PINNACOL
ASSURANCE

Annual Report

AUDITED FINANCIALS

PINNACOL ASSURANCE

Statutory-Basis Financial Statements and
Supplemental Schedules of Investment Information

December 31, 2019 and 2018

(With Independent Auditors' Report Thereon)

LIMITATIONS ON DISCLOSURE OF INFORMATION CONTAINED IN THIS DOCUMENT

The attached document is confidential pursuant to the following state statutes:

Section 2-3-103(2), C.R.S., states in part:

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

Section 2-3-103.7(1), C.R.S., states in part:

Any state employee or other individual acting in an oversight role as a member of a committee, board, or commission, or any employee or other individual acting in an oversight role with respect to any audit conducted pursuant to Sections 2-3-120, 2-3-123, 10-22-105(4)(c), and 25.5-10-209(4), **who willfully and knowingly discloses the contents of any report** prepared by or at the direction of the Office of the State Auditor **prior to the release of such report by a majority vote of the legislative audit committee** as provided in Section 2-3-103(2), C.R.S., **is guilty of a misdemeanor** and, upon conviction thereof, shall be punished by a fine of not more than five hundred dollars. (Emphasis supplied.)

COSA – Updated August 2, 2019

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Senator Jim Smallwood

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Crystal Dorsey *Contract Monitor*

KPMG LLP *Contract Auditors*

PINNACOL ASSURANCE 2020 BOARD OF DIRECTORS

Joseph A Hoff *Chair*

Fiona E. Arnold

Brad R. Busse

Howard L. Carver

Jeffery L. Cummings

Barbara M. Davis

Ellen J. Golombek

Mark D. Goodman

Geraldine A. Lewis-Jenkins

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Report Summary

AUTHORITY & PURPOSE/SCOPE OF THE AUDIT

This audit is conducted under the authority of Section 8-45-121(2) of the Colorado Revised Statutes (C.R.S.), which authorizes the State Auditor to conduct an annual financial audit of Pinnacol Assurance (Pinnacol or the Company) and contract with an auditor or firm of auditors, having the specialized knowledge and experience. The primary purpose of our engagement is to audit the statutory-basis financial statements of Pinnacol as of and for the year ended December 31, 2019, 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 U.S. generally accepted accounting principles.

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, 2019.

AUDIT OPINION & 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).

We issued a report on Pinnacol's compliance and internal control over financial reporting based on an audit of the financial statements performed in accordance with *Government Auditing Standards*. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be deficiencies, significant deficiencies, or material weaknesses. A deficiency in internal control over financial reporting 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 significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

SUMMARY OF CURRENT YEAR FINDINGS & RECOMMENDATIONS

There were no reported findings and recommendations resulting from the audit for fiscal year 2019.

SUMMARY OF PRIOR YEAR FINDINGS & RECOMMENDATIONS

There were no reported findings and recommendations resulting from the audit for fiscal year 2018.

Description of Pinnacol Assurance

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.

Cake Insure, Inc. (Cake) was incorporated on September 20, 2017. Cake is a wholly owned subsidiary of Pinnacol and helps small businesses quote and purchase a workers' compensation insurance policy from Pinnacol. Cake is a digital platform designed to market, underwrite, and service small direct policyholders that are not considered high risk. With the launch of Cake, Pinnacol became subject to Title 10, Article 3, Part 8 of the C.R.S., Insurance Holding Company Systems, which requires additional report filings with the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado. Pinnacol holds 100% of the voting shares ownership in Cake. An "Insurance Holding Company System" is two or more affiliated persons, one or more of which is an insurer.

POLICYHOLDERS' SURPLUS

Pinnacol had policyholders' surplus of $1,461,595,000 and $1,290,998,000 as of December 31, 2019 and 2018, respectively. The increase in surplus is primarily related to current year net income and an increase in unrealized gains.

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-basis statements of admitted assets, liabilities, and surplus as of December 31, 2019 and 2018, and the related statutory-basis statements of operations and changes in policyholders' surplus, and cash flow for the years then ended, and the related notes to the statutory-basis 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 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 financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.

The effects on the 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 practices 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, 2019 and 2018, or the results of its operations or its cash flows for the years 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 surplus of Pinnacol Assurance as of December 31, 2019 and 2018, and the results of its operations and its cash flow for the years 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

Our audits were conducted for the purpose of forming an opinion on the 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 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 financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 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 20, 2020 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 compliance.

KPMG LLP

Denver, Colorado
May 20, 2020

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

DECEMBER 31, 2019 & 2018 (IN THOUSANDS)

Admitted Assets	**2019**	**2018**
Cash and invested assets:		
Bonds at adjusted carrying value, fair value of $2,223,810 in 2019 and $2,099,192 in 2018 (note 4)	$2,116,729	$2,129,597
Preferred stock at adjusted carrying value, fair value of $681 in 2019 and $7,927 in 2018 (note 4)	609	7,924
Common stock at fair value, adjusted cost of $321,291 in 2019 and $387,760 in 2018 (note 4)	440,042	447,357
Mortgage loans on real estate (note 4)	23,814	15,024
Real estate at cost – net of accumulated depreciation of $18,541 in 2019 and $17,196 in 2018	15,057	15,984
Cash, cash equivalents, and short-term investments	215,630	73,492
Other invested assets (note 4 and note 9)	105,232	92,944
Receivables for securities sold	12,271	1,317
Securities lending reinvested collateral assets	92,085	—
Total cash and invested assets	3,021,469	2,783,639
Uncollected premiums	33,049	35,689
Earned but unbilled premiums	27,590	32,485
Funds held by or deposited with reinsurers	4,583	2,182
Electronic data processing equipment – at cost – net of accumulated depreciation of $9,157 in 2019 and $8,772 in 2018	1,139	495
Receivables from subsidiaries and affiliates	283	172
Accrued investment income	18,134	17,940
Total admitted assets	**$3,106,247**	**$2,872,602**

Liabilities and Policyholders' Surplus	**2019**	**2018**
Reserve for unpaid losses and loss adjustment expenses:		
Reserve for unpaid losses (note 2)	$795,911	$813,072
Reserve for unpaid loss adjustment expenses (note 2)	106,211	107,496
Total reserve for unpaid losses and loss adjustment expenses	902,122	920,568
Unearned premiums	78,384	83,113
Advance premiums	11,056	11,029
Dividends payable to policyholders	92,830	103,478
Commissions payable	33,955	39,617
Structured settlement liability (note 3)	387,750	386,352
Payable to subsidiaries and affiliates	92	58
Credit balances due policyholders	8,718	8,953
Payable for securities purchased	6,912	4,430
Payable for securities lending	92,085	—
Other liabilities	30,748	24,006
Total liabilities	1,644,652	1,581,604
Surplus notes (note 7)	100,000	100,000
Special surplus fund for unfunded pension benefits (notes 1 and 7)	217,289	407,510
Unassigned policyholders' surplus (note 7)	1,144,306	783,488
Total liabilities and policyholders' surplus	**$3,106,247**	**$2,872,602**

See accompanying notes to statutory-basis financial statements.

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

YEARS ENDED DECEMBER 31, 2019 & 2018 (IN THOUSANDS)

	2019	2018
Underwriting income:		
Premiums earned	$601,779	$631,755
Deductions:		
Losses incurred (note 2)	301,192	303,206
Loss adjustment expenses incurred (note 2)	77,956	74,775
Other underwriting expenses incurred	154,033	152,720
Total underwriting deductions	533,181	530,701
Net underwriting gain	68,598	101,054
Investment income:		
Net investment income earned (note 4)	85,349	83,380
Net realized capital gain (note 4)	21,069	9,825
Total investment income	106,418	93,205
Other income (loss):		
Provision for uncollectible premiums	(3,376)	(3,442)
Structured settlement expense (note 3)	(8,135)	(10,828)
Other income	1,013	921
Dividends to policyholders	(61,484)	(72,355)
Net income	103,034	108,555
Change in net unrealized gains on investments	68,253	(83,513)
Change in nonadmitted assets	(690)	538
Correction of an error	—	(10,890)
Policyholders' surplus – beginning of year	1,290,998	1,276,308
Policyholders' surplus — end of year	**$1,461,595**	**$1,290,998**

See accompanying notes to statutory-basis financial statements.

Statutory-Basis Statements of Cash Flow

YEARS ENDED DECEMBER 31, 2019 & 2018 (IN THOUSANDS)

	2019	2018
Cash flows from operations:		
Premiums collected — net of reinsurance	$602,342	$628,256
Losses and loss adjustment expenses paid — net of reinsurance and deductibles	(397,594)	(380,509)
Other underwriting expenses paid	(157,223)	(153,444)
Dividends paid to policyholders	(72,133)	(47,478)
Investment income received — net of investment expenses paid	88,785	84,711
Miscellaneous proceeds	1,013	921
Net cash provided by operations	65,190	132,457
Cash flows from investments:		
Proceeds from sale, maturity, or redemption of investments:		
Bonds	517,540	392,213
Stocks	157,314	91,469
Mortgage loans on real estate	7,109	—
Other invested assets	8,703	9,245
Miscellaneous proceeds	2,472	—
Total proceeds from sale or redemption of investments	693,138	492,927
Cost of investments acquired:		
Bonds	(499,005)	(520,217)
Stocks	(56,769)	(54,746)
Mortgage loans on real estate	(15,898)	(15,024)
Other invested assets	(25,525)	(30,506)
Miscellaneous proceeds (applications)	(103,458)	(1,777)
Total investments acquired	(700,655)	(622,270)
Net cash used in investments	(7,517)	(129,343)
Cash flow used in financing and miscellaneous sources:		
Cash provided by (used in) other miscellaneous sources	84,465	(6,521)
Net cash provided by (used in) financing and miscellaneous sources	84,465	(6,521)
Net (decrease) increase in cash, cash equivalents, and short-term investments	142,138	(3,407)
Cash, cash equivalents, and short-term investments — beginning of year	73,492	76,899
Cash, cash equivalents, and short-term investments — end of year	**$215,630**	**$73,492**

See accompanying notes to statutory-basis financial statements.

Notes to the Statutory-Basis Financial Statements

1 / NATURE OF OPERATIONS & 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 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.

Cake Insure, Inc. (Cake) was incorporated on September 20, 2017. Cake is a wholly owned subsidiary of Pinnacol and helps small businesses quote and purchase a workers' compensation insurance policy from Pinnacol.

(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 (SAP), which are codified in the NAIC's Accounting Practices and Procedures Manual (the Manual). Therefore, compliance with the Manual is a prescribed accounting practice. In the preparation of the accompanying statutory-basis financial statements, the Company has followed NAIC guidelines and has not utilized any practices considered to be permitted practices.

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

- Policy acquisition costs, such as commissions, premium surcharges, 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 value, while under GAAP, they would be carried at fair value. For GAAP, changes in fair value in bonds go through net investment income.
- Pinnacol's investment in preferred stock of Cake, a subsidiary, is reported at the lower of cost or fair value. Under GAAP, it would be included in the consolidated financial statements and all significant intercompany balances and transactions would be eliminated in consolidation.
- 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, or those items not meeting the definition of an asset, 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, 2019 and 2018 comprised the following (in thousands):

	2019	2018
Receivables	$15,446	$16,551
Fixed assets	2,710	280
Prepaids	2,239	2,874
Total nonadmitted assets	**$20,395**	**$19,705**

- The reserve for losses and loss adjustment expenses (LAE) is reported net of reinsurance, while under GAAP, the balance sheet reports reinsurance recoverable, including amounts related to losses incurred but not reported, as assets.
- The surplus note is reported as a component of surplus, increasing policyholders' surplus under NAIC SAP. Under GAAP, the surplus note is recorded as long-term debt. The related interest expense may not be accrued under NAIC SAP until approved for payment by the commissioner of the state of domicile while under GAAP, the interest expense is recorded as incurred.
- Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions, which is effective for fiscal years ended June 30, 2014 or later, requires employers that are part of a cost-sharing multiple-employer pension fund to record their portion of the unfunded liability, while under NAIC SAP, the employer must only record the cost of the contribution and any liability for any contributions due and unpaid.
- Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which is effective for fiscal years ended June 30, 2017, and requires employers that are part of a cost-sharing multiple-employer Other Postemployment Benefit (OPEB) plan to record their portion of the net OPEB liability, while under NAIC SAP, the employer must only record the cost of the contribution and any liability for any contributions due and unpaid.

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

(c) Use of Estimates

The preparation of statutory-basis financial statements in accordance with accounting practices prescribed by the Division requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory-basis financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates include the 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. 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 value or fair value, based on their NAIC designation, and are adjusted for other than temporary declines in fair value. Mortgage loans on real estate are carried at the outstanding principal balance, less any allowances for credit losses. Common stocks, mutual funds, and common trust funds are carried at fair value. Other invested assets, including 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 and preferred stocks in an unrealized loss position for both years are recorded as other than temporarily impaired (OTTI) and are recorded as a realized loss in the statutory-basis statement of operations in the period in which they occur.

Bond premium or discount is recognized 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 $1,345,000 and $1,419,000 for the years ended December 31, 2019 and 2018, respectively, and is included in net investment income earned in the statutory-basis statements of operations and changes in policyholders' surplus.

(e) Investment in subsidiary

Cake was incorporated on September 20, 2017 as a subsidiary of Pinnacol. Pinnacol purchased 2,000,000 voting shares of preferred stock in Cake on September 28, 2017. Pinnacol's ownership percentage in Cake is 100%.

As disclosed in note 1(b), Pinnacol does not consolidate their financial results with Cake. Pinnacol and Cake issue stand-alone financial statements that are each independently audited.

Perpetual preferred stock of Cake is reported at the lower of book value or fair value. Cake preferred shares are not publicly priced. As of December 31, 2019, Pinnacol recorded $0 for the carrying value of its investment, which was confirmed by the NAIC's Securities Valuation Office (SVO). Pinnacol recorded an other than temporary impairment on the full value of its investment as of December 31, 2019.

(f) Cash, Cash Equivalents, and Short-Term Investments

For purposes of the statement of cash flow, cash, cash equivalents, and short-term investments include cash on deposit, money market funds, and other investments with maturities of one year or less at the date of acquisition.

As of December 31, 2019, cash, cash equivalents, and short-term investments of approximately $215,630,000 include ($2,018,000) of book overdrafts, $216,899,000 of cash equivalents, and $749,000 of short-term investments. As of December 31, 2018, cash, cash equivalents, and short-term investments of approximately $73,492,000 include ($3,670,000) of book overdrafts, $67,200,000 of cash equivalents, and $9,962,000 of short-term investments.

(g) Receivables for Securities Sold

As of December 31, 2019 and 2018, receivables for securities sold were approximately $12,271,000 and $1,317,000, respectively. Receivables for securities arise when sales of securities are recorded as of the trade date. A receivable due from the custodian 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 stated settlement date are nonadmitted. There were no nonadmitted receivables for securities sold in 2019 or 2018.

(h) Uncollected Premiums

Uncollected premiums are reported net of loss contingencies for uncollectible and nonadmitted balances. Certain receivables are not admissible for statutory accounting purposes.

All receivables for canceled policies and billed receivables that relate to balances outstanding for a period exceeding 90 days are not admissible according to the Manual.

Pinnacol independently estimates the realizable amounts of premiums receivable and records a loss contingency for any uncollectible balances that were not already nonadmitted. During 2019 and 2018, Pinnacol recorded a provision of approximately $3,376,000 and $3,442,000, 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, 2019 and 2018 were from companies

operating in the construction and services industries in Colorado. The construction industry represents approximately 39% of premiums earned as of December 31, 2019 and December 31, 2018. The services industry represents approximately 37% of premiums earned as of December 31, 2019 and 38% as of December 31, 2018, with all other individual industries constituting the remainder of premiums receivable balances.

(i) Earned but Unbilled Premiums

Earned but unbilled premiums represent a receivable or liability for changes in earned premium and audit premiums, which are amounts due from or to policyholders after the respective policy period has expired based on payroll audits performed by Pinnacol. Such amounts are estimated by Pinnacol based upon internal calculations using historical premium data. Pinnacol recorded a net estimated earned but unbilled premium receivable in 2019 and 2018 of approximately $27,590,000 and $32,485,000, respectively.

(j) Credit Balances Due Policyholders

Credit balances due policyholders represent excess premiums or are amounts due to policyholders. Generally, credit balances due policyholders are applied to future premium obligations of policyholders. For 2019 and 2018, such amounts are approximately $8,718,000 and $8,953,000, respectively.

(k) Electronic Data Processing Equipment and Software

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 electronic data processing equipment at December 31, 2019 and 2018 was approximately $1,139,000 and $495,000, respectively. Operating software is recorded at cost, less accumulated depreciation, and depreciated on a straight line basis over an estimated useful life of three years. Nonoperating software is recorded at cost, less accumulated depreciation, and depreciated on a straight line basis over an estimated useful life of five years and nonadmitted. Net book value of software at December 31, 2019 and 2018 was approximately $2,458,000 and $65,000, respectively. Related depreciation expense of approximately $320,000 and $577,000 was incurred during 2019 and 2018, respectively, and is included in LAE and other underwriting expenses incurred in the statutory-basis statements of operations and changes in policyholders' surplus.

(l) Office Equipment, Furniture, Art, and Leasehold Improvements

Office equipment, furniture, art, and leasehold improvements are recorded at cost and depreciated on a straight line basis. Office equipment, furniture, art, and automobiles are 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, 2019 and 2018 was approximately $251,000 and $215,000, respectively. Related depreciation expense of approximately $209,000 and $432,000 was incurred in 2019 and 2018, respectively, and is included in LAE and other underwriting expenses incurred in the statutory-basis statements of operations and changes in policyholders' surplus.

(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 $1,897,000 in 2019 and $2,717,000 in 2018. As of December 31, 2019 and 2018, safety group dividends payable of $2,703,000 and $3,289,000, 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 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 reduction of premium based on the policy premium and the loss ratio. Pinnacol paid out ILCDs of $21,040,000 in 2019 and $17,769,000 in 2018. As of December 31, 2019 and 2018, ILCDs payable of $29,944,000, and $30,061,000, respectively, are included as dividends payable to policyholders in the statutory-basis statements of operations and changes in policyholders' surplus.

(o) General Policyholder Dividends

The board of directors, at its discretion, determines the amount of general policyholder dividends to be declared, based on Pinnacol's overall experience and financial condition. Pinnacol has incurred general policyholder dividends to its policyholders in good standing of approximately $60,174,000 in 2019 and $70,000,000 in 2018. This is included in dividends payable to policyholders. On February 26, 2020, the board of directors determined the final amount of the general policyholder dividend based on year-end 2019 financial results to be $70,000,000. This is $10,000,000 more than the amount recorded in 2019 based on the board of directors declaration of a general policyholder dividend on November 6, 2019 in an amount to be approximately $60,000,000 depending on year-end 2019 results. The additional $10,000,000 was recorded in February 2020.

(p) Reserve for Unpaid Losses and Loss Adjustment Expenses and Structured Settlement Liability

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, 2019 and 2018. 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. Subrogation claims (claims against third parties) are recognized as a reduction of losses incurred when collections are received.

Internal structured settlement liabilities represent obligations to claimants and dependents on cases that have been closed by contract. The discounted reserve for internal structured settlements is estimated by management, which uses an independent third-party actuary to provide estimates based on these obligations.

(q) Revenue Recognition and Unearned Premiums

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.

Unearned premiums represent amounts either collected or billed and due from policyholders at December 31, 2019 and 2018 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, 2019 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 effective period 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 at December 31, 2019 and 2018. Pinnacol considered anticipated investment income at 3.5% when evaluating the premium deficiency reserve for 2019.

(s) Multiemployer Pension Plans and Other Postretirement Benefits

Pinnacol participates in the State Division Trust Fund (SDTF), a cost-sharing multiple-employer defined benefit pension and healthcare trust fund plan administered by the Public Employees' Retirement Association (PERA). SDTF provides retirement, disability, and survivor benefits. All employees of Pinnacol are members of the SDTF.

Pinnacol participates in the Health Care Trust Fund (HCTF), a cost-sharing multiple-employer defined benefit OPEB plan administered by PERA. The HCTF provides a healthcare premium subsidy to eligible participating PERA benefit recipients and retirees who choose to enroll in one of the PERA healthcare plans, however, the subsidy is not available if only enrolled in the dental and/or vision plan(s).

As a participant in a multiple-employer pension plan and HCTF, 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) 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. Premiums earned are reported net of reinsurance (note 5).

(u) Taxes

As a political subdivision of the State of Colorado, Pinnacol is generally 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. However, Pinnacol is subject to income taxes on any net income that is derived from a trade or business regularly carried on and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole. Pinnacol is not aware of any uncertain tax positions.

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)(a), 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 1.45% and 1.00% at December 31 2019 and 2018, respectively. Such amounts are included in other underwriting expenses incurred.

(v) 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 for the transaction and approval to classify the debt as a component of policyholders' surplus.

(w) Special Surplus Fund for Unfunded Pension Benefits

Pinnacol participates in a cost-sharing multiple-employer defined benefit pension plan administered by PERA. PERA has a net pension liability, which represents the unfunded pension benefits. Statutory accounting does not allow Pinnacol's portion of the net pension liability to be recorded as a liability but allows a company to establish a special surplus fund to provide for contingencies. GASB No. 68, Accounting and Financial Reporting for Pensions is effective for fiscal years beginning after June 15, 2014. The statement requires cost-sharing employers participating in defined benefit plans to record their proportionate share of the collective net pension liability in their GASB financial statements. PERA provides Pinnacol with the audited schedule of employers' allocations and net pension liability. The total pension liability used to calculate the net pension liability is determined by an actuarial valuation as of December 31, 2017. PERA uses standard update procedures to roll forward the total pension liability to December 31, 2018. The discount rate changed from 4.72% to 7.25% at December 31, 2018. PERA also provides the employer allocation percentage for purposes of calculating Pinnacol's proportionate share of the collective net pension liability.

Pinnacol participates in the Health Care Trust Fund (HCTF), a cost sharing multiemployer defined benefit Other Postemployment Benefit (OPEB) plan administered by PERA. GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other than Pensions became effective in 2018. Although not required under statutory accounting to record its share of the liability, the Company has identified its portion of the HCTF liability in a special surplus fund in the same manner as the PERA net pension liability obligation.

(x) Application of Recent Statutory Accounting Pronouncements

During 2019 there were no substantive revisions to statutory accounting that were applicable to Pinnacol, and therefore, there were no substantive revisions adopted by the Company.

2 / UNPAID LOSSES & 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.

Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and loss adjustment expenses in 2019 and 2018 is summarized as follows (in thousands):

	Unpaid losses and loss adjustment expenses	
	2019	**2018**
Balance at January 1	$920,568	$923,095
Additional amounts incurred related to:		
Current year	436,336	431,225
Prior years	(57,188)	(53,243)
Total incurred	379,148	377,982
Reductions relating to payments for:		
Current year	144,130	134,677
Prior years	253,464	245,832
Total paid	397,594	380,509
Balance at December 31	**$902,122**	**$920,568**

During the year ended December 31, 2019, the provision for unpaid losses and loss adjustment expenses for insured events of prior years was reduced by $310,652,000 to $609,916,000. This reduction includes payments for unpaid losses and loss adjustment expenses of approximately $253,464,000 and a $57,188,000 reduction in reserves for prior year unpaid losses and loss adjustment expense. 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 and a reduction of ultimate claim frequency in Colorado. Pinnacol management continually evaluates the estimated ultimate cost of all accident years and on a calendar year basis adjusts to the best estimate available, favorable or unfavorable, in the current period. At the end of the current year, the amount of reserve credit recorded for high deductibles on unpaid losses was $3,708,000. Such reduction is collateralized generally with letters of credit for the benefit of Pinnacol. Pinnacol received $5,887,000 and $6,990,000 in subrogation as of December 31, 2019 and 2018, respectively. There were no significant changes in methodologies or assumptions used in calculating the reserves.

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 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 2019 and 2018 is summarized as follows (in thousands):

	2019	2018
Beginning balance	$386,352	$384,790
Amounts incurred:		
Change in valuation	8,135	10,828
Amounts paid	(26,849)	(26,166)
New internal structured settlements	20,112	16,900
Ending balance	**$387,750**	**$386,352**

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, 2019 and 2018.

The amount of the discount for unpaid internal structured settlements as of December 31, 2019 and 2018 is approximately $145,889,000 and $148,736,000, respectively. The discount amounts for internal structured settlement reserves at December 31, 2019 and 2018 are distributed over the years in which the losses were incurred as follows (in thousands):

2019		2018	
Loss Year	**Discount**	**Loss Year**	**Discount**
Prior	$100,004	Prior	$96,240
2009	9,260	2008	9,816
2010	4,793	2009	9,853
2011	6,277	2010	5,113
2012	3,795	2011	6,728
2013	5,451	2012	4,207
2014	6,196	2013	5,331
2015	4,964	2014	6,116
2016	2,025	2015	3,271
2017	2,012	2016	1,484
2018	718	2017	540
2019	394	2018	37
Total	**$145,889**	**Total**	**$148,736**

4 / INVESTMENTS

Estimated fair value of investments in bonds and equities is based on quotations provided by widely accepted third-party data providers. In 2019 and 2018, Interactive Data Corporation (IDC), Reuters (Refinitiv), and Markit Partners were used to obtain fair market values. Additionally, in 2019 and 2018, the fair value of certain common trust funds were primarily determined by net asset value and common stock 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.

(a) Bonds

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

During 2019 and 2018, Pinnacol had investments in long-term bonds, which the NAIC's SVO assigned a 3 or higher designation. Carrying values are equal to the lower of amortized value or fair value for these bonds.

The carrying value and the fair value of investments in long-term bonds in 2019 and 2018 are summarized as follows (in thousands). The carrying value includes investment grade bonds that are reported at amortized value and low rated bonds that are reported at the lower of cost or fair value:

	2019			
	Carrying value	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Government obligations:				
Nonloan-backed bonds	$235,838	$7,960	$(505)	$243,293
Loan-backed bonds	2,340	231	—	2,571
U.S. political subdivisions:				
Nonloan-backed bonds	11,226	848	—	12,074
Loan-backed bonds	—	—	—	—
U.S. special revenue:				
Nonloan-backed bonds	50,707	5,319	(4)	56,022
Loan-backed bonds	364,926	6,742	(292)	371,376
Industrial and miscellaneous:				
Nonloan-backed bonds	1,227,310	83,199	(31)	1,310,478
Loan-backed bonds	216,423	4,128	(1,003)	219,548
Hybrid securities:				
Nonloan-backed bonds	7,840	489	—	8,329
Loan-backed bonds	—	—	—	—
Bank loans:				
Nonloan-backed bonds	119	—	—	119
Loan-backed bonds	—	—	—	—
	$2,116,729	**$108,916**	**$(1,835)**	**$2,223,810**

	2018			
	Carrying value	Gross unrealized gains	Gross unrealized losses	Fair value
Government obligations:				
Nonloan-backed bonds	$115,041	$2,886	$(730)	$117,197
Loan-backed bonds	6,253	204	—	6,457
U.S. political subdivisions:				
Nonloan-backed bonds	11,247	384	(46)	11,585
Loan-backed bonds	—	—	—	—
U.S. special revenue:				
Nonloan-backed bonds	49,939	1,543	(505)	50,977
Loan-backed bonds	382,534	550	(9,438)	373,646
Industrial and miscellaneous:				
Nonloan-backed bonds	1,220,548	10,535	(33,777)	1,197,306
Loan-backed bonds	213,588	948	(2,821)	211,715
Hybrid securities:				
Nonloan-backed bonds	6,704	54	(185)	6,573
Loan-backed bonds	—	—	—	—
Bank loans				
Nonloan-backed bonds	123,743	330	(337)	123,736
Loan-backed bonds	—	—	—	—
	$2,129,597	**$17,434**	**$(47,839)**	**$2,099,192**

The book/adjusted carrying value and estimated fair value of investments in long-term bonds at December 31, 2019, 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.

	2019	
	Book/adjusted carrying value	Fair value
Due in one year or less	$88,571	$88,996
Due after one year through five years	441,426	455,501
Due after five years through ten years	752,028	787,411
Due after ten years	834,704	891,902
	$2,116,729	**$2,223,810**

Proceeds from sales of investments in long-term bonds during 2019 and 2018 were approximately $294,913,000 and $125,208,000, respectively. Realized gains on long-term bonds of approximately $6,089,000 and $2,270,000 and realized losses of approximately ($4,500,000) and ($3,001,000) were recognized during 2019 and 2018, respectively.

The following table provides the length of impairment for those investments in long-term bonds with an unrealized loss as of December 31, 2019 (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	$46,574	$(503)	$4,995	$(2)	$51,569	$(505)
U.S. political subdivisions	—	—	—	—	—	—
U.S. special revenue	20,438	(24)	37,486	(272)	57,924	(296)
Industrial and miscellaneous	58,155	(732)	62,297	(985)	120,452	(1,717)
Hybrid securities	215	—	385	(15)	600	(15)
Bank loans	29	(25)	64	(2)	93	(27)
Total	**$125,411**	**$(1,284)**	**$105,227**	**$(1,276)**	**$230,638**	**$(2,560)**

The following table provides the length of impairment for those investments in long-term bonds with an unrealized loss as of December 31, 2018 (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	$23,712	$(206)	$56,946	$(524)	$80,658	$(730)
U.S. political subdivisions	—	—	2,411	(46)	2,411	(46)
U.S. special revenue	115,798	(1,831)	226,148	(8,112)	341,946	(9,943)
Industrial and miscellaneous	792,596	(26,184)	285,326	(14,912)	1,077,922	(41,096)
Hybrid securities	6,307	(254)	63	(12)	6,370	(266)
Bank loans	110,858	(5,404)	8,677	(710)	119,535	(6,114)
Total	**$1,049,271**	**$(33,879)**	**$579,571**	**$(24,316)**	**$1,628,842**	**$(58,195)**

(b) Loan-Backed and Structured Securities

Loan-backed securities are stated at amortized value or fair value based on their NAIC designation. The prospective method is used to value mortgage-backed securities. Prepayment assumptions for single class and multiclass mortgage-backed/asset-backed securities were obtained from widely accepted models with inputs from major third-party data providers. Any loan-backed and structured securities in an unrealized loss position were reviewed to determine whether an OTTI should be recognized at year-end. At December 31, 2019 and 2018, Pinnacol did not recognize any OTTI on loan-backed securities. 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):

	2019	
	Aggregate amount of unrealized loss	**Aggregate fair value of securities with unrealized loss**
Less than 12 months	$(304)	$61,533
12 months or longer	(991)	77,271
	$(1,295)	**$138,804**

(c) Equities

Unrealized gains on investments in common stocks, mutual funds, and common trust funds are reported as a component of policyholders' surplus. For any decline in the fair value of equities which is determined to be other than temporary, the resulting OTTI loss is 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	Net unrealized gains	Fair value
December 31, 2019	$347,042	$321,291	$118,751	$440,042
December 31, 2018	426,489	387,760	59,597	447,357

The Company is a member of the Federal Home Loan Bank (FHLB) of Topeka. Through its membership, the Company may borrow an amount, which is dependent on the market value and risk related to investments that are held at FHLB. The Company has not conducted any borrowings with the FHLB as of December 31, 2019. As a requirement of the membership, Pinnacol owns FHLB Class A and Class B Capital Stock. In 2019, these assets totaled $500,000 and $22,700, respectively.

(d) Mortgage Loans on Real Estate

The Company held $23,814,095 and $15,024,491 of commercial mortgage loans at December 31, 2019 and December 31, 2018, respectively. Mortgage loans on real estate consist entirely of domestic commercial collateralized loans and are carried at their unpaid principal balances adjusted for any unamortized premiums or discounts, origination fees, provision allowances, and foreign currency translations. Interest income is accrued on the unpaid principal balance for all loans, except for loans on nonaccrual status. Premiums, discounts, and origination fees are amortized to net investment income using the effective interest method.

A third-party manager actively manages the Company's mortgage loan portfolio by completing ongoing comprehensive analysis of factors such as debt service coverage ratios, loan-to-value ratios, payment status, default or legal status, collateral property evaluations, and general market conditions. On a quarterly basis, the Company reviews any provided credit quality risk indicators in its internal assessment of loan impairment and credit loss.

Management's periodic evaluation and assessment for mortgage impairments is based on delinquency status, internally derived fair value, as well as credit concern status based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the fair value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience, and other relevant factors. Risk is mitigated primarily through first lien collateralization, guarantees, loan covenants, and borrower reporting requirements. Since the Company does not hold uncollateralized mortgages, loans are generally not deemed fully uncollectible. Any remaining unrecoverable amounts are written off during the final stage of the foreclosure process.

Loan balances are considered delinquent when payment has not been received based on contractually agreed upon terms. The accrual of interest is discontinued when concerns exist regarding the realization of loan principal or interest. The Company resumes interest accrual on loans when a loan returns to current status or under new terms when loans are restructured or modified.

At December 31, 2019, the Company did not have any troubled, impaired, or delinquent mortgage loans, or any reason to believe payments would be uncollectible on any existing loans. No provision for uncollectible loans has been made.

(e) Securities Lending Transactions

The Company has a securities lending program whereby the Company lends securities, which are included in bonds and common stocks, to financial institutions (counterparties) in short-term arrangements. The Company receives cash collateral equal to a minimum of 102% of the fair value of the loaned securities and monitors the fair value of loaned securities with additional collateral obtained, as necessary. The Company records a corresponding liability in payable for securities lending.

The gross carrying amounts are disclosed in the table below.

The Company invests cash collateral received from its securities lending activity primarily into repurchase agreements (repos). At a minimum margin of 102%, all repurchase agreements at December 31, 2019 are collateralized with U.S. Treasury securities, U.S. agency securities, Farm Credit System Bank securities, or U.S. corporate bonds with a minimum BBB- rating or equivalent from S&P, Moody's, or Fitch. While counterparty default and price movements of the collateral received present the primary risks for repo transactions, all repurchase agreements are indemnified by the Company's securities lending agent when the value of the underlying securities is not sufficient to cover the repurchase price and price differential.

The borrowers of the loaned securities are permitted to sell or repledge those securities. All securities lending agreements are callable by the Company at any time. The contractual maturities on all securities lending arrangements are open as the related loaned security could be returned to the Company on the next business day, which would require the Company to immediately return the cash collateral. To manage the mismatch of maturity dates between the security lending transactions and the related reinvestment of the collateral received, the Company reinvests in highly liquid assets with a minimum of 10% of invested cash collateral assets maturing within the next business day and the remaining invested cash collateral maturing within 95 days.

Upon default of the borrower, the Company has the right to purchase replacement securities using the cash collateral held. Similarly, upon default of the Company, the borrower has the right to sell the loaned securities and apply the proceeds from such sale to the Company's obligation to return the cash collateral held.

The following table presents the Company's security loans outstanding, reinvested collateral, and the corresponding liability (in thousands):

	2019	2018
Security loans outstanding, fair value	$88,973	—
Reinvested collateral, fair value	92,085	—
Cash collateral liability	92,085	—

(f) Other Invested Assets

Investments in 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, 2020 statutory annual statement filing deadline, the unaudited equity value was used. Other invested assets total $105,232,000 and $92,944,000 in 2019 and 2018, respectively, with $105,208,000 and $92,944,000 relating to investments in partnerships. The Company has contributed $100,727,000 in net capital (capital contributions – capital distributions) since investing in partnerships and may be responsible for up to an additional $96,026,000.

(g) Impairment of Investments

The Company writes securities down to fair value that it deems to be OTTI 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 flow has occurred.
- Dividends have been reduced or eliminated or scheduled interest payments have not been made.
- The ability and intent to hold investments until recovery, including consideration of the investment manager's discretion to sell securities.
- The present value of projected cash flows expected to be collected is less than amortized value of loan-backed and structured securities.

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

At December 31, 2019 and 2018, 4.63% and 9.03% of long-term bonds held by the Company were rated non-investment grade, respectively. At December 31, 2019 and 2018, the Company had approximately $2,560,000 and $58,123,000, respectively, of unrealized losses related to its long-term bonds. The unrealized losses on securities are primarily attributable to fluctuations in market interest rates and changes in credit spreads since the securities were acquired.

(h) Other-Than-Temporary Impairment

During 2019 and 2018, the Company recognized $3,306,000 and $4,620,000, respectively, in OTTI on long-term bonds, $12,000 and $31,000, respectively, in OTTI on unaffiliated preferred stock, and $1,844,000 and $8,128,000, respectively, in OTTI on common stocks, mutual funds, and common trust funds. During 2019, the Cake affiliated preferred stock of $7,571,000 was recognized as OTTI and written down to zero after confirmation by the NAIC's SVO that the preferred stock investment in Cake is zero, based on Cake's negative equity value at December 31, 2018. Additionally, the Cake loan of $4,000,000 was recognized as OTTI and written down due to Cake's expected inability to repay the loan.

(i) 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 on a recurring basis includes common stocks, preferred stocks, and money market mutual funds. 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 on a recurring basis 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 stocks, common stock warrants, preferred stocks, and bonds. The estimated fair value of common stock warrants and bonds was determined by internal ratings in the absence of observable inputs.

The following table represents (in thousands) information about the Company's financial assets measured at fair value in Level 3 as of December 31, 2019.

Fair value measurements — Level 3 — December 31, 2019							
Assets	**Beginning Balance January 1, 2019**	**Amortization accretion**	**Current realized net income**	**Change in unrealized surplus**	**Purchases/ transfers into Level 3**	**Sales/ settlements/ transfers out of Level 3**	**Ending Balance December 31, 2019**
Bonds – bank loans	$15,552	$68	$3,380	$535	$29,456	$(48,897)	$94
Perpetual preferred stocks	11	—	(11)	—	—	—	—
Common stocks – industrial and miscellaneous	644	—	122	(148)	18	(504)	132
Total assets	**$16,207**	**$68**	**$3,491**	**$387**	**$29,474**	**$(49,401)**	**$226**

The following table represents (in thousands) information about the Company's financial assets measured at fair value in Level 3 as of December 31, 2018.

Fair value measurements — Level 3 — December 31, 2018							
Assets	**Beginning Balance January 1, 2018**	**Amortization accretion**	**Current realized net income**	**Change in unrealized surplus**	**Purchases/ transfers into Level 3**	**Sales/ settlements/ transfers out of Level 3**	**Ending Balance December 31, 2018**
Bonds – bank loans	$2,035	$18	$(176)	$(620)	$16,949	$(2,654)	$15,552
Perpetual preferred stocks	20	—	(9)	—	—	—	11
Common stocks – industrial and miscellaneous	236	—	(11)	111	374	(66)	644
Total assets	**$2,291**	**$18**	**$(196)**	**$(509)**	**$17,323**	**$(2,720)**	**$16,207**

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, 2019 and 2018, 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, 2019				
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:				
Industrial and miscellaneous	$124,721	$—	$131	$124,852
Common trust funds	—	59,738	—	59,738
Mutual funds	255,452	—	—	255,452
Total common stocks	380,173	59,738	131	440,042
Perpetual preferred stocks	579	—	—	579
Redeemable preferred stocks	—	7	—	7
Money market mutual funds	128,506	—	—	128,506
Total assets	**$509,258**	**$59,745**	**$131**	**$569,134**

Fair value measurements — recurring basis — December 31, 2018				
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:				
Industrial and miscellaneous	$111,324	$—	$644	$111,968
Common trust funds	—	55,031	—	55,031
Mutual funds	280,358	—	—	280,358
Total common stocks	391,682	55,031	644	447,357
Perpetual preferred stocks	320	—	11	331
Money market mutual funds	67,200	—	—	67,200
Total assets	**$459,202**	**$55,031**	**$655**	**$514,888**

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 amortized value, which resulted in an unrealized loss of $725,000 at December 31, 2019 and $9,221,000 at December 31, 2018.

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, 2019 and 2018, respectively. The fair values are also categorized into the three level fair value hierarchy as described above.

December 31, 2019					
Type of financial instrument	**Fair value**	**Admitted value**	**Level 1**	**Level 2**	**Level 3**
Financial instruments-assets:					
Long-term bonds:					
Bank loans	$119	$119	$—	$—	$119
CDOs/CBOs/CLOs	84,348	85,264	—	80,098	4,250
Private placements	73,576	69,544	—	—	73,576
All other bonds	2,065,767	1,961,802	—	2,034,411	31,356
Total long-term bonds	2,223,810	2,116,729	—	2,114,509	109,301
Preferred stocks:					
Perpetual preferred	647	579	647	—	—
Redeemable preferred	34	30	—	34	—
Total preferred stocks	681	609	647	34	—
Common stocks:					
Industrial and misc.	124,852	124,852	124,721	—	131
Common trust funds	59,738	59,738	—	59,738	—
Mutual funds	255,452	255,452	255,452	—	—
Total common stocks	440,042	440,042	380,173	59,738	131
Securities lending reinvested collateral assets	92,085	92,085	7,085	85,000	—
Mortgage loans	23,814	23,814	—	—	23,814
Cash, cash equivalents and short-term investments	215,630	215,630	167,975	47,655	—
Total assets	**$2,996,062**	**$2,888,909**	**$555,880**	**$2,306,936**	**$133,246**

December 31, 2018					
Type of financial instrument	**Fair value**	**Admitted value**	**Level 1**	**Level 2**	**Level 3**
Financial instruments-assets:					
Long-term bonds:					
Bank loans	$123,736	$123,742	$—	$104,900	$18,836
CDOs/CBOs/CLOs	66,993	68,396	—	65,995	998
Private placements	52,602	54,474	—	—	52,602
All other bonds	1,855,861	1,882,985	—	1,834,518	21,343
Total long-term bonds	2,099,192	2,129,597	—	2,005,413	93,779
Preferred stocks:					
Perpetual preferred	331	331	320	—	11
Perpetual preferred — subsidiary Cake	7,571	7,571	—	—	7,571
Redeemable preferred	25	22	25	—	—
Total preferred stocks	7,927	7,924	345	—	7,582
Common stocks:					
Industrial and misc.	111,968	111,968	111,324	—	644
Common trust funds	55,031	55,031	—	55,031	—
Mutual funds	280,358	280,358	280,358	—	—
Total common stocks	447,357	447,357	391,682	55,031	644
Mortgage loans	15,024	15,024	—	—	15,024
Cash, cash equivalents and short-term investments	73,492	73,492	63,530	9,962	—
Other – affiliated non-collateral loan	4,000	4,000	—	—	4,000
Total assets	**$2,646,992**	**$2,677,394**	**$455,557**	**$2,070,406**	**$121,029**

(i) Investment Income

Major categories of net investment income for the years ended December 31, 2019 and 2018 are summarized as follows (in thousands):

	2019	2018
Investment income:		
Corporate and miscellaneous bonds	$77,837	$72,771
U.S. government bonds	3,679	2,893
Cash and other investments	1,740	1,314
Real estate	5,695	5,691
Other invested assets	3,202	2,654
Mortgage loans	1,101	185
Equity securities	9,779	15,636
Securities lending income	171	—
Surplus note interest expense	(8,625)	(8,625)
Investment expenses	(9,230)	(9,139)
Net investment income earned	85,349	83,380
Net realized capital gain (loss):		
Corporate and miscellaneous bonds	(1,648)	(5,352)
U.S. government bonds	(22)	—
Equity securities	26,752	15,177
Cash and other investments	(4,013)	—
Net realized capital gains	21,069	9,825
Net investment income	**$106,418**	**$93,205**

5 / REINSURANCE

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

/ Layer 1 – Limit of $20,000,000 in excess of retention of $20,000,000 per occurrence

/ Layer 2 – Limit of $40,000,000 in excess of retention of $40,000,000 per occurrence

/ Terrorism Only – Limit of $50,000,000 in excess of retention of $80,000,000 per occurrence

Management is not aware of any loss nor did the Company record any loss great enough to attach to these layers during any of the prior policy periods.

Reinsurance contracts do not relieve Pinnacol of its obligations, and a failure of the reinsurer to honor its obligations could result in losses unreimbursed to Pinnacol. Pinnacol evaluates and monitors the financial condition of its reinsurers to minimize its exposure to loss from reinsurer insolvency. Management of Pinnacol believes its reinsurers are financially sound and will continue to meet their contractual obligations.

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, 2019:

Reinsurer	AM Best Rating
Arch Reinsurance Company	A+
Endurance Specialty Insurance Limited	A+
The Cincinnati Insurance Company	A+
Partner Reinsurance Company Ltd.	A+
Lloyd's Syndicate 3000 (Markel Syndicate Management Limited)	A

Assumed Reinsurance — Pinnacol has entered into assumed reinsurance contracts that allow the Company to provide insurance coverage under the workers' compensation provisions of other states for the employees of Colorado companies who work outside of Colorado (Other States Coverage). Effective March 1, 2004, Pinnacol executed a reinsurance contract with Argonaut Insurance Company (a California corporation) for Other States Coverage. The contract was canceled in 2010; however, Pinnacol will continue to pay existing claims in accordance with this reinsurance agreement until these claims are closed or these risks are transferred. As the Company entered into a reinsurance agreement in 2010 with Zurich American Insurance Company, there were no gaps in coverage. This agreement was still in effect as of December 31, 2019. 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.

Funds have been placed on deposit as collateral with Argonaut Insurance Company and Zurich American Insurance Company in the amount of $4,583,000 and $2,182,000 in 2019 and 2018, respectively.

Pinnacol held unearned premium reserves related to assumed business of $1,080,000 and $919,000 for the years ended December 31, 2019 and 2018, respectively. Pinnacol had loss and loss adjustment expense reserves related to assumed business of $18,687,000 and $26,024,000 for the years ended December 31, 2019 and 2018, respectively.

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

	2019	2018
Direct premiums written	$588,500	$623,848
Premiums ceded	(1,257)	(1,325)
Premiums assumed	9,806	8,914
Net premiums written	**$597,049**	**$631,437**
Direct premiums earned	$593,391	$624,274
Premiums ceded	(1,257)	(1,325)
Premiums assumed	9,645	8,806
Net premiums earned	**$601,779**	**$631,755**
Direct losses incurred	$305,126	$300,001
Losses ceded	—	—
Losses assumed	(3,934)	3,205
Net losses incurred	**$301,192**	**$303,206**
Direct loss adjustment expenses incurred	$76,689	$73,108
Loss adjustment expenses ceded	—	—
Loss adjustment expenses assumed	1,267	1,667
Net loss adjustment expenses incurred	**$77,956**	**$74,775**

6 / EMPLOYEE BENEFITS

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

Pensions — Pinnacol participates in the State Division Trust Fund (SDTF), a cost-sharing multiple-employer defined benefit pension fund administered by the Public Employees' Retirement Association of Colorado (PERA). The net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position and additions to/deductions from the fiduciary net position of the SDTF have been determined using the economic resources measurement focus and the accrual basis of accounting. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

The Colorado General Assembly passed significant pension reform through Senate Bill (SB) 18 200: *Concerning Modifications to the Public Employees' Retirement Association Hybrid Defined Benefit Plan Necessary to Eliminate with a High Probability the Unfunded Liability of the Plan Within the Next Thirty Years*. The bill was signed into law by Governor Hickenlooper on June 4, 2018. A full copy of the bill can be found online at https://www.leg.colorado.gov.

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

Benefits provided — PERA provides retirement, disability, and survivor benefits. Retirement benefits are determined by the amount of service credit earned and/or purchased, highest average salary, the benefit structure(s) under which the member retires, the benefit option selected at retirement, and age at retirement. Retirement eligibility is specified in tables set forth at C.R.S. § 24-51-602, 604, 1713, and 1714.

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

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

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

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

Benefit recipients who elect to receive a lifetime retirement benefit are generally eligible to receive postretirement cost-of-living adjustments (COLAs) in certain years, referred to as annual increases in the C.R.S. Pursuant to (SB) 18-200, there are no annual increases (AI) for 2018 and 2019 for all benefit recipients. Thereafter, benefit recipients under the PERA benefit structure who began eligible employment before January 1, 2007 will receive an annual increase, unless PERA has a negative investment year, in which case the annual increase for the next three years is the lesser of 1.5% or the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for the prior calendar year. Benefit recipients under the PERA benefit structure who began eligible employment after January 1, 2007 will receive the lesser of an annual increase of 1.5% or the average CPI-W for the prior calendar year, not to exceed 10% of PERA's Annual Increase Reserve (AIR) for the SDTF. The automatic adjustment provision may raise or lower the aforementioned AI for a given year by up to one-quarter of 1% based on the parameters specified in C.R.S. § 24-51-413.

Disability benefits are available for eligible employees once they reach five or more years of service credit and are determined to meet the definition of disability. The disability benefit amount is based on the retirement benefit formula shown above considering a minimum 20 years of service credit, if deemed disabled.

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

Contributions — Eligible employees, Pinnacol and the State are required to contribute to the SDTF at a rate set by Colorado statute. The contribution requirements are established under C.R.S. § 24-51-401, et seq and C.R.S. § 24-51-413. Eligible employees were required to contribute 8.00% of their PERA-includable salary until June 30, 2019, thereafter the contribution increased to 8.75% of PERA-includable salary. The employer contribution requirements for Pinnacol are summarized in the table below:

	For the year ended December 31		
	2019	**2018**	**2017**
Employer contribution rate (includes 1.02% allocation to the Health Care Trust Fund — see note 6c) [1]	10.40%	10.15%	10.15%
Amortization Equalization Disbursement (AED) as specified in C.R.S. § 24-51-411 [1]	5.00	5.00	5.00
Supplemental Amortization Equalization Disbursement (SAED) as specified in C.R.S. § 24-51-411 [1]	5.00	5.00	5.00
Total employer contribution rate	**20.40%**	**20.15%**	**20.15%**

[1] Contribution rates are expressed as a percentage of salary as defined in C.R.S. § 24-51-101(42).

Employer contributions are recognized by the SDTF in the period in which the compensation becomes payable to the member and Pinnacol is statutorily committed to pay the contributions to the SDTF. Employer contributions recognized by the SDTF from Pinnacol were $12,954,000 and $12,627,000, for the years ended December 31, 2019 and December 31, 2018, respectively. These contributions met the contribution requirement for each year.

(b) Voluntary Tax Deferred Retirement Plans

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

Funding Policy — The Voluntary Investment Program is funded by voluntary member contributions up to the maximum limits set by the Internal Revenue Service, as established under Title 24, Article 51, Section 1402 of the C.R.S., as amended. In addition, Pinnacol has agreed to match employee's elective contributions into the PERA 401(k) Plan at 50% up to the first 6% of employees' elected deferrals. Employees are immediately vested in their own contributions, employer contributions, and investment earnings. For the years ended December 31, 2019 and 2018, Pinnacol contributed approximately $1,586,000 and $1,556,000, respectively, in matching contributions to the PERA 401(k) Plan. Pinnacol also offers a 457 deferred compensation plan.

(c) Defined Benefit Other Postemployment Benefit (OPEB) Plan

OPEB Plan – Pinnacol participates in the Health Care Trust Fund (HCTF), a cost-sharing multiple-employer defined benefit OPEB plan administered by PERA.

Plan Description — The HCTF is established under Title 24, Article 51, Part 12 of the C.R.S., as amended. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. Title 24, Article 51, Part 12 of the C.R.S., as amended, sets forth a framework that grants authority to the PERA Board to contract, self-insure, and authorize disbursements necessary in order to carry out the purposes of the PERACare program, including the administration of the premium subsidies. Colorado State law provisions may be amended from time to time by the Colorado General Assembly. PERA issues a publicly available comprehensive annual financial report that can be obtained at https://www.copera.org/investments/pera-financial-reports.

Benefits — The HCTF provides a healthcare premium subsidy to eligible participating PERA benefit recipients and retirees who choose to enroll in one of the PERA healthcare plans, however, the subsidy is not available if only enrolled in the dental and/or vision plan(s). The healthcare premium subsidy is based upon the benefit structure under which the member retires and the member's years of service credit.

C.R.S. § 24-51-1202 et seq. specifies the eligibility for enrollment in the healthcare plans offered by PERA and the amount of the premium subsidy. The law governing a benefit recipient's eligibility for the subsidy and the amount of the subsidy differs slightly depending under which benefit structure the benefits are calculated. All benefit recipients under the PERA benefit structure are eligible for a premium subsidy, if enrolled in a healthcare plan under PERACare.

Funding Policy – Pinnacol is required to contribute at a rate of 1.02% of PERA-includable salary for all PERA members as set by statute. Pinnacol's contribution is included in the contribution rate of 20.40% in note 6(a). No member contributions are required to the HCTF. The contribution requirements for Pinnacol are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The apportionment of the contributions to the HCTF is established under Title 24, Article 51, Section 208(1)(f) of the C.R.S., as amended. For the years ending December 31, 2019 and 2018, Pinnacol contributions to the HCTF were approximately $652,000 and $639,000, respectively, equal to the required contributions for each year.

(d) Other

Health and Welfare Trust — Effective January 1, 2010, Pinnacol entered into certain self-funded benefit programs with its vendors for healthcare, dental care, and vision care and established a separate legal trust for administrative purposes. In 2019, Pinnacol also entered into a guaranteed cost program with one of its two healthcare vendors. Pinnacol withholds monthly premium from its employee participants' payroll checks and uses these premiums and the employer contribution

amounts to fund the trust account. These premiums are used to reimburse medical claims paid by the third-party vendors for the self-funded programs or pay premiums to the healthcare vendor for the guaranteed cost program. Employer contributions in 2019 and 2018 were $6,944,000 and $6,661,000, respectively.

Accrued Paid Leave — Pinnacol employees may accrue paid time off based on their length of service subject to certain limitations on the amount that will be paid upon termination or taken in future periods. Paid time off is recorded as an expense and a liability at the time the paid time off is earned. The estimated liability for cumulative accrued paid time off of approximately $3,161,000 and $2,811,000 at December 31, 2019 and 2018, respectively, is included in other liabilities in the statutory-basis statements of admitted assets, liabilities, and policyholders' surplus.

7 / POLICYHOLDERS' SURPLUS

The board of directors declared general policyholder dividends in 2019 of $60,174,000 and 2018 of $70,000,000. The 2019 dividend was subsequently increased by $10,000,000 in February 2020, for a total of approximately $70,000,000 in general policyholder dividends based upon 2019 operations. The 2019 and 2018 dividends were paid to policyholders in March 2020 and March 2019, respectively. General policyholder dividends are a component of other income.

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 $184,346,000 for 2019.

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 Division 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 2019, $8,625,000 of interest was paid on the note and recorded as investment expense. The note, which is subordinate to the prior payment of all other liabilities of the Company, will be due and payable twenty years from the issuance date, with an optional prepayment date in whole or part in fifteen years with no penalty. The surplus note was issued to partially cover Pinnacol's estimated proportionate share of PERA's unfunded liability for vested service of Pinnacol employees and retirees. This liability is not required to be recorded in the statutory-basis financial statements as of December 31, 2019, but it reduces the capital adequacy assessments of outside rating agencies, such as A.M. Best. In accordance with the note agreement, Pinnacol may apply the proceeds for general corporate purposes.

The surplus note agreement contains customary affirmative and negative covenants and requires that Pinnacol maintain certain specified ratios and thresholds. Among others, these covenants include maintaining a maximum writing ratio, debt to capitalization ratio and interest coverage ratio. Management believes that at December 31, 2019 Pinnacol is in compliance with such covenants, ratios, and thresholds.

The Company participates in a cost-sharing multiple-employer defined benefit pension plan administered by PERA. PERA has a net pension liability, which represents the unfunded pension benefits. The funded portion of PERA's total pension liability as of December 31, 2018 is 56.1%. The Company has a special surplus fund to identify its portion of the unfunded pension benefits. Based on information provided by PERA as of June 30, 2018, the Company's special surplus fund for the unfunded pension benefits has decreased by $200,311,000 from $407,510,000 in 2018 to a new balance of $207,200,000 for 2019. The discount rate changed from 4.72% to 7.25% at December 31, 2018. The primary factors that contributed to the use of the assumed investment rate of return as the discount rate included the increases to future contributions from members and employers, the State of Colorado's direct distribution payment to PERA, and changes to benefit provisions, which are required by SB-200. There are no limitations for using the special surplus fund for policyholders, injured workers, or other creditors.

The Company participates in the Health Care Trust Fund (HCTF), a cost-sharing multiple-employer defined benefit Other Postemployment Benefit (OPEB) plan administered by PERA. Although not required under statutory accounting to record its share of the liability, the Company has identified its portion of the HCTF liability in a special surplus fund in the same manner as the PERA net pension liability obligation as of December 31, 2019 in the amount of $10,089,000.

8 / COMMITMENTS & CONTINGENCIES

The Company has made total commitments of $96,026,000 to provide additional funds as needed to the following partnerships:

Partnership name	2019
NB Pinnacol Assurance Fund LP	$76,000,000
Blackstone Tactical Opportunities Fund II LP	6,402,000
GCM Grosvenor Opportunistic Credit Fund IV Ltd	4,248,000
North Haven Credit Partners LP	3,244,000
Entrust Permal Special Opportunities Fund IV Ltd	2,655,000
NB Strategic Co-Investment Partners III LP	1,897,000
Kayne Credit Opportunities Fund LP	1,004,000
Warburg Pincus Private Equity XII LP	500,000
Blue Ocean Income Fund LP	76,000
Total	**$96,026,000**

The Company has also committed to fund an additional $6,186,000 for mortgage loan investments held at December 31, 2019.

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, 2019 and 2018, Pinnacol had a letter of credit for the benefit of Argonaut Insurance Company under an assumed reinsurance agreement for approximately $6,017,000 and $6,297,000, respectively. This reinsurance agreement allows Argonaut Insurance Company 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 $10,106,000 and $10,300,000, compared to a requirement of $6,017,000 and $6,297,000, as of December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, Pinnacol had a trust for the benefit of Zurich American Insurance Company under an assumed reinsurance agreement. This reinsurance agreement allows Zurich American Insurance Company, the beneficiary, to claim the trust assets at any time to secure any of Pinnacol's obligations under the agreement. Included in long-term bonds are amounts held in the trust of approximately $41,062,000 and $41,065,000, compared to a requirement of $34,176,000 and $39,000,000 as of December 31, 2019 and 2018.

Pinnacol is contingently liable for approximately $38,430,000 of claims closed by the purchase of annuities from life insurers for structured settlements. Pinnacol has not purchased annuities from life insurers under which the Company is payee, and therefore, no balances are due from such annuity insurers.

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

9 / RELATED-PARTY TRANSACTIONS

In September 2018, Cake repurchased all outstanding common stock, which increased Pinnacol's voting ownership in Cake from 90% to 100%. There was no change to the 2,000,000 preferred shares owned by Pinnacol. On December 31, 2019, Pinnacol recognized OTTI on the full balance of its investment and recorded a realized loss of $7,571,000 after confirmation by the NAIC's SVO that the preferred stock investment in Cake is zero, based on Cake's negative equity value at December 31, 2018.

Effective April 30, 2018, there is a loan agreement between Pinnacol and Cake. Cake, as the borrower, can draw down up to $4,000,000 over a period of up to two years at an interest rate of LIBOR plus 3.00%. This loan amount was fully funded as of December 31, 2019 with a maturity date of April 30, 2020. Interest is due upon maturity, and there is no prepayment penalty. On December 31, 2019, Pinnacol recognized OTTI on the full balance of the loan and accrued interest as the balance was deemed uncollectible. The balance of $4,000,000 was recorded as a realized loss and the accrued interest of $279,000 was recorded as a reduction of investment income due to Cake's expected inability to repay the loan.

At December 31, 2019 Pinnacol's share of losses exceed its investment in Cake. The losses in Cake do not have an impact on Pinnacol's other investments. The losses are summarized in the table below:

Entity	Pinnacol's share of net income (loss)	Accumulated share of net income (losses)	Pinnacol's share of equity, including negative equity	Guaranteed obligation commitment for financial support (yes/no)	Reported value
Cake	$(10,612,000)	$(10,612,000)	$(3,994,000)	No	$—

Under a program administrator agreement approved by the Division, Cake writes policies for Pinnacol through its digital platform that potential policyholders can utilize to receive a quote and bind a policy. Pinnacol pays Cake program administration fees on premium that Cake generates organically or through a referral program with Pinnacol and makes payments to Cake monthly as policies are generated. During 2019, Pinnacol incurred $1,098,000 in program administrator fees.

Pinnacol is currently leveraging the research and development done by Cake using its license of Cake's software to transform Pinnacol's business and reimagine enterprise-wide systems. The use of this technology will allow Pinnacol to operate a digital platform for multiple distribution channels while continuing to build digital capabilities for all policies.

Under a management service agreement approved by the Division, Pinnacol provides certain personnel services to its subsidiary for a variable monthly fee and receives reimbursement for costs Cake incurred. During 2019, Pinnacol received $2,667,000 in management fees and reimbursed costs from its subsidiary. The management fees offset various expenses in the income statement.

At December 31, 2019 Pinnacol reported $92,000 due to subsidiary for commissions due Cake as an agent. Pinnacol also reported $283,000 due from subsidiary for management fees and reimbursable expenses under the management service agreement.

There were no transactions with affiliates in amounts that exceeded 0.5% of the total admitted assets of Pinnacol.

10 / SUBSEQUENT EVENTS

The board of directors declared general dividends on November 6, 2019 in an amount to be approximately $60,000,000. The final dividend amount was subsequently increased to $70,000,000 and confirmed by the Board in February 2020. General dividends were paid in March 2020.

On March 10, 2020, Colorado declared a state of emergency in response to the spread of the COVID-19 pandemic. Pinnacol could be materially and adversely affected by the risks, or the public perception of the risks, related to a pandemic, such as COVID-19. The ultimate impact of the COVID-19 outbreak on Pinnacol and its financial condition will depend on future developments, which are highly uncertain. Broad based declines across financial markets have adversely impacted the value

of Pinnacol's investments and market volatility remains at elevated levels. COVID-19 claims may be covered under Colorado Workers' Compensation laws, depending on the facts and circumstances of each claim. A presumption law, in the context of a COVID-19 claim, may mean that a claim for compensation arising out of a workplace that provides a defined "essential service" will be deemed compensable, unless the defending insurance carrier can meet the necessary burden of proof by proving that the employee contracted the virus outside of the workplace. However, such a law has not been adopted in Colorado at this time. On March 19, 2020, Pinnacol instituted an emergency policy to provide wage replacement benefits for first responders and healthcare workers for up to 14 days of quarantine, the cost of which will not be incorporated into premium calculations. Pinnacol has implemented a short-term policy of not charging premium for the portion of time policyholder employees are being paid wages but are not performing work. In addition to the targeted policyholder support initiatives, Pinnacol has contributed to key philanthropic Colorado relief efforts.

An expected reduction in payroll and headcount by policyholders would reduce earned premiums, while adverse developments in loss frequency and severity (in addition to the emergency benefits described previously) will likely increase incurred losses and loss adjustment expenses. Uncollected and uncollectible premiums are projected to increase, however, all policyholders will be exempt from cancellation of coverage for nonpayment of premiums until further notice from the Division.

On March 13, 2020, Pinnacol directed its agent bank to suspend securities lending activity in light of uncertain market conditions. Accordingly, all security loans and repurchase agreements were closed out as of March 25, 2020. As the program is only suspended and not terminated, Pinnacol may commence securities lending activity at a future date.

Subsequent events have been evaluated through May 20, 2020, the date these statutory-basis financial statements were available to be issued.

Supplemental Schedules of Investment Information (See Independent Auditors' Report)

Supplemental Schedule of Investment Information: Investment Risks Interrogatories

YEAR ENDED DECEMBER 31, 2019 (IN THOUSANDS)

1 / Pinnacol's total admitted assets as reported on page 2 of its annual statement are $3,106,247.

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 Investment Analysis Office* as exempt, (ii) property occupied by Pinnacol,(iii) policy loans, and (iv) all SEC and foreign registered funds (open-end, closed-end, UIT and ETFs) 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	FEDERAL NATIONAL MORTGAGE ASSOCIATION	MBS	$245,229	7.895%
2.02	FREDDIE MAC	MBS, CMO	119,697	3.853
2.03	NB PINNACOL ASSURANCE FUND LP	Other Long-Term Assets	25,129	0.809
2.04	EXXON MOBIL CORPORATION	Bonds, Commercial Paper	15,441	0.497
2.05	GUGGENHEIM PRIVATE DEBT FUND NOTE ISSUER 2.0, LLC	Other Long-Term Assets, Long–Term Bonds	13,641	0.439
2.06	ALPHABET INC.	Bonds, Equity	12,641	0.407
2.07	BLUE OCEAN INCOME FUND LP	Other Long-Term Assets, Long–Term Bonds	11,892	0.383
2.08	MICROSOFT INC.	Bonds, Equity	11,554	0.372
2.09	JP MORGAN CHASE & CO.	Bonds, Preferred Stock	11,525	0.371
2.10	WELLS FARGO & COMPANY	Bonds, Equity	11,223	0.361

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	$1,628,773	52.435%
NAIC-2	435,981	14.036
NAIC-3	40,131	1.292
NAIC-4	42,574	1.371
NAIC-5	15,140	0.487
NAIC-6	1,784	0.057
Preferred stocks:		
P/RP-1	—	—
P/RP-2	260	0.008
P/RP-3	319	0.010
P/RP-4	23	0.001
P/RP-5	—	—
P/RP-6	7	—
	$2,164,992	

4 / Assets held in foreign investments are $263,111 and assets held in foreign-currency-denominated investments are $0, which is approximately 8.5% 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	$228,363	7.352%
Countries designated NAIC-2	27,268	0.878
Countries designated NAIC-3 or below	7,480	0.241
	$263,111	

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:	Cayman Islands	$59,564	1.918%
Country 2:	United Kingdom	32,669	1.052
Countries designated NAIC-2:			
Country 1:	Mexico	12,401	0.399
Country 2:	Panama	5,003	0.161
Countries designated NAIC-3 or below:			
Country 1:	British Virgin Islands	6,975	0.225
Country 2:	Jamaica	289	0.009
		$116,901	

7 / Aggregate unhedged foreign currency exposure is $0, which is approximately 0.0% 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
10.01	BNP PARIBAS SA	1	$9,999	0.322%
10.02	ALLERGAN FUNDING SCS	2	8,863	0.285
10.03	MACQUARIE GROUP LIMITED	1	8,500	0.274
10.04	CREDIT SUISSE GROUP AG	2,3	8,228	0.265
10.05	HSBC HOLDINGS PLC	1	7,011	0.226
10.06	SCENTRE GROUP TRUST 1	1	6,992	0.225
10.07	SINOPEC GROUP OVERSEAS DEVELOPMENT LIMITED	1	6,975	0.225
10.08	PETRONAS ELECTRONICS GROUP S.A.	1	6,968	0.224
10.09	TYCO ELECTRONICS GROUP S.A.	1	6,502	0.209
10.10	APTIV PLC	2	5,171	0.166

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

12 / Amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions:

12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

Issuer		Amount	Percentage of total admitted assets
12.02	Aggregate statement value of investments held in investments with contractual sales restrictions	$105,231	3.388%
Largest three investments held in investments with contractual sales restrictions:			
12.03	NB PINNACOL ASSURANCE FUND LP	25,129	0.809%
12.04	NB STRATEGIC CO-INVESTMENT PARTNERS III LP	9,799	0.315
12.05	GCM GROSVENOR SPECIAL OPPORTUNITIES FUND, LTD	9,288	0.299

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 *Purposes and Procedures Manual of the NAIC Investment Analysis Office* as exempt or NAIC Class 1):

Issuer		Amount	Percentage of total admitted assets
13.01	HARDING LOEVNER INTERNATIONAL EQUITY FUND & EMERGING MARKETS FUND	$51,352	1.653%
13.02	BLACKROCK EQUITY INDEX FUND B CTF	40,438	1.302
13.03	DODGE & COX INTERNATIONAL STOCK FUND	38,042	1.225
13.04	VANGUARD INST INDEX FUND	37,940	1.221
13.05	T. ROWE PRICE INSTITUTIONAL SMALL-CAP STOCK FUND	36,549	1.177
13.06	FRANKLIN INTERNATIONAL GROWTH FUND	28,362	0.913
13.07	FIRST EAGLE OVERSEAS FUND	24,644	0.793
13.08	LSV VALUE EQUITY FUND	19,384	0.624
13.09	WELLINGTON INT SMALL CAP EQUITY FUND	19,299	0.621
13.10	MORGAN STANLEY INSTITUTIONAL FUND	19,179	0.617

Items 14 through 19 are not applicable.

20 / Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

		At Year-End		At End of Each Quarter		
			%	1st Qtr	2nd Qtr	3rd Qtr
20.01	Securities lending agreements (do not include assets held as collateral for such transactions)	$92,085,230	3.00%	$—	$158,027,020	$106,479,940
20.02	Repurchase agreements					
20.03	Reverse repurchase agreements					
20.04	Dollar repurchase agreements					
20.05	Dollar reverse repurchase agreements					

Items 21 through 23 are not applicable.

See accompanying independent auditors' report.

Supplemental Schedule of Investment Information: Summary Investment Schedule

DECEMBER 31, 2019 (IN THOUSANDS)

	Gross investment holdings*		Admitted assets as reported in the annual statement	
Investment categories	**Amount**	**Percentage of gross investment holdings**	**Amount**	**Percentage of total admitted assets**
Long-Term Bonds:				
U.S. Governments	$214,367	7.1%	$214,367	7.1%
All Other Governments	23,811	0.8	23,811	0.8
U.S. States, Territories and Possessions	—	—	—	—
U.S. Political Subdivisions of States, Territories, and Possessions	11,226	0.4	11,226	0.4
U.S. Special Revenue and Special Assessment Obligations	415,632	13.8	415,632	13.8
Industrial and Miscellaneous	1,443,734	47.8	1,443,734	47.8
Hybrid Securities	7,840	0.3	7,840	0.3
Parent, Subsidiaries, and Affiliates	—	—	—	—
SVO Identified Funds	—	—	—	—
Unaffiliated Bank Loans	119	—	119	—
Preferred Stocks:				
Industrial and Miscellaneous (Unaffiliated)	609	—	609	—
Parent, Subsidiaries, and Affiliates	—	—	—	—
Common Stocks:				
Industrial and Miscellaneous Publicly Traded (Unaffiliated)	124,329	4.1	124,329	4.1
Industrial and Miscellaneous Other (Unaffiliated)	523	—	523	—
Parent, Subsidiaries, and Affiliates Publicly Traded	—	—	—	—
Parent, Subsidiaries, and Affiliates Other	—	—	—	—
Mutual Funds	315,190	10.4	315,190	10.4
Unit Investment Trusts	—	—	—	—
Closed-End Funds	—	—	—	—
Mortgage Loans:				
Farm Mortgages	—	—	—	—
Residential Mortgages	—	—	—	—
Commercial Mortgages	23,814	0.8	23,814	0.8
Mezzanine Real Estate Loans	—	—	—	—

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

Investment categories	Gross investment holdings*		Admitted assets as reported in the annual statement	
	Amount	Percentage of gross investment holdings	Amount	Percentage of total admitted assets
Real Estate:				
Property occupied by Company	$15,057	0.5%	$15,057	0.5%
Property held for production of income	—	—	—	—
Property held for sale	—	—	—	—
Cash, Cash Equivalents, and Short-Term Investments:				
Cash	(2,018)	(0.1)	(2,018)	(0.1)
Cash Equivalents	216,899	7.2	216,899	7.2
Short-Term Investments	749	—	749	—
Contract Loans	—	—	—	—
Derivatives	—	—	—	—
Other Invested Assets (Schedule BA)	105,232	3.5	105,232	3.5
Receivables for Securities	12,271	0.4	12,271	0.4
Securities Lending	92,085	3.0	92,085	3.0
Other Invested Assets	—	—	—	—
Total Invested Assets	**$3,021,469**	**100.0%**	**$3,021,469**	**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.

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-basis statements of admitted assets, liabilities, and policyholders' surplus as of December 31, 2019, and the related statutory-basis statements of operations and changes in policyholders' surplus, and cash flow for the year then ended, and the related notes to the statutory-basis financial statements, and have issued our report thereon dated May 20, 2020. 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 consolidated 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 a 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 & 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 the 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 the Pinnacol Assurance's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Denver, Colorado
May 20, 2020

The Members of the Legislative Audit Committee and
Risk and Audit Committee of the Board of Directors
Pinnacol Assurance
Denver, Colorado

Ladies and Gentlemen:

We have audited the financial statements 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 of Pinnacol Assurance (the Company) as of December 31, 2019 and 2018 and for each of the years then ended, and expect to issue our report thereon under date of May 20, 2020. Under our professional standards, we are providing you with the accompanying information related to the conduct of our audits.

Our Responsibility Under Professional Standards

We are responsible for forming and expressing an opinion about whether the financial statements, that have been prepared by management with the oversight of the Pinnacol Assurance Risk and Audit Committee of the Board of Directors (Pinnacol Risk and Audit Committee), are presented fairly, in all material respects, using accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado, which practices differ from U.S. generally accepted accounting principles. We have a responsibility to perform our audit of the financial statements in accordance with auditing standards generally accepted in the United States of America. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected. Our audit does not relieve management or the Pinnacol Risk and Audit Committee of their responsibilities.

In addition, in planning and performing our audit of the financial statements, we considered internal control over financial reporting (internal control) as a basis for designing 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 the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

We also have a responsibility to communicate significant matters related to the financial statement audit that are, in our professional judgment, relevant to the responsibilities of the Pinnacol Risk and Audit Committee in overseeing the financial reporting process. We are not required to design procedures for the purpose of identifying other matters to communicate to you.

Other Information in Documents Containing Audited Statutory Financial Statements

Our responsibility for other information in documents containing the Company's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents.

Accounting Practices and Alternative Treatments

Significant Accounting Policies

The significant accounting policies used by the Company are described in note 1 to the financial statements.

Unusual Transactions

There have been no unusual transactions that we are aware of that need to be disclosed to you.

Qualitative Aspects of Statutory Accounting Practices

We have discussed with the Pinnacol Assurance Risk and Audit Committee and management our judgments about the quality, not just the acceptability, of the Company's statutory accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the Company's statutory accounting policies and their

application, and the understandability and completeness of the Company's financial statements, which include related disclosures.

Management Judgments and Accounting Estimates

The preparation of the financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. 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 2019 statutory-basis financial statements include the following:

Reserve for Unpaid Losses and Loss Adjustment Expenses is based on an analysis of historical paid and incurred claims. To assist management in estimating the liability for unpaid losses and loss adjustment expenses, Pinnacol retains the assistance of an actuarial consulting firm. We evaluated the key factors and assumptions used to develop the reserve for unpaid losses and loss adjustment expenses, including possible management bias in developing the estimate, in determining that the reserve for unpaid losses and loss adjustment expenses is reasonable in relation to the financial statements as a whole

Structured Settlement Liability is based on mortality risk and discounted using a market rate. Pinnacol discounts internal structured settlement liabilities on a tabular basis using a discount rate of 2.5% for 2019. 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. To assist management in estimating the internal structured settlement liability, Pinnacol retains the assistance of an actuarial consulting firm. We evaluated key factors and assumptions used to develop the structured settlement liability, including possible management bias in developing the estimate, in determining that the structured settlement liability is reasonable in relation to the financial statements as a whole.

Earned but Unbilled Premiums Asset is based on an analysis of internal calculations using historical premium data, including audit premium data. We evaluated key factors and assumptions used to develop the earned but unbilled premiums asset, including possible management bias in developing the estimate, in determining that the earned but unbilled premiums asset is reasonable in relation to the financial statements as a whole.

Uncorrected and Corrected Misstatements

In connection with our audit of the Company's financial statements, we have not identified any significant financial statement misstatements that have not been corrected in the Company's books and records as of and for the year ended December 31, 2019 and have communicated that finding to management.

Disagreements with Management

There were no disagreements with management on financial accounting, and reporting matters that would have caused a modification of our auditors' reports on the Company's statutory financial statements.

Management's Consultation with Other Accountants

To the best of our knowledge, management has not consulted with our obtained opinions, written or oral, from other independent accountants during the year ended December 31, 2019.

Significant Issues Discussed, or Subject to Correspondence, with Management

Major Issues Discussed with Management Prior to Retention

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with the Pinnacol Risk and Audit Committee and management each year prior to our retention by the Legislative Audit Committee as the Company's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Material Written Communications

The following material written communications between management and us have been provided:

1 / Internal legal letter

2 / Management representation letter

Significant Difficulties Encountered During the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Independence

We are not aware of any additional relationships between our firm and the Company and persons in a financial reporting oversight role at the Company that may reasonably be thought to bear on independence.

Confirmation of Audit Independence

We hereby confirm that as of May 20, 2020, we are independent accountants with respect to the Company under all relevant professional and regulatory standards.

* * * * * * *

This letter to the Legislative Audit Committee and Pinnacol Risk and Audit Committee is intended solely for the information and use of the Legislative Audit Committee and the Pinnacol Assurance Risk and Audit Committee of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties. However, upon release by the Legislative Audit Committee, the report is a public document.

Very truly yours,

KPMG LLP