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**AUG 14 2013**  
Department of Insurance  
State of Idaho

*Attorneys for Department of Insurance*

**BEFORE THE DIRECTOR OF THE DEPARTMENT OF INSURANCE  
OF THE STATE OF IDAHO**

In the Matter of:

IDAHO STATE INSURANCE FUND

Certificate of Authority No. 1924  
NAIC No. 36129

Docket No. 18-2885-13

**ORDER ADOPTING REPORT  
OF EXAMINATION AS OF  
DECEMBER 31, 2011**

The State of Idaho, Department of Insurance (Department), having conducted an examination of the affairs, transactions, accounts, records, and assets of the Idaho State Insurance Fund (the State Fund), pursuant to Idaho Code § 41-219(1), hereby alleges the following facts that constitute a basis for the issuance of an order, pursuant to Idaho Code § 41-227(5)(a), adopting the Report of Examination of the Idaho State Insurance Fund as of December 31, 2011 (Report), as filed.

**FINDINGS OF FACT**

1. For purposes of regulation, the State Fund is deemed to be an Idaho-domiciled mutual insurance company, pursuant to Idaho Code § 72-901(4), and is authorized to transact workers' compensation insurance in Idaho under Certificate of Authority No. 1924.

2. The Department completed an examination of the State Fund pursuant to Idaho Code § 41-219(1) on or about July 29, 2013. The Department's findings are set forth in the Report.

3. Pursuant to Idaho Code § 41-227(4), a copy of the Report, verified under oath by the Department's examiner-in-charge, was filed with the Department on July 29, 2013, and a copy of such verified Report was transmitted to the State Fund on July 30, 2013. A copy of the verified Report is attached hereto as Exhibit A.

4. On or about August 1, 2013, the Department received a Waiver signed by James M. Alcorn, Manager of the State Fund. By execution of such Waiver, a copy of which is attached hereto as Exhibit B, the State Fund acknowledged receipt of the Report, waived the right to examine the Report for up to thirty (30) days and consented to the immediate entry of a final order by the Director of the Department (Director) adopting the Report without any modifications. Such Waiver also included the State Fund's agreement to waive other statutory rights, to include waiver of the right to make a written submission or rebuttal to the Report; and waiver of rights to request a hearing and to seek reconsideration or appeal from the Director's final order.

5. No written submissions or rebuttals, pursuant to Idaho Code § 41-227(4), with respect to any matters contained in the Report were submitted to the Department by the State Fund.

#### **CONCLUSIONS OF LAW**

6. Idaho Code § 41-227(5)(a) provides that "[w]ithin thirty (30) days of the end of the period allowed for the receipt of written submissions or rebuttals, the director shall fully consider and review the report, together with any written submissions or rebuttals and relevant

portions of the examiner's work papers" and shall enter an order adopting the report of examination as filed or with modifications or corrections.

7. Having fully considered the Report, the Director concludes that the State Fund meets the minimum requirements set forth in Idaho Code § 41-313(1).

**ORDER**

NOW, THEREFORE, based on the foregoing, IT IS HEREBY ORDERED that the Report of Examination of the Idaho State Insurance Fund as of December 31, 2011, is hereby ADOPTED as filed, pursuant to Idaho Code § 41-227(5)(a), and a copy of this Order with all exhibits referenced herein, including the adopted Report, is hereby transmitted to the governor of the state of Idaho, in accordance with Idaho Code § 72-914.

IT IS FURTHER ORDERED, pursuant to Idaho Code § 41-227(8), that the adopted Report is a public record and shall not be subject to the exemptions from disclosure provided in chapter 3, title 9, Idaho Code.

**IT IS SO ORDERED.**

DATED this 14<sup>TH</sup> day of August, 2013.

STATE OF IDAHO  
DEPARTMENT OF INSURANCE

  
\_\_\_\_\_  
WILLIAM W. DEAL  
Director

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that, on this 14th day of August, 2013, I caused a true and correct copy of the foregoing ORDER ADOPTING REPORT OF EXAMINATION AS OF DECEMBER 31, 2011 to be served upon the following by the designated means:

Idaho State Insurance Fund  
Attn: James M. Alcorn, Manager  
1215 West State Street  
Boise, ID 83720-0044  
[JamesM.Alcorn@idahosif.org](mailto:JamesM.Alcorn@idahosif.org)

- first class mail
- certified mail
- hand delivery
- email

The Honorable C.L. "Butch" Otter  
Governor, State of Idaho  
Idaho Statehouse  
Boise, ID 83720

- first class mail
- certified mail
- hand delivery
- email
- Statehouse Mail

Georgia Siehl, CPA, CFE  
Bureau Chief/Chief Examiner  
Idaho Department of Insurance  
700 W. State Street, 3<sup>rd</sup> Floor  
Boise, ID 83720-0043  
[georgia.siehl@doj.idaho.gov](mailto:georgia.siehl@doj.idaho.gov)

- first class mail
- certified mail
- hand delivery
- email

  
\_\_\_\_\_  
Teresa Jones  
Assistant to the Director

DEPARTMENT OF INSURANCE

STATE OF IDAHO



REPORT OF EXAMINATION

of the

IDAHO STATE INSURANCE FUND

(NAIC Company Code 36129)

as of

December 31, 2011



## TABLE OF CONTENTS

	<u>Page</u>
Salutation.....	1
Scope of Examination .....	2
Prior Examination .....	2
History and Description .....	3
General .....	3
Dividends to Policyholders .....	4
Management and Control.....	4
General .....	4
Board of Directors.....	5
Fund Manager and Assistant Fund Managers.....	5
Committees .....	5
Conflict of Interest .....	6
Contracts and Agreements .....	6
Corporate Records.....	7
Articles of Incorporation and Bylaws .....	7
Minutes of Meetings .....	7
Fidelity Bond and Other Insurance .....	8
Pension, Stock Ownership and Insurance Plans .....	8
Territory and Plan of Operation .....	8
Statutory and Special Deposits.....	9
Growth of the State Fund .....	9
Loss Experience .....	10
Reinsurance .....	10
Assumed.....	10
Ceded.....	10
Insurance Products and Related Practices.....	11
Accounts and Records.....	12
General Accounting .....	12
Independent Accountants .....	13
Actuarial Opinion.....	13
Information Systems Review .....	14
Subsequent Events .....	15
Financial Statements .....	16
Balance Sheet as of December 31, 2011 .....	17
Statement of Income, for the Year Ending December 31, 2011 .....	19
Capital and Surplus Account, for the Year Ending December 30, 2011 .....	19
Reconciliation of Capital and Surplus, December 31, 2006 to December 31, 2011....	20
Notes to the Financial Statements.....	21
Summary, Comments, and Recommendations .....	21
Summary .....	21
Conclusion.....	21
Affidavit of Examiner .....	22

*State of Idaho*

**DEPARTMENT OF INSURANCE**

C. L. "BUTCH" OTTER  
Governor

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Boise, Idaho 83720-0043  
Phone (208)334-4250  
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WILLIAM W. DEAL  
Director

Boise, Idaho  
July 29, 2013

The Honorable William W. Deal  
Director of Insurance  
State of Idaho  
700 West State Street  
Boise, Idaho 83720

Dear Director:

Pursuant to your instructions, in compliance with Sections 41-219(1), and 72-914, Idaho Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2011, of the financial condition and corporate affairs of:

Idaho State Insurance Fund  
1215 West State Street  
Boise, Idaho 83702

hereinafter referred to as the "State Fund," at its offices in Boise, Idaho. The following Report of Examination is respectfully submitted.

## SCOPE OF EXAMINATION

This examination covered the period January 1, 2007, through December 31, 2011. The examination was conducted at the Boise, Idaho office of the State Fund by examiners from the State of Idaho. The examination was conducted in accordance with Sections 41-219(1) and 72-914, Idaho Code, the National Association of Insurance Commissioners (NAIC) *Financial Condition Examiners Handbook* and the NAIC *Accounting Practices and Procedures Manual*.

All accounts and activities of the State Fund were considered in accordance with the NAIC's risk-focused examination process. The NAIC *Financial Condition Examiners Handbook* requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the State Fund by obtaining information about the State Fund including corporate governance, identifying and assessing inherent risks within the State Fund and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with statutory accounting principles and NAIC *Annual Statement Instructions* as governed and prescribed by Idaho law.

A Letter of Representation was signed by the State Fund attesting to its ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities.

The actuarial review of reserves, related liabilities, and other actuarial items was performed by Lewis & Ellis, Inc., consulting actuaries, for the Idaho Department of Insurance. A risk assessment review of the State Fund's information technology systems and controls was performed by Jennan Enterprises, LLC. There was some reliance placed on the 2011 Certified Public Accountants' statutory audit report and workpapers during the examination of the State Fund.

In addition to the Report of Examination, a Management Letter was issued to the State Fund by the Department which covered items that were not included in the Report, due to the materiality threshold, items that were related to proprietary/operational issues, as well as minor accounting and/or annual statement reporting corrections.

## PRIOR EXAMINATION

The prior financial examination was conducted by the Idaho Department of Insurance covering the period January 1, 2002 through December 31, 2006.

A review was made to ascertain what action was taken by the State Fund with regard to comments and recommendations made by the Department in the prior examination report. Unless otherwise mentioned in the *Comments and Recommendations* section of this report, the prior report exceptions were adequately addressed by the State Fund.



## HISTORY AND DESCRIPTION

### General

The State Fund was established by an act of the legislature of the State of Idaho and was approved on March 16, 1917, in conjunction with the passage of the “Workmen’s Compensation Act”, which became effective on January 1, 1918, pursuant to Idaho Code, Title 72, Chapter 9. The Fund Manager’s office was organized effective July 1, 1917, in preparation for the establishment of the Workers’ Compensation Act. The State Fund was incorporated/organized on December 31, 1917 and commenced business on January 1, 1918. Under Section 41-902, Idaho Code, the Board of Directors appoints a manager of the State Insurance Fund.

The State Fund was founded for the purpose of providing Idaho employers a reliable source of workers’ compensation insurance protection at a low cost. Workers’ compensation coverage generally provides compensation for injuries sustained by the employees that are work related, including bodily injury, accidental death, occupational disabilities and disease.

On April 3, 1998, legislation was enacted relating to the State Fund by amending Title 72, and to provide application of the Idaho Insurance Code, Title 41 for the purpose of regulation. The State Fund is an independent body corporate politic. For purposes of regulation, the State Fund is deemed to be a mutual insurer pursuant to Section 72-901(4), Idaho Code. The State Fund operates under Certificate of Authority No. 1924, which was issued on April 3, 1998.

In accordance with Sections 72-301(1)-(2) Idaho Code, “Every employer shall secure the payment of compensation under this law in one (1) of the following ways:”

- Keeping insured with a policy from an insurer “*authorized by the director of the department of insurance...*” or
- “...[E]very public employer shall insure its liability for payment of compensation with the state insurance fund unless such fund shall refuse to accept the risk when the application for insurance is made;” or
- An employer may become self-insured by obtaining the approval of the industrial commission.

The State Fund is operated exclusively from insurance premiums received from policyholders, is not tax supported, and the State of Idaho is not liable for any of its indebtedness. Pursuant to Section 72-912, Idaho Code, invested assets of the State Fund are managed by the Idaho Endowment Fund Investment Board, with the direction and approval of the State Fund Manager.

The State Fund is not subject to federal income taxes or state and local property taxes. However, the State Fund is required to pay premium taxes to the Idaho Department of Insurance, pursuant to Section 41-402, Idaho Code. Under Section 72-523, Idaho Code, the State Fund also pays a 2.5 percent premium tax to the Idaho Industrial Commission. Effective January 1, 2012, the tax rate will be 2 percent. Section 72-523, Idaho Code, allows a credit on the Idaho Department of Insurance Premium Tax Return for the taxes paid to the Idaho Industrial Commission. During the examination period, the premium tax credit was equal to 1.3 percent of net written premiums.

Starting in 2012, the premium tax credit will be 50 percent of the tax paid to the Industrial Commission or a minimum of \$75.

The *Idaho Insurance Guaranty Association Act*, which generally provides for limited coverage of policyholders in the event of a failure or liquidation of an insurance company, does not apply to the State Fund (see Section 41-3603(9), Idaho Code). Therefore, there is no guaranty association coverage for State Fund policyholders, nor are there any guaranty association assessments made on, or required of, the State Fund.

#### Dividends to Policyholders

Dividends, which were funded by underwriting gains and investment earnings, were paid annually to policyholders. Amounts distributed as dividends represented how much premium could be safely returned to policyholders and were based on the State Fund's future business needs, how much surplus it should retain, and future loss contingencies.

Dividends paid to policyholders for the five-year period under examination are illustrated below:

<u>Year</u>	<u>Amount</u>
2007	\$21,101,317
2008	\$14,372,455
2009	\$14,771,238
2010	\$11,582,301
2011	\$ 9,781,926

Dividends are discussed in more detail under the caption, "*SUBSEQUENT EVENTS*".

### MANAGEMENT AND CONTROL

#### General

The management and control of the State Fund is provided for under Sections 72-901 and 72-902, Idaho Code, as amended April 3, 1998. The Governor appoints five persons to the board of directors of the State Fund who, by law, one-each must come from the following categories:

- Licensed insurance agent
- Representative of business of the state
- Representative of labor
- Member of the state senate
- Member of the state house of representatives

The members of the board then appoint a Manager of the State Fund who serves at their pleasure along with such other officers and employees as may be required. It is the duty of the board of directors to direct the policies and operations of the State Fund to assure that it is operated as an efficient insurance company. During the examination period, the Fund was subject to and

complied with the provisions of the Idaho Insurance Code, Title 41. As mentioned earlier, for the purposes of regulation, the State Fund is deemed to be a mutual insurer (see Section 72-901(4), Idaho Code). The State Fund Manager, subject to the direction and supervision of the board, conducts the business of the State Fund, and does “*any and all things which are necessary and convenient in the administration thereof...*” (see Section 72-902, Idaho Code). The State Fund is not a member of a holding company system.

Board of Directors

At year-end 2011, the following persons were serving on the Board of Directors pursuant to Section 72-901(2), Idaho Code:

<u>Name</u>	<u>Position</u>
Rodney A. Higgins	Chairman of the Board and Licensed Insurance Agent
Max C. Black	Representative of Business
Terry F. Gestrin	Member of State House of Representatives
John W. Goedde	Member of State Senate
Steven C. Landon	Representative of Labor

Fund Manager and Assistant Fund Managers:

The following individuals were serving as the Fund Manager and Assistant Fund Managers as of December 31, 2011:

<u>Name</u>	<u>Position</u>
James M. Alcorn, CIC	Fund Manager
Clark Barnett	Assistant Fund Manager – Administration & Finance
Connie Barnett	Assistant Fund Manager – Underwriting
Julie Cooper	Assistant Fund Manager – Claims
Kathy Hickman	Assistant Fund Manager – Premium Audit
James McCoy	Assistant Fund Manager – Risk Management
Richard Gerrard	Chief Information Officer
George Parham	Chief Legal Counsel
Michael Brush	Division Chief, Petroleum Storage Tank Fund

Subsequent to the examination date, Julie Cooper retired as Assistant Fund Manager – Claims. She was replaced by Paulette Boyle. Mike Brush also retired and was replaced by Douglas Garner.

Committees

The full Board of Directors also serves as the State Fund’s Audit Committee. The State Fund does not have any other committees.

Conflict of Interest

The State Fund adopted a conflict of interest policy on January 17, 2008 that required the Directors, the State Fund Manager and key employees to complete a Conflict of Interest Statement annually. The statements completed during the examination period and subsequent thereto appeared to appropriately disclose any possible conflicts of interest.

Contracts and Agreements

The State Fund had the following contract in force as of December 31, 2011.

Exclusive Management and Administrative Contract for the Idaho Petroleum Clean Water Trust Fund

The Idaho Petroleum Clean Water Trust Fund (Tank Fund) was created by the Idaho Legislature in 1990. Starting in 2003, the Tank Fund was subject to the direction and supervision of its Board of Trustees pursuant to Section 41-4904(3), Idaho Code. The administrator of the Tank Fund is the State Fund unless replaced by the Tank Fund’s Board of Trustees with another person, in accordance with Section 41-4904(2), Idaho Code.

In accordance with Section 41-4905(5), Idaho Code, the Tank Fund entered into an exclusive management and administrative contract with the State Fund. The original contract was executed, and approved by the Idaho Department of Insurance, on September 17, 1990 in accordance with Section 41-4929(1), Idaho Code.

As noted above, the Board of Trustees became responsible for direction and supervision of the Tank Fund in 2003. In this connection, a modified version of the agreement was submitted to the Idaho Department of Insurance on August 23, 2004. This contract was entered into by the State Fund, through its Manager, and the Tank Fund, through its Board of Trustees. The Idaho Department of Insurance approved this agreement on August 25, 2004.

The State Fund, as Administrator of the Tank Fund, provided the following management and administrative functions to the Tank Fund:

Hiring Qualified Personnel	Accounting and Record Keeping	Underwriting
Claims Handling	Auditing and Reporting	Actuarial
Computer and Data Processing	Computer Programming	Legal Services
All Other Managerial & Administrative Functions.		

The contract also provides a cost allocation/reimbursement, that applies to various items, which are shared by the State Fund and the Tank Fund in their working arrangement, such as, equipment, office space, parking space, general office expenses, supplies, electronic data processing equipment and software.

Contract revenue from management services provided to the Tank Fund during the examination period is set forth below:

<u>Year</u>	<u>Contract Revenue from Management Services</u>	<u>Revenue from Rent and Parking</u>
2007	\$346,878	\$30,120
2008	\$328,556	\$30,120
2009	\$307,223	\$31,520
2010	\$289,194	\$30,920
2011	\$269,621	\$30,920

The examination reviewed the actual operation of the contract terms and fees paid during the examination period and determined that they appeared to be fair and reasonable (see Section 41-4929(4), Idaho Code).

Pursuant to Section 41-4929(2), Idaho Code, the State Fund, as the Administrator of the Tank Fund, is required to furnish to the Director of Insurance a written summary of receipts and disbursements made under the terms of the agreement on an annual basis (within 90 days after the end of each calendar year). It should include emoluments received by principal management personnel of the State Fund involved in the affairs of the Tank Fund, and such other detailed information as the Director may require. Such information was included in the annual statements submitted to the Department of Insurance.

The contract may not be amended by either party without written consent of the Director of the Idaho Department of Insurance, except as may be required by duly enacted amendments to Idaho Code, Title 41, and Chapter 49.

The Tank Fund shall be administered without liability on the part of the State Fund or the State of Idaho beyond the amount of said trust fund pursuant to Section 41-4905(6), Idaho Code.

## CORPORATE RECORDS

### Articles of Incorporation and By-laws

The State Fund was established by an act of the Idaho State Legislature approved on March 16, 1917 in conjunction with the "Workmen's Compensation Act". The Act became effective January 1, 1918. Consequently, the State Fund was not required to draft Articles of Incorporation or By-laws, which are required for conventional insurance companies. The duties of the Board of Directors are set forth under Title 72, Idaho Code.

### Minutes of Meetings

A review of the minutes of the meetings of the Board of Directors for the period January 1, 2007 through December 31, 2011 and subsequent thereto indicated that a quorum was present at all meetings held during the examination period.

The minutes of the January 17, 2008 Directors' meeting indicated the Department of Insurance Report of Examination as of December 31, 2006 and management letter were reviewed.

#### FIDELITY BOND AND OTHER INSURANCE

Insurance coverages for the protection of the State Fund were maintained during the period covered by the examination. The Idaho State Office of Insurance Management of the Department of Administration arranges for comprehensive blanket coverages for all agencies of the State of Idaho, including the State Fund. Coverages in effect as of December 31, 2011 included employee bond and crime; major property and fine arts; boiler and machinery; comprehensive liability; auto physical damage; inland marine, and notary bonds.

The *protection of the financial institution* bond (fidelity bond) met the suggested minimum limits recommended by the NAIC *Financial Condition Examiners Handbook*.

The insurance companies providing coverage to the State Fund were authorized to do business in the State of Idaho. The State of Idaho retained the risk on the comprehensive liability, auto physical damage, inland marine, and notary bonds coverages.

#### PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

Management and employees of the State Fund were provided a number of benefits, which are available to other employees of the State of Idaho. The major benefits and programs provided to the employees included medical care and a behavior health plan, dental care, vision, life and disability insurance, flexible spending accounts, a 401(k) plan and holiday, vacation and sick leave. The State Fund's employees are required to participate in the Public Employee Retirement System of Idaho (PERSI). PERSI is a cost-sharing multiple-employer public retirement system, created by the Idaho State Legislature.

#### TERRITORY AND PLAN OF OPERATION

The State Fund was authorized to write workers' compensation insurance only, pursuant to Certificate of Authority No. 1924. The State Fund was licensed only in the State of Idaho. Section 72-301, Idaho Code requires every public employer and/or governmental entity (unless self-insured) to be insured with the State Fund. The State Fund also insures employers from the private sector, if the underwriting criteria is acceptable.

Effective January 1, 1997, Idaho agricultural workers, previously exempt from the workers' compensation law, were required to maintain coverage.

The State Fund operates from its main administrative office located in Boise, Idaho, and has five field offices located in Coeur d'Alene, Idaho Falls, Lewiston, Pocatello, and Twin Falls.

The State Fund utilizes independent producers and agencies to produce business on its behalf. According to the Idaho Department of Insurance, as of April 3, 2013, there were approximately 512 licensed and appointed producers and agencies.

### STATUTORY AND SPECIAL DEPOSITS

As of December 31, 2011, the examination confirmed with the Idaho Department of Insurance that the State Fund had made provision for the following deposits to be held in trust for the protection of all its policyholders and/or creditors through said office of the Director of Insurance, State of Idaho, in compliance with Sections 41-316A, 41-803 and 41-804, Idaho Code.

<u>Description</u>	<u>Par Value</u>	<u>Market Value</u>	<u>Statement Value</u>
U.S. Treasury Bonds, 7.25%, Due 5/15/2016	\$ 1,000,000	\$ 1,282,422	\$ 1,096,351
Total:	<u>\$ 1,000,000</u>	<u>\$ 1,282,422</u>	<u>\$ 1,096,351</u>

In compliance with Section 72-301(2), Idaho Code, the State Fund deposited \$93.45 million of U.S. Treasury Notes as of December 31, 2011, with the Idaho State Treasurer as required by the Idaho Industrial Commission. The purpose of this deposit was to cover the unpaid outstanding awards of the State Fund in the amount of \$67,935,108 on the above date. It was the State Fund's decision to deposit a higher amount than the unpaid outstanding award amount as required by the Idaho Industrial Commission.

### GROWTH OF THE STATE FUND

The State Fund's growth for the years indicated, as taken from the prior examination report and its Annual Statements, is shown in the following schedule:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	<u>Net Income(Loss)</u>
2007	\$642,175,947	\$431,137,582	\$211,038,365	\$48,575,781
2008	612,177,507	421,282,117	190,895,389	(5,038,033)
2009	614,816,970	416,876,585	197,940,384	(239,501)
2010	609,312,524	407,548,170	201,764,354	2,466,673
2011*	580,849,525	386,782,685	194,066,840	3,930,152

\*As determined by Examination.

A net loss was reported in 2008 due to dividends paid to policyholders (see the *Dividends to Policyholder* section of this report for more detail). Improvements in the economy were reflected in surplus gains and increases in net income during 2010. Surplus was down in 2011 from the prior year due mostly to non-admittance of application software plus an accrual for a

class action lawsuit (see NOTES TO FINANCIAL STATEMENT section of this report). Decreases in liabilities during the examination period were due mostly to lower loss and loss adjustment expense reserves.

LOSS EXPERIENCE

The ratios of claims and underwriting expenses incurred to premiums earned shown in the following schedule were derived from amounts reported in the State Fund’s Annual Statements:

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses &amp; Loss Adjustment Expenses Incurred</u>	<u>Underwriting Expenses Incurred</u>	<u>Ratio of Expenses to Premiums Earned</u>
2007	\$225,988,792	\$155,987,364	\$30,767,649	82.64%
2008	195,024,864	158,331,593	27,270,604	95.17%
2009	158,815,704	137,837,964	28,727,024	104.88%
2010	140,133,151	125,595,036	23,928,430	106.70%
2011*	143,713,418	132,869,822	25,516,938	110.21%

\*As determined by Examination.

Premiums declined in 2008 through 2010 due primarily to poor general economic conditions. Increases were noted in 2011 as economic activity picked up. Fluctuations in losses and loss adjustment expenses were due mainly to lower reserves. Underwriting expenses, except for 2009, declined because of staff reductions due to attrition and other expense containment measures.

REINSURANCE

Assumed

The State Fund participates in the National Workers’ Compensation Reinsurance Pool (NWCPR), which is a voluntary, non-profit, unincorporated association that is administered by the National Council on Compensation Insurance (NCCI).

The State Fund participated on Idaho risks insured through the Pool and its participation was directly proportional to the percentage of its direct writings for all workers’ compensation business written in the State of Idaho.

Ceded

The State Fund ceded business classified as Statutory Workers’ Compensation and Employers’ Liability Business under the “Underlying Through Fourth Per Occurrence Excess of Loss Reinsurance Contract”. The Subscribing Reinsurers signed Interests and Liabilities Agreements that set forth their share in the interest and liabilities pursuant to the contract.



The reinsurers are liable in respect of each loss occurrence for 100 percent of the ultimate net loss over and above the State Fund's retentions, subject to a limit of liability to the Reinsurers, for each loss occurrence as illustrated below:

<u>Layer</u>	<u>Ultimate Net Loss</u>		<u>Aggregate Limit</u>
	State Fund's Retention in Respect of Each Loss Occurrence	Reinsurer's Limit of Liability in Respect of Each Loss Occurrence	Reinsurer's Limit of Liability in the Aggregate as Respects All Claims Arising Hereunder
Underlying Excess	\$ 2,500,000	\$ 2,500,000	\$ 7,500,000
First Excess	\$ 5,000,000	\$ 5,000,000	\$15,000,000
Second Excess	\$10,000,000	\$10,000,000	\$20,000,000
Third Excess	\$20,000,000	\$30,000,000	\$60,000,000
Fourth Excess	\$50,000,000	\$25,000,000	\$50,000,000

The State Fund also entered into an NBCR Terrorism Excess of Loss Reinsurance Contract. Under the contract, the State Fund is indemnified in respect of the liability that may accrue to it as a result of loss(es) arising from an NBCR Act(s) of Terrorism under policies classified as Statutory Workers' Compensation and Employers' Liability Business. The contract applies only to losses occurring entirely within the State of Idaho.

The reinsurer is liable in respect of each loss occurrence, for the ultimate net loss over and above the initial ultimate net loss of \$10,000,000, each loss occurrence, subject to a limit of liability to the reinsurer of \$40,000,000, each loss occurrence, subject further to an aggregate limit of liability of \$40,000,000 respecting all claims arising under the contract.

The State Fund obtained reinsurance coverages through intermediary, Guy Carpenter & Company, LLC, Seattle, Washington. The reinsurance contracts, effective July 1, 2011 through July 1, 2012, contained the clauses and termination provisions suggested in the NAIC *Financial Condition Examiners Handbook*. The reinsurance contracts are in compliance with Statement of Statutory Accounting Principles No. 62R and risk transfer is evident pursuant to the criteria of SSAP 62R, paragraph 13.

The Subscribing Reinsurers participating in the contracts were either licensed insurers, authorized to transact business in the State of Idaho, or trustee reinsurers accredited by the Department as required under Section 41-511, Idaho Code.

#### INSURANCE PRODUCTS AND RELATED PRACTICES

A separate limited scope market conduct examination as of December 31, 2011 was conducted concurrently with the financial examination by the Idaho Department of Insurance.

## ACCOUNTS AND RECORDS

### General Accounting

The State Fund utilized the SunGard Insurance Systems, Inc.'s Enterprise Accounting System (EAS). EAS is run on the Windows environment as the general ledger processing application. Summary general ledger entries from PowerSuite (Claims and Underwriting System) are downloaded each day to EAS through an automated process/script. Previous to February 2012, the WCIS application was utilized for claims and underwriting system. These summary entries contain premium billings, refund payments, indemnity payments, medical provider bill payments, and cash receipts. Summary information for commission payments, dividend transactions and miscellaneous transactions for producers, policyholders and claimants are also downloaded from PowerSuite to EAS through this automated process. Detail general ledger information from PowerSuite is obtained daily and can be accessed for review. A senior accountant reviews and approves all summary general ledger entries from PowerSuite and then releases and posts them to the EAS general ledger.

Expenditure cycle entries (invoices) are scanned into DMS and processed by the accounts payable clerk on an as needed basis and released for payment by the State Fund's controller. The accounts payable transactions from the EAS A/P module are uploaded daily into the EAS general ledger.

Journal entries are entered into the EAS general ledger system throughout the month with approval from the controller which is evidenced by physical sign off. Investments (accumulated through SunGard's Iworks investment accounting software), employee payroll (from the State Controller's Office), and fixed assets entries (from Sage Fixed Asset Accounting application) are uploaded into the general ledger at month-end.

There are no automated batch processes that release and post entries to EAS. All journal entries are released and posted to EAS by members of the accounting staff.

SunGard routinely provides "patches" for EAS and periodically migrates to new updated versions. Except for the patches and updated versions of EAS, there are no changes to the SunGard software nor has the State Fund customized the application. SunGard owns and manages the user tables but the State Fund maintains its own database.

Cash receipts are received by the mail room personnel and prepped for the document imaging process. Batches made up with checks and supporting documents are scanned into the DMS system, indexed and balanced to the State Fund's cash receipt application, and then loaded into PowerSuite (posted to the policyholder accounts).

Deposits are made at a local bank (Idaho State Treasurer's account marked for the State Fund) and a STARS entry is made to receipt the cash into the State's accounting system. STARS is the accounting software that the Idaho State Controller's Office uses for statewide accounting.

A senior accountant releases and posts downloaded summary general ledger information from PowerSuite each day to the EAS general ledger. This is an automated process in which the accountant must only review the transactions in the EAS accounting system and change the status from work in process (WIP) to approved.

Manual journal entries are prepared on an Excel spreadsheet by the State Fund's senior accountants and then entered into EAS, usually on a monthly basis. All journal entries are reviewed, approved and released by the controller.

After all of the journal entries have been made, EAS information is pulled-in by Crystal Reports software to produce monthly financial statements. The completed financial statements are reviewed by the controller and then presented electronically to the State Fund Manager for review. The State Fund submits statutory financial statements on a quarterly and annual basis (required by Idaho Code) to the Idaho Department of Insurance. These financial statements are generated using a software application from Booke Seminars.

On a daily basis, the cash balance in STARS (for all intents and purposes, the "bank") is reconciled to the State Fund's general ledger cash balance. All reconciling items are noted and researched and reconciling items are cleared in a timely manner.

#### Independent Accountants

The annual independent audits of the State Fund for the years under examination were performed by Deloitte & Touche LLP, Boise, Idaho. Audit reports for all years under examination were unqualified.

The financial statements in each report were on a statutory basis. There was some reliance on the 2011 audit reports and workpapers in this examination of the State Fund.

#### Actuarial Opinion

David R. Kennerud, FCAS, MAAA, the State Fund's Appointed Actuary, issued a statement of actuarial opinion, regarding the unpaid losses and loss adjustment expenses reported by the State Fund in its 2011 annual statement. The opinion stated that Mr. Kennerud is associated with the firm of Milliman, Inc., Seattle Washington, and is a member of the American Academy of Actuaries and a Fellow of the Casualty Actuarial Society.

The Appointed Actuary's analysis underlying the opinion included the use of such actuarial assumptions and methods and such tests of calculations as considered necessary. The opinion stated that the reserve amounts:

- (1) Meet the requirements of the insurance laws of the State of Idaho,
- (2) Are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board (including the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves), and

- (3) Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the State Fund under the terms of its contracts and agreements.

The actuarial items reported in the 2011 Annual Statement, on which the Appointed Actuary's opinion was rendered, were as follows:

<u>Loss Reserves</u>	
1. Reserves for Unpaid Losses (Page 3, Line 1, Column 1)	\$305,108,992
2. Reserve for Unpaid Loss Adjustment Expenses (Page 3, Line 3, Column 1)	\$ 34,831,010
3. Reserve for Unpaid Losses – Direct and Assumed (Schedule P, Part 1, Total from Columns 13 and 15, Line 12)	\$312,754,000
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Schedule P, Part 1, Totals from Columns 17, 19, and 21, Line 12)	\$ 34,831,000
5. Retroactive Reinsurance Reserve Assumed (Page 3, Write-in Item)	\$ 0
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion.	\$ 0
<u>Premium Reserves</u>	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	\$ 0

The State Fund's opening actuary was appointed pursuant to NAIC *Annual Statement Instructions Property and Casualty*.

See the subsequent *NOTES TO THE FINANCIAL STATEMENTS* section of this report for further information concerning the Department's consulting actuary's review of losses and loss adjustment expenses.

### INFORMATION SYSTEMS REVIEW

The State Fund's information systems were reviewed by the Department's Information System Specialist (contractor), Jenny L. Jeffers, CISA, AES, of Jennan Enterprises, LLC. The procedures were performed in accordance with the guidelines and procedures set forth in the "Exhibit C, Evaluation of Controls in Information Technology (IT)" contained in the NAIC *Financial Condition Examiners Handbook*. In summary, the functional areas reviewed by the Information System Specialist included the following:

- Use of Information Technology.
- Information Technology Governance.
- Information Technology Infrastructure.
- Information Technology Audits, Reviews and Risk Assessments.
- Information Technology Security.
- System Development/Change Management.
- Business Continuity.

- Financially Significant System.

The results of the IT review were discussed with management. There were no recommendations.

### SUBSEQUENT EVENTS

The State Fund was named a defendant in a class action lawsuit filed during the prior examination period. Randolph E. Farber, Scott Alan Becker; Critter Clinic et al. v. State Insurance Fund, James M. Alcorn; et al. was filed in District Court on July 21, 2006 on behalf of all State Fund policyholders that had policies with annual premiums of \$2,500 or less who did not receive a dividend within the five years preceding the filing. The plaintiffs argued that the withholding of the dividend from some policyholders was beyond the discretion of the Fund Manager and that the State Fund should disburse dividends without regard as to the size of their annual premium or policy losses.

The District Court's decision was favorable to the State Fund and ruled that the class action was governed by a three year statute of limitations. However, that decision was appealed to the Idaho Supreme Court and the lower court's decision was overturned. The higher court held that once a dividend is declared, the dividend must be paid on a pro-rata basis based on the size of the paid premium. The State Fund filed for a rehearing; the Idaho Supreme Court withdrew the original decision and a substitute opinion was issued on May 5, 2009, which again ruled in favor of the plaintiffs. Prior to issuance of the final decision, the dividend statute, Section 72-915, Idaho Code, was retroactively repealed. This statute formed the basis of the Idaho Supreme Court's decision. The legislation carved out an exception to the retroactive repeal of Section 72-915, Idaho Code, which allowed the Farber lawsuit to proceed; sending the case back to the District Court for further proceedings.

The District Court again ruled that the class was limited to those policyholders which had not received a pro-rata dividend in the three years prior to the date the class action was filed. A settlement was entered into in which the State Fund paid the plaintiffs \$6.9 million in May 2010 in exchange for dismissal of pending claims. The settlement applied only to those class members within the three year statute of limitations.

An appeal was filed with the Idaho Supreme Court to overturn the decision regarding the five year statute of limitations. On January 27, 2012, the Idaho Supreme Court ruled in favor of the plaintiffs, holding that a five year statute of limitations was appropriate. The State Fund filed for a rehearing, which was denied on March 23, 2012. This adverse decision resulted in the State Fund paying two additional years of dividends on a pro rata basis, plus interest dating back to the dividend declaration dates in 2001 and 2002.

The State Fund settled the remaining issues in the case in 2012 by agreeing to pay \$2.9 million. The Final Judgment and Dismissal with Prejudice was filed by the court on April 18, 2013 and the matter was fully resolved.

A lawsuit similar to Farber was filed in December 2009. The Coeur d'Alene Dairy Queen, Inc., and Discovery Care Centre, LLC of Salmon v. The Idaho State Insurance Fund, et al. case was filed on behalf of all State Fund policyholders that had policies with annual premiums of more than \$2,500 who received less than a pro-rata share of the dividends for the five years prior to filing of the lawsuit. The plaintiffs argued that the withholding of the dividend from some policyholders was beyond the discretion of the Fund Manager and that the State Fund should disburse dividends without regard as to the size of their annual premium or policy losses.

The District Court's decision was favorable to the State Fund but was appealed to the Idaho Supreme Court. On January 23, 2013, the Idaho Supreme Court entered a decision unfavorable to the State Fund. Upon a petition for rehearing, the Court withdrew its original opinion and issued a Substitute Opinion on April 9, 2013 which was also unfavorable to the State Fund.

Due to the precedent set in the Farber case, the State Fund determined it is probable dividends will have to be paid on a pro rata basis to policyholders for the five years preceding the filing of the lawsuit plus interest dating as far back as January 2005. The provision calculated by the State Fund is \$36 million, including accrued interest. In this connection, the State Fund filed an amended 2012 Annual Statement to disclose this contingent liability.

### FINANCIAL STATEMENTS

The financial section of this report contains the following statements:

Balance Sheet as of December 31, 2011

Statement of Income, for the Year Ending December 31, 2011

Capital and Surplus Account, for the Year Ending December 31, 2011

Reconciliation of Capital and Surplus Account, December 31, 2006, through December 31, 2011.

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## Balance Sheet

As of December 31, 2011

### ASSETS

	<u>Assets</u>	Non Admitted <u>Assets</u>	<u>Net Admitted</u>
Bonds	\$472,181,634	\$ 0	\$472,181,634
Common stocks	65,990,451	0	65,990,451
Real estate: Properties occupied by the State Fund	2,000,000	0	2,000,000
Cash, cash equivalents and short-term investments	26,430,914	0	26,430,914
Other invested assets	603,331	0	603,331
Receivables for securities	2,963,260	0	2,963,260
Investment income due and accrued	3,950,879	0	3,950,879
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	5,991,395	1,807,682	4,183,714
Deferred premiums, agents' balances and installments booked but deferred and not yet due	5,629	0	5,629
Reinsurance:			
Amounts recoverable from reinsurers	168,232	0	168,232
Funds held by or deposited with reinsured companies	312,462	0	312,462
Electronic data processing equipment and software	24,301,236	23,970,087	331,149
Furniture and equipment, including health care delivery assets	347,790	347,790	0
Aggregate write-ins for other than invested assets:			
National Guard Receivable	2,526	0	2,526
Premium Tax Refund Rec – IDOI	1,725,343	0	1,725,343
Prepaid Expenses	474,031	474,031	0
Travel Advances	350	350	0
Rounding	1	(1)	1
Totals	<u>\$607,449,464</u>	<u>\$26,599,939</u>	<u>\$580,849,525</u>

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Balance Sheet (continued)

As of December 31, 2011

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses (Note 1)	\$305,108,992
Loss adjustment expenses (Note 1)	34,831,010
Other expenses	1,889,864
Taxes, licenses and fees	1,940,677
Unearned premiums	21,506,789
Advance premium	112,599
Dividends declared and unpaid: Policyholders	80,233
Ceded reinsurance premiums payable	8,858
Amounts withheld or retained by State Fund for account of others	705,315
Remittances and items not allocated	27,820
Payable for securities	16,107,730
Aggregate write-ins for liabilities:	
Credits Due Policyholders	1,462,798
Estimate for Class Action Lawsuit (Note 2)	<u>3,000,000</u>
Total liabilities	<u>\$386,782,685</u>
Unassigned funds (surplus)	<u>\$194,066,840</u>
Total Surplus as regards policyholders	<u>\$194,066,840</u>
Total liabilities, capital and surplus	<u>\$580,849,525</u>

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## STATEMENT OF INCOME

For the Year Ending December 31, 2011

	<u>Per Examination and Per State Fund</u>
Premiums earned	\$143,713,418
Losses incurred	117,792,128
Loss adjustment expenses incurred	15,077,694
Other underwriting expenses incurred	<u>25,516,938</u>
Total underwriting deductions	<u>\$ 158,386,760</u>
Net underwriting loss	<u>\$(14,673,342)</u>
Net investment income earned	\$ 17,042,372
Net realized capital losses	<u>11,504,517</u>
Net investment gain	<u>\$ 28,546,889</u>
Net loss from agents' or premium balances charged off	\$ (161,960)
Miscellaneous Income	<u>491</u>
Total other income (loss)	<u>\$ (161,469)</u>
Net income before dividends to policyholders	<u>\$ 13,712,078</u>
Dividends to policyholders	<u>9,781,926</u>
Net income	<u>\$ 3,930,152</u>

## CAPITAL AND SURPLUS ACCOUNT

For the Year Ending December 31, 2011

	<u>Per State Fund</u>	<u>Examination Changes</u>	<u>Per Examination</u>
Capital and surplus, December 31, 2010	\$201,764,354	\$ 0	\$201,764,354
<b>GAINS AND (LOSSES) IN SURPLUS</b>			
Net income	\$ 3,930,152	\$ 0	\$ 3,930,152
Change in net unrealized capital losses	(7,988,369)	0	(7,988,369)
Change in nonadmitted assets	<u>(3,639,297)</u>	<u>0</u>	<u>(3,639,297)</u>
Change in surplus as regards policyholders for the year	<u>\$ (7,697,514)</u>	<u>\$ 0</u>	<u>\$ (7,697,514)</u>
Surplus as regards policyholders, December 31, 2011	<u>\$194,066,840</u>	<u>\$ 0</u>	<u>\$194,066,840</u>

RECONCILIATION OF CAPITAL AND SURPLUS ACCOUNT

December 31, 2006 Through December 31, 2011

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Capital and Surplus, December 31, previous year	<u>*\$166,370,962</u>	<u>\$211,038,367</u>	<u>\$190,895,389</u>	<u>\$197,940,384</u>	<u>\$201,764,354</u>
<b>GAINS AND (LOSSES) IN SURPLUS</b>					
Net income (loss)	\$ 48,575,781	\$ (5,038,033)	\$ (239,501)	\$ 2,466,673	\$ 3,930,152
Change in net unrealized capital gains (losses)	(2,205,145)	(8,677,072)	13,547,312	7,502,939	(7,988,369)
Change in nonadmitted assets	(1,703,231)	(6,427,873)	(6,262,816)	(6,145,643)	(3,639,297)
Rounding	<u>0</u>	<u>0</u>	<u>0</u>	<u>1</u>	<u>0</u>
Change in surplus as regards policyholders for the year	<u>\$ 44,667,405</u>	<u>\$(20,142,978)</u>	<u>\$ 7,044,995</u>	<u>\$ 3,823,970</u>	<u>\$ (7,697,514)</u>
Surplus as regards policyholders, December 31	<u>\$211,038,367</u>	<u>\$190,895,389</u>	<u>\$197,940,384</u>	<u>\$201,764,354</u>	<u>* \$194,066,840</u>

\*As determined by Examination.

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## NOTES TO THE FINANCIAL STATEMENTS

Note (1) Losses	\$305,108,992
<u>Loss adjustment expenses</u>	<u>34,831,010</u>

Lewis & Ellis, Inc. was retained by the Department to perform the actuarial portion of the examination. The scope of Lewis & Ellis' duties included a review of the State Fund's actuarial report supporting the 2011 Statement of Actuarial Opinion. Based on its review, Lewis & Ellis concluded that the loss, loss adjustment expense and reserve computations were performed correctly and the selected estimates were reasonable. Lewis & Ellis also reviewed the assumptions and methodology used by the Appointed Actuary and found them to be appropriate.

<u>Note (2) Estimate for Class Action Lawsuit</u>	<u>\$3,000,000</u>
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Estimated liability to settle remaining issues in class action lawsuit in 2012. See SUBSEQUENT EVENTS section of this report for more detail.

## SUMMARY, COMMENTS AND RECOMMENDATIONS

### Summary

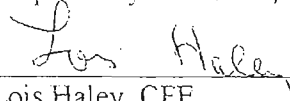
The results of this examination disclosed that as of December 31, 2011, the State Fund had admitted assets of \$580,849,525, liabilities of \$386,782,685 and total surplus as regards policyholders of \$194,066,840. Therefore, the State Fund's total capital and surplus exceeded the \$2,000,000 minimum prescribed by Section 41-313, Idaho Code.

## CONCLUSION

The undersigned acknowledges the assistance and cooperation of the State Fund's Chairman of the Board of Directors, the Fund Manager, Assistant Managers and employees in conducting the examination.

In addition to the undersigned, Kelvin Ko, CFE, Senior Insurance Examiner, participated in the examination. Gregory Wilson, FCAS, MAAA and Wesley Campbell, FSA, MAAA, of Lewis & Ellis, Inc. conducted the actuarial portion of the examination. The State Fund's information systems were reviewed by Information System Specialist, Jenny L. Jeffers, CISA, AES, of Jennan Enterprises, LLC.

Respectfully submitted,

  
Lois Haley, CFE  
Senior Insurance Examiner  
Department of Insurance  
State of Idaho

AFFIDAVIT OF EXAMINER

State of Idaho  
County of Nez Perce

Lois Haley, being duly sworn, deposes and says that she is a duly appointed Examiner for the Department of Insurance of the State of Idaho, that she has made an examination of the affairs and financial condition of the Idaho State Insurance Fund for the period from January 1, 2007 through December 31, 2011, including subsequent events, that the information contained in the report consisting of the foregoing pages is true and correct to the best of her knowledge and belief, and that any conclusions and recommendations contained in the report are based on the facts disclosed in the examination.

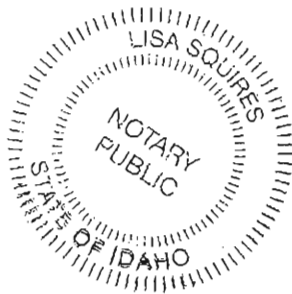
Lois Haley

Lois Haley, CFE  
Senior Insurance Examiner  
Department of Insurance  
State of Idaho

Subscribed and sworn to before me the 29<sup>th</sup> day of July 2013 at Lewiston, Idaho

Lisa Squires  
Notary Public

My commission expires: 1/3/2018



C.L. "BUTCH" OTTER  
Governor

State of Idaho  
**DEPARTMENT OF INSURANCE**

700 West State Street, 3rd Floor  
P.O. Box 83720  
Boise, Idaho 83720-0043  
Phone (208)334-4250  
FAX # (208)334-4398

WILLIAM W. DEAL  
Director

**WAIVER**

In the matter of the Report of Examination as of December 31, 2011, of:

**IDAHO STATE INSURANCE FUND  
1215 WEST STATE STREET  
BOISE, IDAHO 83720**

By executing this Waiver, the Fund hereby acknowledges receipt of the above-described examination report, verified as of the 29<sup>th</sup> day of July, 2013 and by this Waiver hereby consents to the immediate entry of a final order by the Director of the Department of Insurance adopting said report without any modifications.

By executing this Waiver, the Fund also hereby waives:

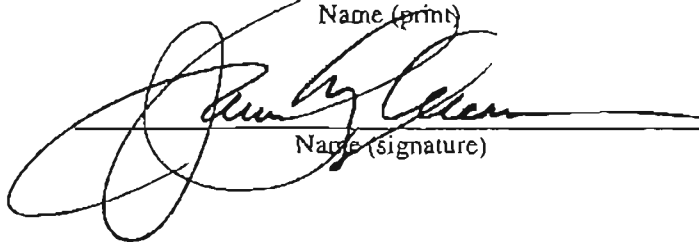
1. its right to examine the report for up to thirty (30) days as provided in Idaho Code section 41-227(4),
2. its right to make a written submission or rebuttal to the report prior to entry of a final order as provided in Idaho Code section 41-227(4) and (5),
3. any right to request a hearing under Idaho Code sections 41-227(5) and (6), 41-232(2)(b), or elsewhere in the Idaho Code, and
4. any right to seek reconsideration and appeal from the Director's order adopting the report as provided by section 41-227(6), Idaho Code, or elsewhere in the Idaho Code.

Dated this 31st day of July, 2013

**IDAHO STATE INSURANCE FUND**

James M. Alcorn

Name (print)



Name (signature)

Manager

Title

*Equal Opportunity Employer*

