and deductibles		(387,988)	(407,821)
Underwriting expenses paid		(108,187)	(107,475)
Dividends paid to policyholders		880	(1,202)
Investment income received, net of investment expenses paid		74,043	73,924
Net amount withheld or retained for account of others		(6,166)	(11,680)
Net cash provided by operations		129,151	23,680
Cash flows from investments:			
Proceeds from sale, maturity, or redemption of investments:			
Bonds		799,232	404,872
Stocks		363,451	58,366
Total proceeds from sale or redemption of investments		1,162,683	463,238
Cost of investments acquired:			
Bonds		(1,024,920)	(459,608)
Stocks		(374,529)	(100,104)
Other invested assets		(9,041)	—
Miscellaneous proceeds (applications)		(22,146)	25,771
Total investments acquired		(1,430,636)	(533,941)
Net cash used in investments		(267,953)	(70,703)
Cash flows from financing and miscellaneous sources :			
Surplus notes		100,000	—
Cash used in other miscellaneous sources		(8,236)	3,868
Net cash provided by financing and miscellaneous sources		91,764	3,868
Net decrease in cash, cash equivalents, and short-term investments		(47,038)	(43,155)
Cash, cash equivalents, and short-term investments – beginning of year		86,416	129,571
Cash, cash equivalents, and short-term investments – end of year	$	39,378	86,416

See accompanying notes to statutory-basis financial statements.

(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, which are considered to be permitted practices.

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

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

- 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, 2014 and 2013 comprised the following (in thousands):

		2014	2013
Receivables	$	7,749	8,377
Fixed assets		1,480	1,111
Prepaids		2,066	3,496
Total nonadmitted assets	$	11,295	12,984

- 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.

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.

(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, and common trust funds in an unrealized loss position for the years ended December 31, 2014 and 2013 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 $1,127,000 and $1,131,000 for the years ended December 31, 2014 and 2013, respectively, and is included in investment expenses incurred 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 flows, cash, cash equivalents, and short-term investments include cash on deposit, money market funds, and other investments with maturities of one year or less at the date of acquisition.

As of December 31, 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. As of December 31, 2013, cash, cash equivalents, and short-term investments of approximately $86,416,000 include $(11,502,000) of book overdrafts, $0 of cash equivalents, and $97,918,000 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, 2014, receivables for securities sold were approximately $4,390,000. As of December 31, 2013, receivables for securities sold were $699,000. 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 2014 and 2013, Pinnacol recorded a provision of approximately $3,196,000 and $2,480,000, 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, 2014 and 2013 were from companies operating in the construction and services industries in Colorado. The construction industry represents approximately 33% of premiums earned as of December 31, 2014 and 31% as of December 31, 2013. The services industry represents approximately 43% of premiums earned as of December 31, 2014 and 44% as of December 31, 2013, 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 recorded an estimated audit premiums receivable in 2014 and 2013 of approximately $30,260,000 and $18,690,000, 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

(Continued)

policyholders. For 2014 and 2013, such amounts are approximately $8,077,000 and $6,686,000, 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, 2014 and 2013 was approximately $1,525,000 and $514,000, respectively. Related depreciation expense of approximately $794,000 and $536,000 was incurred during 2014 and 2013, 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, 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, 2014 and 2013 was approximately $1,480,000 and $1,111,000, respectively. Related depreciation expense of approximately $683,000 and $680,000 was incurred in 2014 and 2013, 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, 2014 and 2013, Pinnacol had prepaid assets and deposits totaling approximately $4,042,000 and $6,323,000, respectively. In accordance with the Manual, funds held by or deposited with reinsurance companies of $1,976,000 in 2014 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 $1,440,000 in 2014 and $1,650,000 in 2013. As of December 31, 2014 and 2013, safety group and association dividends payable of $2,320,000 and $2,170,000, 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 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 $10,758,000 in 2014 and $7,744,000 in 2013. As of December 31, 2014 and 2013, ILCD payable of $13,412,000 and $11,079,000, respectively, are included in dividends payable to policyholders.

(o) 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.

(p) 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, 2014 and 2013. 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 2014 and 2013.

(q) Unearned Premiums

Unearned premiums represent amounts either collected or billed and due from policyholders at December 31, 2014 and 2013 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, 2014 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.

(r) 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 and $7,600,000 at December 31, 2014 and 2013, respectively. Pinnacol increased rates from 2011 through 2014 to achieve rate adequacy, which is reflected in the 2014 elimination of the premium deficiency reserve. The premium deficiency reserve evaluation was completed on January 22, 2015 by an independent actuary. Pinnacol considered anticipated investment income at 3.5% when evaluating the premium deficiency reserve for 2014.

(s) 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.

(t) Subrogation

Subrogation claims (claims against third parties) are recognized as a reduction of losses incurred when collections are received. The Company received $5,463,000 and $5,338,000 in subrogation as of December 31, 2014 and 2013, respectively.

(u) 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).

(v) 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 1.13% for 2014 and 1.27% for 2013. Such amounts are included in other underwriting expenses incurred.

(w) 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 2014, $3,019,000 of interest was paid on the note and recorded as investment expense.

(x) Application of Recent Statutory Accounting Pronouncements

During 2014 there were no substantive revisions to statutory accounting that were applicable to Pinnacol, and therefore, there were no substantive revisions adopted by the Company.

(y) Reclassifications

The Company reclassified $9,546,000 in structured settlement expenses from losses and LAE incurred to structured settlement expense, $366,084,000 in structured settlement liability from reserves for unpaid losses and LAE to structured settlement liability, and $15,443,000 in cash paid related to structured settlement liabilities from losses and LAE paid in cash flows from operations to cash used in other miscellaneous sources in cash flows from financing and miscellaneous sources in the accompanying 2013 financial statements to be consistent with the current year presentation. This reclassification has no impact on prior year's net income or policyholders' surplus.

(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.

(a) Discount of Liabilities for Unpaid Losses

Effective January 1, 2013, Pinnacol no longer discounts its case reserves on a tabular basis. Workers' Compensation case unpaid loss reserves had been discounted on a tabular basis using a discount rate of 2.5% from 2010 through December 31, 2012. The change in accounting principle was adopted in accordance with Statements of Statutory Accounting Principles (SSAP) 65, *Property and Casualty Contracts*, which permits insurers to discount their tabular reserves; however, it is not required. The prior year accounting change represents a change in the method of applying this principle, which differs from the previous method.

(b) Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses in 2014 and 2013 is summarized as follows (in thousands):

	Unpaid losses and loss adjustment expenses	
	2014	**2013**
Balance at January 1	$ 876,954	788,778
Removal of tabular reserve discount	—	71,593
Additional amounts incurred related to:		
Current year	480,625	458,584
Prior years	(39,979)	(34,180)
Total incurred	440,646	424,404
Reductions relating to payments for:		
Current year	144,896	141,377
Prior years	243,092	266,444
Total paid	387,988	407,821
Balance at December 31	$ 929,612	876,954

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 $39,979,000 and $34,180,000 in 2014 and 2013, respectively. During the year ended December 31, 2014, approximately $243,092,000 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 $593,883,000 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 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 $5,708,000. Such reduction is collateralized generally with letters of credit for the benefit of Pinnacol.

(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, 2014 and 2013. 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 2014 and 2013 is summarized as follows (in thousands):

		2014	2013
Beginning balance	$	366,084	350,641
Amounts incurred:			
Change in valuation		3,962	9,546
Amounts paid		(21,975)	(20,939)
New internal structured settlements		17,701	26,836
Ending balance	$	365,772	366,084

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, 2014 and 2013.

The amount of the discount for unpaid internal structured settlements as of December 31, 2014 and 2013 is approximately $157,962,000 and $160,753,000, respectively. The discount amounts for internal structured settlement reserves at December 31, 2014 and 2013 are distributed over the years in which the losses were incurred as follows (in thousands):

2014			2013		
Loss year		**Discount**	**Loss year**		**Discount**
Prior	$	81,885	Prior	$	85,850
2005		12,621	2005		13,064
2006		14,647	2006		15,895
2007		10,318	2007		10,382
2008		12,587	2008		13,417
2009		11,937	2009		11,787
2010		4,943	2010		4,654
2011		6,068	2011		4,748
2012		2,087	2012		942
2013		811	2013		14
2014		58	2014		—
Total	$	157,962	Total	$	160,753

(4) Investments

Estimated fair value of investments in bonds is based on quotations provided by widely accepted third-party data providers. In 2014 and 2013, Interactive Data Corporation (IDC), Reuters, and Markit Partners were used to obtain fair market values. Additionally, in 2014 and 2013, 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 2014 and 2013, Pinnacol had investments in long-term bonds, which the SVO assigned a 3 or higher designation. At December 31, 2014 and 2013, the fair value on long-term bonds was less than amortized cost, which resulted in a cumulative unrealized loss of $5,094,000 and $89,000, respectively. Carrying values are equal to the lower of amortized cost or fair value for these bonds.

The book/adjusted carrying value and the fair value of investments in long-term bonds in 2014 and 2013 are summarized as follows (in thousands):

	2014			
	Book/adjusted carrying value	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Government obligations:				
Nonloan-backed bonds	$ 77,565	7,633	(48)	85,150
Loan-backed bonds	47,014	3,072	—	50,086
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
	$ 1,716,470	77,695	(3,393)	1,790,772

	2013			
	Book/adjusted carrying value	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Government obligations:				
Nonloan-backed bonds	$ 247,098	21,643	(2,181)	266,560
Loan-backed bonds	76,383	5,074	—	81,457
Special revenue:				
Nonloan-backed bonds	9,962	853	(220)	10,595
Loan-backed bonds	74,033	2,230	(1,093)	75,170
Industrial and miscellaneous:				
Nonloan-backed bonds	977,953	69,680	(13,802)	1,033,831
Loan-backed bonds	69,277	273	(224)	69,326
	$ 1,454,706	99,753	(17,520)	1,536,939

The book/adjusted carrying value and estimated fair value of investments in long-term bonds at December 31, 2014, 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.

		2014	
		Book/adjusted carrying value	**Fair value**
Due in one year or less	$	76,543	78,498
Due after one year through five years		749,878	780,051
Due after five years through ten years		651,385	668,699
Due after ten years		238,664	263,524
	$	1,716,470	1,790,772

Proceeds from sales, redemptions, or maturities of investments in long-term bonds during 2014 and 2013 were approximately $799,232,000 and $404,872,000, respectively. Realized gains on long-term bonds of approximately $50,801,000 and $5,195,000 and realized losses of approximately $(4,967,000) and $(2,208,000) were recognized during 2014 and 2013, respectively.

In 2014, 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, 2015 statutory annual statement filing deadline, the unaudited equity value was used. At December 31, 2014, these assets totaled $9,093,000 and were $0 in 2013. The Company has contributed $9,041,000 in capital calls since the acquisition and may be responsible for up to an additional $15,959,000.

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):

		Original cost	**Adjusted cost**	**Gross unrealized gains**	**Fair value**
December 31, 2014	$	419,199	397,928	53,491	451,419
December 31, 2013		330,924	308,824	119,606	428,430

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):

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

The following table provides the length of impairment for those investments in long-term bonds with an unrealized loss as of December 31, 2013 (in thousands):

		Less than 12 months		12 months or greater		Total	
Description of securities		**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
U.S. government	$	27,907	(2,181)	—	—	27,907	(2,181)
U.S. special revenue and special assessment		32,463	(1,313)	—	—	32,463	(1,313)
Industrial and miscellaneous		284,026	(10,932)	19,611	(3,184)	303,637	(14,116)
Total	$	344,396	(14,426)	19,611	(3,184)	364,007	(17,610)

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

The assessment of whether an 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 flows 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, 2014 and 2013, 10.8% and 6.2% of long-term bonds held by the Company were rated noninvestment grade, respectively. At December 31, 2014 and 2013, the Company had approximately $8,419,000 and $17,610,000, 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. Pinnacol did not recognize any OTTI on loan-backed securities during the years ended December 31, 2014 and 2013. Loan-backed and structured securities in an unrealized loss position as of year-end, stratified based on length of time continuously in these unrealized loss positions, are as follows (in thousands):

	2014	
	Aggregate amount of unrealized loss	**Aggregate fair value of securities with unrealized loss**
Less than twelve months	$ 325	102,094
Twelve months or longer	—	—
	$ 325	102,094

Other-Than-Temporary Impairment – During 2014 and 2013, the Company recognized $2,115,000 and $524,000, respectively, in OTTI on long-term bonds, $7,000 and $0, respectively, in OTTI on preferred stock, and $12,218,000 and $89,000, respectively, in OTTI on common stocks, mutual funds, and common trust funds. These impairments relate to market declines in value as of the last day of the year.

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.

The following table represents (in thousands) information about the Company's financial assets measured at fair value in Level 3 as of December 31, 2014.

	Fair value measurements – Level 3 December 31, 2014		
Assets	**Beginning Balance January 1, 2014**	**Purchases**	**Ending Balance December 31, 2014**
Common Stock	$ —	10	10
Total assets	$ —	10	10

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, 2014 and 2013, respectively, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

		Fair value measurements – recurring basis December 31, 2014			
Assets		**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
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

		Fair value measurements – recurring basis December 31, 2013			
Assets		**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
Common stocks, mutual funds, and common trust funds	$	356,707	71,723	—	428,430
Total assets	$	356,707	71,723	—	428,430

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 $5,094,000 at December 31, 2014 and $89,000 at December 31, 2013.

The Company did not have any significant concentrations by industry or by issuer as of December 31, 2014 or 2013.

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, 2014 and 2013, respectively. The fair values are also categorized into the three-level fair value hierarchy as described above.

December 31, 2014							
Type of financial instrument		**Fair value**	**Admitted value**	**Level 1**	**Level 2**	**Level 3**
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	$	2,282,470	2,208,165	447,542	1,834,918	10

December 31, 2013						
Type of financial instrument		**Fair value**	**Admitted value**	**Level 1**	**Level 2**	**Level 3**
Financial instruments-assets:						
Long-term bonds	$	1,536,939	1,454,706	—	1,536,939	—
Common stocks, mutual funds, and common trust funds		428,430	428,430	356,707	71,723	—
Cash equivalents and short-term investments		86,416	86,416	86,416	—	—
Total assets	$	2,051,785	1,969,552	443,123	1,608,662	—

Investment Income – Major categories of net investment income for the years ended December 31, 2014 and 2013 are summarized as follows (in thousands):

	2014	2013
Investment income:		
Corporate and miscellaneous bonds	$ 54,429	49,269
U.S. government bonds	9,127	15,256
Cash and other investments	3	55
Real estate	4,932	4,431
Equity securities	12,943	8,408
Surplus note interest expense	(3,019)	—
Investment expenses	(7,678)	(5,571)
Net investment income earned	70,737	71,848
Net realized capital gain (loss):		
Corporate and miscellaneous bonds	23,510	3,210
U.S. government bonds	20,209	(747)
Cash and other investments	1	1
Equity securities	78,924	19,892
Net realized capital gains	122,644	22,356
Net investment income	$ 193,381	94,204

(5) Reinsurance

Ceded Reinsurance – Pinnacol purchases excess of loss reinsurance with two layers and added terrorism coverage effective July 1, 2014. 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.

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, 2014:

Reinsurer	AM Best Rating
Arch Reinsurance Company	A+
AXIS Reinsurance Company (U.S.)	A+
Partner Reinsurance Company of the U.S.	A+
Aspen Insurance UK Limited	A
Validus Reinsurance Limited	A
Endurance Specialty Insurance Limited	A
Lloyd's Syndicate 2003 (Catlin Underwriting Agencies Ltd)	A
Lloyd's Syndicate 3000 (Markel Syndicate Management Ltd)	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, 2014. 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 $970,000 and $1,564,000 for the years ended December 31, 2014 and 2013, respectively. Pinnacol had loss and loss adjustment expense reserves related to assumed business of $27,436,000 and $26,186,000 for the years ended December 31, 2014 and 2013, respectively.

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

		2014	2013
Direct premiums written	$	571,694	478,230
Premiums ceded		(1,274)	(1,014)
Premiums assumed		7,477	11,213
Net premiums written	$	577,897	488,429
Direct premiums earned	$	562,521	469,204
Premiums ceded		(1,274)	(1,014)
Premiums assumed		8,072	11,529
Net premiums earned	$	569,319	479,719
Direct losses incurred	$	370,743	355,496
Losses ceded		—	—
Losses assumed		8,348	6,214
Net losses incurred	$	379,091	361,710
Direct loss adjustment expenses incurred	$	60,412	61,297
Loss adjustment expenses ceded		—	—
Loss adjustment expenses assumed		1,143	1,398
Net loss adjustment expenses incurred	$	61,555	62,695

(6) Employee Benefits

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

Plan Description – All of Pinnacol's employees participate in a defined-benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by PERA. PERA was established by state statute in 1931. 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. The state plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at PO Box 5800, Denver, Colorado 80217, by calling PERA at 1-800-759-PERA (7372), or by visiting http://www.copera.org.

PERA members electing the defined-contribution plan are allowed an irrevocable election between the second and fifth year to use their defined-contribution account to purchase service credit and be covered under the defined-benefit retirement plan. However, making this election subjects the member to the rules in effect for those hired on or after January 1, 2007, as discussed below. Employer contributions to both defined-contribution plans are the same as the contributions to the PERA defined-benefit plan.

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

- Hired before July 1, 2005 – age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with 5 years of service.
- Hired between July 1, 2005 and December 31, 2006 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with any years of service.
- Hired between January 1, 2007 and December 31, 2010 – any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service. For members with less than five years of service credit as of January 1, 2011 age and service requirements increase to those required for members hired between January 1, 2007 and December 31, 2010.
- Hired between January 1, 2011 and December 31, 2016 – any age with 35 years of service, age 58 with 30 years of service, or age 65 with 5 years of service.
- Hired on or after January 1, 2017 – any age with 35 years of service, age 60 with 30 years of service, or age 65 with 5 years of service.

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

- Hired before January 1, 2007 – age 55 with a minimum of 5 years of service credit and age plus years of service equals 80 or more.
- Hired between January 1, 2007 and December 31, 2010 – age 55 and age plus years of service equals 85 or more. For members hired before January 1, 2007, age plus years of service increase to 85 for members with less than five years of service credit as of January 1, 2011.
- Hired on or after January 1, 2011 but before January 1, 2017 – age 58 and age plus years of service equals 88 or more.
- Hired on or after January 1, 2017 – age 60 plus years of service equals 90.

Members automatically receive the higher of the defined-retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5% times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit and limited to a 15% increase between periods. For retirements after January 1, 2009, or persons hired on or after January 1, 2007, more restrictive limits are placed on salary increases between periods used in calculating HAS.

Retiree benefits are increased annually in July after one year of retirement based on the member's original hire date as follows:

- Hired before July 1, 2007 – the lesser of 2% or the average of the monthly national Consumer Price Index (CPI) increases.

- Hired on or after January 1, 2007 – the lesser of 2% or the actual increase in the CPI, limited to a 10% reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007 (the reserve is funded by one-percentage point of salaries contributed by employers for employees hired on or after January 1, 2007).
- The upper limits on benefits increase by one-quarter percentage point each year when the funded ratio of PERA equals or exceeds 103% and declines by one-quarter percentage point when the funded ratio drops below 90% after having exceeded 103%. The funded ratio increase does not apply for three years when a negative return on investment occurs.

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

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

Most employees contribute 8.0% of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan.

From January 1, 2013 to December 31, 2013, Pinnacol contributed 16.55% and from January 1, 2014 to December 31, 2014, Pinnacol contributed 17.45% of the employee's salary. During all of 2014, 1.02% of the employees' total salary was allocated to the Health Care Trust Fund.

Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2013, the division of PERA in which Pinnacol participates has a funded ratio of 57.5% and a 60-year amortization period based on current contribution rates. The funded ratio on the market value of assets is higher at 61.0%.

In the 2004 and 2010 legislative sessions, the General Assembly authorized an Amortization Equalization Disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional 0.5% of salary beginning January 1, 2006, another 0.5% of salary in 2007, with subsequent year increases of 0.4% of salary through 2017, to a maximum of 5%.

In the 2006 and 2010 legislative sessions, the General Assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one-half percentage point of total salaries paid beginning January 1, 2008 through 2017, to a maximum 5%.

At a 103% funding ratio, both the AED and the SAED will be reduced by one-half percentage point, and for subsequent declines to below 90% funded both the AED and SAED will be increased by one-half percentage point.

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

Pinnacol expects the annual contribution rate, including AED and SAED, to increase as follows from 2015 to 2018:

Year	Employer contribution	AED	SAED	Total Pinnacol contribution
2015	10.15%	4.20%	4.00%	18.35%
2016	10.15	4.60	4.50	19.25
2017	10.15	5.00	5.00	20.15
2018	10.15	5.00	5.00	20.15

Pinnacol’s contributions to PERA for the years ending December 31, 2014 and 2013 were $7,830,000 and $7,146,000, respectively. These contributions met the contribution requirement for each year.

(b) Voluntary Tax-Deferred Retirement Plans

PERA offers a voluntary 401(k) plan entirely separate from the defined-benefit pension plan. Pinnacol matches employee’s elective contributions into the PERA 401(k) plan at 50% up to the first 6% of employees’ elected deferrals. The matching contribution is immediately vested and available to the employees. During the years ended December 31, 2014 and 2013, Pinnacol contributed approximately $1,137,000 and $1,022,000, respectively, in matching contributions to the 401(k) plan. Pinnacol also offers a 457 deferred compensation plan.

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

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

After the PERA subsidy, the benefit recipient pays the balance of the premium through an automatic deduction from the monthly retirement benefit. Monthly premium costs for participants depend on the healthcare plan selected, the PERA subsidy amount, Medicare eligibility, and the number of persons covered. Effective July 1, 2000, the maximum monthly subsidy is $230 per month for benefit recipients who are under 65 years of age and who are not entitled to Medicare and $115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare.

The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction of 5% for each year less than 20 years.

Employees are not required to contribute to the Health Care Trust Fund, which is maintained by employer's contributions as discussed above. Beginning July 1, 2004, employers are required to contribute 1.02% of gross covered wages to the Health Care Trust Fund. Pinnacol contributed approximately $458,000 and $442,000 as required by statute in the years ended December 31, 2014 and 2013, respectively. In each year, the amount contributed was 100% of the required contribution.

The Health Care Trust Fund offers two general types of plans: fully insured plans offered through healthcare organizations and self-insured plans administered for PERA by third-party vendors. As of December 31, 2013, there were 53,041 enrolled participants, including spouses and dependents, from all contributors to the plan. At December 31, 2013, the Health Care Trust Fund had an unfunded actuarial accrued liability of $1.26 billion, a funded ratio of 18.8%, and a 30-year amortization period.

(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.

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 $1,717,000 and $1,677,000 at December 31, 2014 and 2013, 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 2014 or 2013.

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 $161,878,000 for 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 2014, $3,019,000 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 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, 2014. In accordance with the note agreement, Pinnacol may apply the proceeds for general corporate purposes.

(8) Commitments and Contingencies

The Company has made total commitments of $15,959,000 to provide additional funds as needed to the following partnerships: Kayne Credit Opportunities Fund LP $6,651,000 and Morgan Stanley Credit Partners LP $9,308,000.

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.

At December 31, 2014 and 2013, Pinnacol had a letter of credit for the benefit of Argonaut Insurance Company under an assumed reinsurance agreement for approximately $14,024,000 and $17,386,000, 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, 2014 and 2013, 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 $68,006,000 and $94,472,000, compared to a requirement of $51,024,000 and $54,386,000, as of December 31, 2014 and 2013, respectively.

Pinnacol is contingently liable for approximately $46,667,000 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 PERA's unfunded pension liability. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, will require cost-sharing employers participating in defined-benefit plans to record their proportionate share of the unfunded pension liability for financial statements presented on a GAAP basis, and is effective for fiscal years beginning after June 15, 2014. PERA will provide each employer its proportionate amount. The variables that impact the size of PERA's unfunded pension liability are the number of active and inactive members, annual payroll, required contribution rates, and the investment returns of PERA. At this time, management is unable to estimate the magnitude of Pinnacol's share of PERA's unfunded pension liability, but it is expected to be material and may exceed $100,000,000. The proportionate share for vested service of Pinnacol employees and retirees is not required to be recorded as a liability in Pinnacol's statutory-basis financial statements as of December 31, 2014. Pinnacol is currently working to determine the potential impact of this matter on its future statutory-basis financial statements.

(9) Subsequent Events

New Board Members – One new member was appointed to the Company’s Board of Directors in December 2014 with an effective date of January 1, 2015.

Subsequent events have been evaluated through May 15, 2015, 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, 2014

(In thousands)

1. Pinnacol's total admitted assets as reported on page 2 of its annual statement are: $ 2,315,375

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	$ 67,373	2.910%
2.02	FREDDIE MAC GOLD POOLS	LONG–TERM BONDS	50,992	2.202
2.03	FANNIE MAE POOLS	LONG–TERM BONDS	47,463	2.050
2.04	FGLMC POOLS	LONG–TERM BONDS	30,561	1.320
2.05	CITIBANK CREDIT CARD ISSUANCE SERIES 201	LONG–TERM BONDS	23,907	1.033
2.06	FHLMC POOLS	LONG–TERM BONDS	20,007	0.864
2.07	MEDTRONIC INC	LONG–TERM BOND AND COMMON STOCK	13,111	0.566
2.08	JPMORGAN CHASE & CO	LONG–TERM BOND AND COMMON STOCK	11,715	0.506
2.09	CITIGROUP INC	LONG–TERM BOND AND COMMON STOCK PREFERRED STOCK	11,489	0.496
2.10	AT&T INC	LONG–TERM BOND AND COMMON STOCK	11,433	0.494

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	$ 1,279,842	55.276%
NAIC-2	290,410	12.543
NAIC-3	72,319	3.123
NAIC-4	104,611	4.518
NAIC-5	14,554	0.629
NAIC-6	1,166	0.050
Preferred stocks:		
P/RP-1	—	—
P/RP-2	—	—
P/RP-3	575	0.025
P/RP-4	323	0.014
P/RP-5	—	—
P/RP-6	—	—
	$ 1,763,800	

4. Assets held in foreign investments are $188,691 and assets held in foreign-currency-denominated investments are $0, which is approximately 8.149% and 0% of Pinnacol's total admitted assets, respectively.

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

Foreign investment assets

NAIC Designation	Amount	Percentage of total admitted assets
Countries designated NAIC-1	$ 140,074	6.050%
Countries designated NAIC-2	35,817	1.547
Countries designated NAIC-3 or below	12,800	0.553
	$ 188,691	

(In thousands)

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

Foreign investment assets

NAIC Designation	Country	Amount	Percentage of total admitted assets
Countries designated NAIC-1:			
Country 1:	UNITED KINGDOM	$ 36,913	1.594%
Country 2:	NORWAY	19,577	0.846
Countries designated NAIC-2:			
Country 1:	MEXICO	23,545	1.017
Country 2:	PHILIPPINES	6,421	0.277
Countries designated NAIC-3 or below:			
Country 1:	SOUTH KOREA	6,995	0.302
Country 2:	VIRGIN ISLANDS-BRITISH	5,081	0.219
		$ 98,532	

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

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

Foreign-Currency-Denominated investment assets

NAIC Designation	Amount	Percentage of total admitted assets
Countries designated NAIC-1	$ —	—%
Countries designated NAIC-2	—	—
Countries designated NAIC-3 or below	—	—
	$ —	

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

Foreign-Currency-Denominated investment assets

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:		—	—
		$ —	

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

Issuer	NAIC Designation	Amount	Percentage of total admitted assets
10 PETROELEOS MEXICANOS	2FE	$ 10,906	0.471%
10 BARCLAYS BANK PLC	1FE	10,607	0.458
10 LLOYDS BANK PLC	1FE	10,034	0.433
10 MACQUARIE BANK LTD	1FE	9,998	0.432
10.1 WEATHERFORD BERMUDA	2FE	9,995	0.432
10.1 TOTAL CAPITAL INTL SA	1FE	9,982	0.431
10.1 DIAGEO CAPITAL PLC	1FE	9,696	0.419
10.1 OBEBRECHT FINANCE LTD	2FE	8,000	0.346
10.1 STATOIL ASA-SPON ADR	1FE	7,887	0.341
10.10 AMERICA MOVIL SAB DE CV	1FE	7,174	0.310

PINNACOL ASSURANCE

Supplemental Schedule of Investment Information
Investment Risks Interrogatories

Year ended December 31, 2014

(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	WESTWOOD INCOME OPPORTUNITY FUND	$ 44,304	1.913%
13	HARDING LOEVNER INTL EQ & EMERGING MKTS FUND	42,683	1.843
13	BLACKROCK EQUITY INDEX FUND B CTF	36,693	1.585
13	T.ROWE PRICE INSTITUTIONAL SMALL CAP FUND	34,360	1.484
13.1	VANGUARD INTL STOCK FUND	32,543	1.406
13.1	DODGE & COX INTL STOCK FUND	31,095	1.343
13.1	FRANKLIN INTL GROWTH FUND	25,784	1.114
13.1	GMO BENCHMARK-FREE ALLOCATION FUND-III	24,138	1.043
13.1	FIRST EAGLE OVERSEAS FUND	19,549	0.844
13.10	LSV VALUE EQUITY FUND	17,581	0.759

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, 2014

Investment Categories	Gross Investment Holdings* Amount	Gross Investment Holdings* Percentage of Gross Investment Holdings	Admitted assets as reported in the annual statement Amount	Admitted assets as reported in the annual statement Percentage of total admitted assets
Bonds:				
U.S. Treasury securities	$ 77,564,949	3.5%	$ 77,564,949	3.5%
U.S. government agency obligations (excluding mortgage-backed securities):				
– Issued by U.S. government agencies				
– Issued by U.S. government-sponsored agencies	5,009,422	0.2	5,009,422	0.2
Non-U.S. government (including Canada, excluding mortgage-backed securities)				
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
– States, territories, and possessions general obligations	600,000	—	600,000	—
– Political subdivisions of states, territories, and possessions and political general obligations				
– Revenue and assessment obligations	10,400,000	0.5	10,400,000	0.5
– Industrial development and similar obligations				
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
– Issued or guaranteed by GNMA	6,493,010	0.3	6,493,010	0.3
– Issued or guaranteed by FNMA and FHLMC	216,396,395	9.7	216,396,395	9.7
– All other				
CMOs and REMICs:				
– Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	50,337,935	2.2	50,337,935	2.2
– Issued by non-U.S. government issuers and collateralized by mortgage-based securities issued by above				
– All other	83,991,626	3.8	83,991,626	3.8
Other debt and other fixed income securities (excluding short term):				
– Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	1,047,730,175	46.8	1,047,730,175	46.8
– Unaffiliated non-U.S. securities (including Canada)	217,946,338	9.7	217,946,338	9.7
– Affiliated securities				
Equity interests:				
– Investments in mutual funds	289,582,801	12.9	289,582,801	12.9
Preferred stocks:				
– Affiliated				
– Unaffiliated	898,436	—	898,436	—
Publicly traded equity securities (excluding preferred stocks):				
– Affiliated				
– Unaffiliated	117,690,174	5.3	117,690,174	5.3
Other equity securities:				
– Affiliated				
– Unaffiliated	44,146,649	2.0	44,146,649	2.0
Other equity interests including tangible personal property under lease:				
– Affiliated				
– Unaffiliated				

(Continued)

PINNACOL ASSURANCE

Supplemental Schedule of Investment Information
Summary Investment Schedule

December 31, 2014

Investment Categories	Gross Investment Holdings* Amount	Gross Investment Holdings* Percentage of Gross Investment Holdings	Admitted assets as reported in the annual statement Amount	Admitted assets as reported in the annual statement 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	17,097,726	0.8	17,097,726	0.8
– Property held for production of income				
– Property held for sale				
Contract loans				
Derivatives				
Receivables for securities	4,390,164	0.1	4,390,164	0.1
Securities lending				
Cash, cash equivalents, and short-term investments	39,377,724	1.8	39,377,724	1.8
Other invested assets	9,092,693	0.4	9,092,693	0.4
Total invested assets	$ 2,238,746,217	100.0%	$ 2,238,746,217	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
Suite 800
1225 17th Street
Denver, CO 80202-5598

Independent Auditors’ Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of 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, 2014, and the related statutory statements of operations and changes in policyholders’ surplus, and cash flows for the year then ended, and the related notes to the statutory financial statements, and have issued our report thereon dated May 15, 2015. 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 15, 2015