

AN AUDIT

State Life Insurance Fund
Office of the Commissioner of Insurance

02-18

November 2002

2001-2002 Joint Legislative Audit Committee Members

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November 14, 2002

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

We have completed an audit of the financial statements of the State Life Insurance Fund for the period January 1, 1999 through December 31, 2001, as required by s. 13.94 (1)(de), Wis. Stats. The Fund, which was created in 1911 to provide low-cost life insurance policies to Wisconsin residents, is administered by the Office of the Commissioner of Insurance. As of December 31, 2001, the Fund had 30,407 life insurance policies in effect, and total life insurance in force of approximately \$226.4 million. The Fund is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. However, it operates under other specific statutory restrictions, including a prohibition on advertising and maximum coverage to any insured person of \$10,000.

The State Life Insurance Fund prepares its financial statements in accordance with insurance accounting practices prescribed by the Commissioner of Insurance. We found the statutory-based financial statements to be fairly presented in accordance with these accounting practices.

The Fund, which is self-funded through premiums and investment earnings, returned between \$3.7 million and \$3.9 million to policyholders as dividends in each of the three years we audited. Statutes require that any fund surplus that accumulates be maintained at a level between 7.0 and 10.0 percent of fund assets, in so far as is practically possible. The Fund's surplus-to-asset ratio was 8.1 percent as of December 31, 2001. However, net losses, which totaled \$679,629 over the three years audited, contributed to a lower ratio in each of the years and may affect future dividend levels if the trend continues.

We appreciate the courtesy and cooperation extended to us by the staff of the Office of the Commissioner of Insurance in completing our audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Janice Mueller".

Janice Mueller
State Auditor

JM/DA/ss

Independent Auditor's Report on the Financial Statements of the Wisconsin State Life Insurance Fund

We have audited the accompanying statutory balance sheet of the Wisconsin State Life Insurance Fund as of December 31, 2001, December 31, 2000, and December 31, 1999, and the related statutory statements of operations and changes in fund surplus and of cash flows for the years then ended. These financial statements are the responsibility of the management of the State Life Insurance Fund. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the State Life Insurance Fund and are not intended to present fairly the financial position of the State of Wisconsin and the results of its operations and changes in financial position of its proprietary fund types in conformity with accounting principles generally accepted in the United States.

As described more fully in Note 2, the State Life Insurance Fund presents these financial statements using the accounting practices prescribed or permitted by the Commissioner of Insurance of the State of Wisconsin, which practices differ from accounting principles generally accepted in the United States. The effects on the financial statements of the variances between the statutory basis of accounting and accounting principles generally accepted in the United States have not been determined, but are presumed to be material.


In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States, the financial position of the State Life Insurance Fund as of December 31, 2001, December 31, 2000, and December 31, 1999, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Life Insurance Fund as of December 31, 2001, December 31, 2000, and December 31, 1999, and the results of its operations and changes in fund surplus and its cash flows for the years then ended in conformity with the accounting practices prescribed or permitted by the Commissioner of Insurance of the State of Wisconsin.

As discussed in Note 3 to the financial statements, in 2001 the State Life Insurance Fund changed various accounting policies to be in accordance with the revised National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual*, as adopted by the Commissioner of Insurance of the State of Wisconsin.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 5, 2002, on our consideration of the State Life Insurance Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

November 5, 2002

LEGISLATIVE AUDIT BUREAU
by 
Diann Allsen
Audit Director

Office of the Commissioner of Insurance
Wisconsin State Life Insurance Fund
Balance Sheet—Statutory Basis

December 31, 2001, December 31, 2000, and December 31, 1999

	<u>12/31/01</u>	<u>12/31/00</u>	<u>12/31/99</u>
Assets			
Bonds and Private Placements (Note 4)	\$ 65,082,910	\$ 62,168,724	\$ 59,819,356
Policy Loans	3,814,690	3,775,217	3,794,203
Cash and Cash Equivalents (Note 4)	5,257,811	5,630,746	5,880,160
Premiums Deferred and Uncollected (Note 10)	109,933	120,292	118,182
Investment Income Receivable	1,304,486	1,385,754	1,322,695
Amounts Recoverable from Reinsurers	0	0	1,301
Total Assets	<u>\$ 75,569,830</u>	<u>\$ 73,080,733</u>	<u>\$ 70,935,897</u>
Liabilities and Fund Surplus			
Aggregate Reserves for Life Insurance			
Policies and Contracts (Note 8)	\$ 51,931,867	\$ 50,399,075	\$ 48,968,251
Liability for Deposit-type Contracts (Notes 3 and 9)	12,168,674	0	0
Supplementary Contracts without Life			
Contingencies (Notes 3 and 9)	0	315,437	294,982
Policyholders Dividends Left to			
Accumulate (Notes 3 and 9)	0	9,596,799	8,849,965
Liability for Accrued Deposits to Pay Future			
Premiums (Notes 3 and 9)	0	1,334,547	1,291,666
Dividends Due and Unpaid, Plus Those			
Payable in the Following Year (Note 6)	3,935,180	3,846,053	3,552,600
Policy Claims Payable (Note 2)	178,049	149,162	138,500
Premiums Received in Advance	34,884	15,817	133,801
Interest Maintenance Reserve (Note 2)	585,849	234,767	319,592
General Expenses Payable	84,887	59,705	77,926
Asset Valuation Reserve (Note 2)	382,925	337,817	268,096
Other Liabilities	134,365	164,911	134,069
Total Liabilities	<u>69,436,680</u>	<u>66,454,090</u>	<u>64,029,448</u>
Fund Surplus	<u>6,133,150</u>	<u>6,626,643</u>	<u>6,906,449</u>
Total Liabilities and Fund Surplus	<u>\$ 75,569,830</u>	<u>\$ 73,080,733</u>	<u>\$ 70,935,897</u>

The accompanying notes are an integral part of this statement.

Office of the Commissioner of Insurance
Wisconsin State Life Insurance Fund
Statement of Operations and Changes in Fund Surplus—Statutory Basis
for the Years Ended December 31, 2001, December 31, 2000, and December 31, 1999

	Year Ended 12/31/2001	Year Ended 12/31/2000	Year Ended 12/31/1999
Revenues			
Premiums and Annuity Considerations (Note 2)	\$ 2,458,132	\$ 2,546,465	\$ 2,613,339
Considerations for Supplementary Contracts and Dividend Accumulations (Note 3)	0	886,527	894,356
Net Investment Income (Note 5)	5,010,318	5,099,327	4,891,821
Amortization of Interest Maintenance Reserve	77,626	42,791	44,304
Miscellaneous Income	1,083	1,330	1,623
Total Revenues	<u>7,547,159</u>	<u>8,576,440</u>	<u>8,445,443</u>
Operating Expenses			
Benefits:			
Death benefits	790,868	868,019	665,264
Matured endowments	282,500	293,500	398,750
Disability benefits	10,360	11,042	12,583
Surrender benefits	280,393	316,195	294,684
Interest and adjustments on policy or deposit-type contract funds (Note 3)	571,158	0	0
Interest on policy or contract funds (Note 3)	0	75,346	68,594
Payments on supplementary contracts and dividend accumulations (Note 3)	0	578,219	696,259
Increase in reserve for supplementary contracts and dividend accumulations (Note 3)	0	767,289	619,978
Increase in aggregate reserves for life insurance policies and contracts	1,532,792	1,430,824	1,519,070
Total Benefits	<u>3,468,071</u>	<u>4,340,434</u>	<u>4,275,182</u>
General Expenses	629,332	677,886	517,750
Total Operating Expenses	<u>4,097,403</u>	<u>5,018,320</u>	<u>4,792,932</u>
Net Income from Operations before Dividends	3,449,756	3,558,120	3,652,511
Dividends to Policyholders (Note 6)	(3,898,141)	(3,768,205)	(3,673,670)
Net Income (loss)	<u>\$ (448,385)</u>	<u>\$ (210,085)</u>	<u>\$ (21,159)</u>
Changes in Fund Surplus			
Surplus at Beginning of Period	\$ 6,626,643	\$ 6,906,449	\$ 6,952,653
Prior-Period Adjustment (Note 12)	0	0	14,668
Adjusted beginning surplus	<u>6,626,643</u>	<u>6,906,449</u>	<u>6,967,321</u>
Net Income (Loss)	(448,385)	(210,085)	(21,159)
Change in Asset Valuation Reserve	(45,108)	(69,721)	(39,713)
Net change in surplus account	<u>(493,493)</u>	<u>(279,806)</u>	<u>(60,872)</u>
Surplus at End of Period	<u>\$ 6,133,150</u>	<u>\$ 6,626,643</u>	<u>\$ 6,906,449</u>

The accompanying notes are an integral part of this statement.

Office of the Commissioner of Insurance
Wisconsin State Life Insurance Fund
Statement of Cash Flows—Statutory Basis
for the Years Ended December 31, 2001, December 31, 2000, and December 31, 1999

	Year Ended <u>12/31/2001</u>	Year Ended <u>12/31/2000</u>	Year Ended <u>12/31/1999</u>
Cash from Operations			
Premium and Annuity Considerations	\$ 2,490,526	\$ 2,423,627	\$ 2,720,451
Considerations for Supplementary Contracts and Dividend Accumulations	0	886,527	894,356
Net Investment Income	5,079,696	5,019,090	4,932,547
Other Income Received	9,621	70,077	28,425
Total Receipts	<u>7,579,843</u>	<u>8,399,321</u>	<u>8,575,779</u>
Death Benefits Paid	772,341	867,098	653,794
Matured Endowments Paid	282,500	293,500	398,750
Surrender Benefits Paid	280,393	316,195	294,684
Interest and Adjustments on Policy or Deposit-type Contracts	8,488	0	0
Interest on Policy or Contract Funds	0	70,368	71,631
Payments on Supplementary Contracts and Dividend Accumulations	0	578,219	696,259
Total Benefits Paid	<u>1,343,722</u>	<u>2,125,380</u>	<u>2,115,118</u>
General Expenses Paid	607,118	693,365	559,110
Other Payments Made	39,088	0	0
Dividends Paid	3,809,014	3,474,752	3,848,305
Total Expenses Paid	<u>4,455,220</u>	<u>4,168,117</u>	<u>4,407,415</u>
Net Cash Provided by Operating Activities	<u>1,780,901</u>	<u>2,105,824</u>	<u>2,053,246</u>
Cash from Investments			
Cash Received from Sale of Bonds	7,479,098	2,743,410	5,183,766
Cash Paid for Purchase of Bonds	(9,952,683)	(5,117,634)	(6,884,260)
Decrease (Increase) in Policy Loans	(39,473)	18,986	51,090
Net Cash Used in Investing Activities	<u>(2,513,058)</u>	<u>(2,355,238)</u>	<u>(1,649,404)</u>
Cash from Financing and Miscellaneous Sources			
Deposits on Deposit-type Contract Funds and Other Liabilities without Life or Disability Contingencies	1,244,175	0	0
Withdrawals on Deposit-type Contract Funds and Other Liabilities without Life or Disability Contingencies	(884,953)	0	0
Net Cash Provided by Financing and Miscellaneous Activities	<u>359,222</u>	<u>0</u>	<u>0</u>
Net Change in Cash and Cash Equivalents	(372,935)	(249,414)	403,842
Cash and Cash Equivalents at January 1	5,630,746	5,880,160	5,476,318
Cash and Cash Equivalents at December 31	<u>\$ 5,257,811</u>	<u>\$ 5,630,746</u>	<u>\$ 5,880,160</u>

The accompanying notes are an integral part of this statement.

1. Description of the Fund

The State Life Insurance Fund, which is part of the State of Wisconsin financial reporting entity and is reported as an enterprise fund in the State's Comprehensive Annual Financial Report, was created in 1911 to provide life insurance policies to Wisconsin residents at the lowest possible cost. The Fund is administered by the Office of the Commissioner of Insurance.

The Fund's operation is similar to that of a mutual life insurance company, and the Fund is subject to the same regulatory requirements as any life insurance company licensed to operate in Wisconsin. The Fund is also subject to other specific statutory restrictions, such as a prohibition on advertising and a maximum coverage of \$10,000, designed to limit the competitive advantage the Fund may have over private insurance companies. The Fund offers two basic policies: whole life insurance and term insurance. As of December 31, 2001, the Fund had 30,407 life insurance policies in effect.

2. Summary of Significant Accounting Policies

A. Accounting Practices - The financial statements of the State Life Insurance Fund are presented on the basis of statutory accounting practices prescribed or permitted by the Wisconsin Commissioner of Insurance, which include practices recommended by the National Association of Insurance Commissioners (NAIC). For calendar year 2001, NAIC's *Accounting Practices and Procedures Manual*, version effective January 1, 2001 (commonly referred to as the Codification), has been adopted as the prescribed and permitted practices for the Fund as permitted by s. 623.02, Wis. Stats. The Fund's financial statements for calendar years 1999 and 2000 also have been prepared in accordance with the accounting practices recommended by the NAIC; however, prior to 2001, the NAIC had not yet codified its accounting practices and procedures. Though many of the statutory accounting practices prior to the Codification continue to remain in effect, the passage of the Codification changed some statutory reporting requirements. Additionally, statutory accounting practices and procedures required by the Commissioner of Insurance and the NAIC (both pre-codified and codified) vary in some respects from generally accepted accounting principles. The following table shows the most significant differences between pre-codified statutory requirements, codified statutory requirements, and generally accepted accounting principles.

<i>Financial Statement Area</i>	<i>Pre-codified Statutory Accounting Practices (CYs 1999 and 2000)</i>	<i>Codified Statutory Practices (CY 2001)</i>	<i>Generally Accepted Accounting Principles</i>
BOND AND PRIVATE PLACEMENT VALUATION	NAIC category 1 to 5 at amortized cost; NAIC category 6 at NAIC stipulated value. Adjustments are made for impairment of value only to the extent it is not provided for in the Asset Valuation Reserve.	NAIC category 1 to 5 at amortized cost; NAIC category 6 at lower of amortized cost or fair value. A permanent impairment should be recorded as a realized loss, with the cost basis written down to fair value.	Fair value.
ASSET VALUATION RESERVE (AVR)	Formula-driven reserve balance. Established to mitigate potential credit-related investment losses. Changes are charged directly to surplus.	Formula-driven reserve balance. Established to mitigate potential credit-related investment losses. Changes are charged directly to surplus.	Not applicable.
INTEREST MAINTENANCE RESERVE (IMR)	Established as a buffer against realized gains and losses caused by general interest rate changes. Changes are amortized to income.	Established as a buffer against realized gains and losses caused by general interest rate changes. Changes are amortized to income.	Not applicable.
REALIZED INVESTMENT GAINS (LOSSES)	Only non-IMR gains are reported in income.	Only non-IMR gains are reported in income.	Reported as income.
UNREALIZED INVESTMENT GAINS (LOSSES)	Recorded directly to surplus.	Recorded directly to surplus for assets recorded at fair value.	Reported as income.
DUE AND DEFERRED PREMIUMS	Recorded as assets.	Due premiums recorded as asset, except that certain balances over 90 days due would be nonadmitted; deferred premiums recorded as asset.	Due premiums reported as asset; deferred premiums offset against liabilities for future policy benefits.
DIVIDENDS	Provision made for dividends payable on next contract anniversary in the following year.	Provision for dividends expected to be paid over the year subsequent to the date of the financial statements, whether or not declared or apportioned.	Provision made for accumulated earnings expected to be paid to policyholders, including pro rata portion of dividends incurred to valuation date; future dividends are accrued over the premium-paying period of the contract.
CONTRACT ACQUISITION COSTS	Charged to expense in current operations when incurred.	Charged to expense in current operations when incurred.	Deferred and amortized in relation to the premium revenue recognized.

B. Use of Estimates - The preparation of the financial statements in conformity with statutory accounting practices requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Due to the inherent uncertainty involved, actual results could differ from those estimates.

C. Accounting Policies

Premiums - Premiums are reported as earned on the policy anniversary date.

New Business Expenses - Expenses incurred in connection with acquiring new insurance business, including acquisition costs, are charged to operations as incurred.

Dividends - The amount of dividends to be paid to policyholders is determined annually by the contracted actuary and the Fund's management at the Office of the Commissioner of Insurance. The aggregate amount of policyholders' dividends is related to actual interest, mortality, and expense experience for the year and judgment as to the appropriate level of statutory surplus to be retained by the Fund in order to be in accordance with the requirement of s. 607.15, Wis. Stats., which requires that the ratio of surplus to assets be kept between 7.0 and 10.0 percent.

Policy Loans - Policy loans are reported at outstanding indebtedness to the Fund, not in excess of policy cash surrender value.

Bonds - All mortgage-backed and asset-backed securities are carried at amortized cost using the "prospective scientific method," which recognizes the time-value of money and amortizes principal receipts on a pro-rata basis, using the securities' current information as opposed to the initial amortized value. All other bonds are carried at amortized cost using the straight-line method of amortization, except for NAIC category 6 bonds, which are carried at the value stipulated by NAIC.

Interest Maintenance Reserve - The interest maintenance reserve (IMR) accumulates interest-related realized gains and losses and amortizes them into income over the remaining life of the investments sold. The State Life Insurance Fund uses the IMR method that amortizes groups of assets based on the average maturity dates using standard amortization tables developed by NAIC.

Policy Claims Payable - The liability for unpaid claims includes reported claims that were not paid at year-end and estimates of claims that were incurred but not reported, based on claims reported in January.

3. Accounting Changes

With the NAIC Codification, the following changes affected the State Life Insurance Fund financial statements beginning with calendar year 2001:

- liabilities for supplementary contracts without life contingencies, policyholders' dividends left to accumulate, and accrued deposits to pay future premiums, previously reported separately on the balance sheet, are reported collectively under the liability for deposit-type contracts;
- consideration received for supplementary contracts and dividend accumulations, previously reported as a revenue, is reported as an increase to the liability for deposit-type contracts;
- payments on supplementary contracts and dividend accumulations, previously reported as an expense, are reported as a deduction to the liability for deposit-type contracts; and
- interest on supplementary contracts and accumulated dividends, previously reported as part of the expense for payments on supplementary contracts and dividend accumulations, and interest on accrued deposits and death claims, previously reported as the expense for interest on policy or contract funds, are combined and reported as the expense for interest and adjustments on policy or deposit-type contract funds.

4. Deposits and Investments

All cash is deposited with the State of Wisconsin Treasurer and is invested by the State of Wisconsin Investment Board through the State Investment Fund, a short-term pool of state and local funds managed by the State of Wisconsin Investment Board with oversight by its Board of Trustees as authorized in ss. 25.14 and 25.17, Wis. Stats. The State Investment Fund is not registered with the Securities and Exchange Commission as an investment company. Shares in the State Investment Fund are reported as cash equivalents and are carried at the cost of the participating shares, which is also the realizable value as of December 31. The various types of securities in which the State Investment Fund may invest are enumerated in ss. 25.17(3)(b), (ba), and (bd), Wis. Stats., and include direct obligations of the United States and Canada; securities guaranteed by the United States; securities of federally chartered corporations, such as the African Development Bank; unsecured notes of financial and industrial issuers; Yankee/Eurodollar issues; certificates of deposit issued by banks in the United States and solvent financial institutions in this state; and bankers acceptances. Interest income, gains, and losses of the State Investment Fund are allocated monthly.

The State Life Insurance Fund's investments are managed by the Investment Board with an investment objective to maintain a diversified portfolio of high-quality income obligations that will preserve principal, maximize income while minimizing costs to policyholders, and approximate the expected life of the Fund's insurance contracts. The Fund's investments include public bonds and privately negotiated fixed-income securities and consist of U.S. government obligations; other state, territory, or possession obligations; and public utility, railroad, industrial, and miscellaneous corporate obligations.

The State Life Insurance Fund's deposits are insured or collateralized with securities held by the State or by its agent in the State's name. The Fund's bonds are insured or registered, or are held by the State or its agent in the State's name.

The book and fair values of the Fund's investments as of December 31, 2001, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer obligations	\$24,864,244	\$26,480,643
Mortgage-backed and asset-backed	<u>1,372,215</u>	<u>1,387,575</u>
Total Government	26,236,459	27,868,218
Utilities	4,234,695	4,137,757
Industrials and Others	<u>34,611,756</u>	<u>34,776,683</u>
Total	\$65,082,910	\$66,782,658

The book and fair values of the Fund's investments as of December 31, 2000, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer obligations	\$20,464,339	\$22,906,101
Mortgage-backed and asset-backed	<u>1,491,641</u>	<u>1,508,222</u>
Total Government	21,955,980	24,414,323
Utilities	5,809,657	5,786,134
Industrials and Others	<u>34,403,087</u>	<u>33,835,454</u>
Total	\$62,168,724	\$64,035,911

The book and fair values of the Fund's investments as of December 31, 1999, are as follows:

	<u>Book Value</u>	<u>Fair Value</u>
Government:		
Issuer obligations	\$17,589,372	\$17,829,500
Mortgage-backed and asset-backed	<u>1,606,392</u>	<u>1,601,930</u>
Total Government	19,195,764	19,431,430
Utilities	6,036,179	5,838,113
Industrials and Others	<u>34,587,413</u>	<u>33,967,744</u>
Total	\$59,819,356	\$59,237,287

Book values represent the securities' amortized costs using the methods of amortization discussed in Note 2. Fair values were obtained from information provided by NAIC's Securities and Valuation Office and the State of Wisconsin Investment Board.

Excluding investments in U.S. Treasury securities and obligations to the U.S. government, the Fund is not exposed to any significant concentration of credit risk in its investments. However, the effect of the market on the Fund's investments has resulted in an increase in the amount of the Fund's bonds rated by NAIC as 3, 4, 5, or 6, which represent non-investment grade securities. The following table shows the book and fair values of the Fund's total investment in bonds with a NAIC rating of 3, 4, 5, or 6, as of December 31:

<u>Calendar Year</u>	<u>Total Book Value</u>	<u>Total Fair Value</u>
2001	\$5,694,432	\$4,882,027
2000	2,006,690	1,859,982
1999	2,083,849	1,928,332

5. Net Investment Income

Net investment income for calendar years 2001, 2000, and 1999 consisted of the following components:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Bonds and private placements	\$4,605,209	\$4,584,751	\$4,405,956
Policy loans	250,689	247,396	251,280
State Investment Fund	<u>213,453</u>	<u>333,279</u>	<u>284,085</u>
Subtotal	5,069,351	5,165,426	4,941,321
Less investment expenses	<u>59,033</u>	<u>66,099</u>	<u>49,500</u>
Net investment income	\$5,010,318	\$5,099,327	\$4,891,821

6. Surplus and Policyholders' Dividend Restrictions

One hundred percent of policies are participating. Dividends payable in the following year are charged to current operations, with 25 percent of the payable amount apportioned for payment between January 1 and March 31. The apportioned amount was \$999,537 for 2001, \$963,802 for 2000, and \$724,840 for 1999.

Section 607.15, Wis. Stats, requires that the surplus be maintained at a level between 7.0 and 10.0 percent of assets, as far as is practically possible. The dividend formula was last changed in 1998, primarily to comply with illustrative NAIC regulations requiring an accurate reflection of investment earnings, to incorporate service fees paid to the Wisconsin Department of Administration (statutes require a service fee of 2.0 percent of net premiums), and to reflect gains made due to favorable mortality. This change resulted in a decrease in dividends paid out. The Fund's surplus-to-asset ratio was 8.1 percent as of December 31, 2001; 9.1 percent as of December 31, 2000; and 9.7 percent as of December 31, 1999.

7. Reinsurance

The State Life Insurance Fund currently has a contract with Optimum Reinsurance Company for insuring those applicants considered high risk by the Fund. This contract began in 2000, when Optimum purchased the business of the Fund's previous reinsurer—Lincoln Life Insurance Company. Neither of these companies are affiliated, owned in excess of 10.0 percent, or controlled, either directly or indirectly, by the Fund or any representative of the Fund. In addition, no policies issued by the Fund have been reinsured with a company chartered in a country other than the United States (excluding U.S. branches of such companies) that is owned in excess of 10.0 percent or controlled directly or indirectly by an insured, a beneficiary, a creditor of an insured, or any other person not primarily engaged in the insurance business.

Under its reinsurance agreement, the Fund retains the reserves and related assets; pays the reinsurer premiums for the ceded business; and is reimbursed for benefits, unusual expenses, and adjustments to required reserves. The reinsurer has no obligation for the reimbursement of dividends related to the ceded business. The Fund does not have any reinsurance agreements in effect under which the reinsurer may unilaterally cancel any reinsurance for reasons other than for nonpayment of premium or other similar credits. Neither does the Fund have any reinsurance agreements in effect such that the amount of losses paid or accrued through the statement date may result in payment to the reinsurer of amounts that, in aggregate and allowing for offset of mutual credits from other reinsurance agreements with the same reinsurer, exceed the total direct premium collected under the reinsured policies.

The following table contains the total life insurance in force and the amount of reinsurance ceded as of the end of each calendar year:

<u>As of:</u>	<u>Total Life Insurance in Force</u>	<u>Reinsurance Ceded</u>
December 31, 2001	\$226,426,000	\$2,694,000
December 31, 2000	227,552,000	2,687,000
December 31, 1999	228,195,000	2,661,000

The Fund is contingently liable with respect to ceded insurance should the reinsurer be unable to meet its assumed obligations.

Revenues received from the reinsurer are treated as a reduction of benefit expense; payments to the reinsurer are treated as a reduction of premium income.

Reinsurance transactions reported in the Fund's operations are as follows:

	<u>Premiums</u>	<u>Claims</u>
2001 (Optimum Reinsurance Company)	\$41,709	\$8,632
2000 (Optimum Reinsurance Company)	34,529	4,981
1999 (Lincoln National Life Insurance Company)	41,173	5,236

8. Reserves for Life Contracts and Deposit-Type Contracts

The Aggregate Reserve for Life Insurance Policies and Contracts for policies issued prior to April 1977 is determined in accordance with the Net Level Premium Method, using the American Experience or 1958 Commissioners Standard Ordinary (CSO) mortality tables and an interest rate of 3.0 percent. Aggregate reserves for policies issued from April 1977 through March 1986 are based on the Commissioners Reserve Valuations Method, using the 1958 CSO mortality tables and an interest rate of 4.0 percent. Reserves for policies issued from April 1986 through December 1994 are based on a modified version of the Commissioners Reserve Valuations Method, using the 1980 CSO mortality tables and an interest rate of 5.0 percent. Reserves for policies issued since January 1, 1995, are based on the Commissioners Reserve Valuations Method, using the 1980 CSO mortality tables and an interest rate of 4.0 percent.

The Fund waives deduction of deferred fractional premiums upon the death of the insured and returns any portion of the final premium beyond the date of death. Surrender values are not promised in excess of the legally computed reserves.

Extra premiums are charged for policies for individuals with high-risk factors issued after April 1, 1977, plus the gross premium for a rated age. The Fund cedes 100 percent of the risk on substandard policies to its reinsurer. The Fund holds the standard reserve in its financial statements and does not take reserve credits related to reinsurance. Therefore, the actual reserve held by the Fund for substandard policies exceeds the minimum reserve that is required for such policies.

The State Life Insurance Fund had the following amounts of insurance in force for which gross premiums were less than net premiums determined according to the standard valuation set by the State of Wisconsin, and the following amounts of reserves to cover this deficiency as of December 31, 2001, 2000, and 1999:

	<u>December 31, 2001</u>	<u>December 31, 2000</u>	<u>December 31, 1999</u>
Insurance in force for which gross premiums were less than net premiums	\$8,526,500	\$8,896,500	\$9,283,500
Portion of aggregate reserves to cover deficiency	\$65,503	\$73,218	\$81,335

Tabular interest, tabular less actual reserve released, and tabular cost have been determined by NAIC formulas. Tabular interest on funds not involving life contingencies is also determined by a separate NAIC formula.

9. Analysis of Deposit Liabilities by Withdrawal Characteristics

All of the deposit fund liabilities for the Fund, which are subject to discretionary withdrawal without adjustment, are reported at book value and are not affected by reinsurance. The liability accounts reported for calendar years 2001, 2000, and 1999 include:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Supplementary contracts without life contingencies	\$ 367,278	\$ 315,437	\$ 294,982
Dividends left to accumulate	10,353,937	9,596,799	8,849,965
Accrued deposits	<u>1,447,459</u>	<u>1,334,547</u>	<u>1,291,666</u>
Total liability for deposit-type contracts	\$12,168,674	\$11,246,783	\$10,436,613

As discussed in Note 3, prior to 2001 the three separate liabilities were each shown on the Fund's balance sheet, but beginning with 2001 they are shown collectively under the liability for deposit-type contracts, as required by NAIC.

10. Premiums Deferred and Uncollected

As of December 31, deferred and uncollected life insurance premiums and annuity considerations, all of which were for ordinary life insurance, were:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Gross premium:			
Ordinary new business	\$ 1,142	\$ 3,293	\$ 3,294
Ordinary renewal	<u>141,424</u>	<u>152,600</u>	<u>147,746</u>
Total	142,566	\$155,893	\$151,040
Premium net of loading:			
Ordinary new business	\$ 656	\$ 1,869	\$ 2,094
Ordinary renewal	<u>109,277</u>	<u>118,423</u>	<u>116,088</u>
Total	\$109,933	\$120,292	\$118,182

Gross premium is the premium charged to the policyholder. Net premium is the amount of premium used in the calculation of the statutory reserves and represents the amount needed to provide contract benefits based on statutory interest and mortality reserve assumptions. Loading refers to the difference between the gross and net premium and represents the amount available for expenses.

11. Wisconsin Retirement System

Permanent, full-time employees of the State Life Insurance Fund are participants in the Wisconsin Retirement System, a cost-sharing, multiple-employer, defined benefit plan governed by Chapter 40 of Wisconsin Statutes. State and local government public employees are entitled to an annual formula retirement benefit based on: 1) the employee's final average earnings; 2) years of creditable service; and 3) a formula factor. If an employee's contributions, matching employer's contributions, and interest credited to the employee's account exceed the value of the formula benefit, the retirement benefit may instead be calculated as a money purchase benefit. The Wisconsin Retirement System is considered part of the State of Wisconsin's financial reporting entity. Copies of the separately issued financial report that includes financial statements and required supplementary information for the year ending December 31, 1999, may be obtained by writing to:

Department of Employee Trust Funds
P.O Box 7931
Madison, WI 53707-7931

The report is also available on the Department of Employee Trust Funds' Web site, <http://badger.state.wi.us/agencies/etf/>.

The financial reports for the years ended December 31, 2000, and December 31, 2001, have not yet been issued.

Generally, the State's policy is to fund retirement contributions on a level-percentage-of-payroll basis to meet normal and prior service costs of the retirement system. Prior service costs are amortized over 40 years, beginning January 1, 1990. The retirement plan requires employee contributions equal to specified percentages of qualified earnings based on the employee's classification, plus employer contributions at a rate determined annually. The relative position of the State Life Insurance Fund in the Wisconsin Retirement System is not available, since the system is a statewide, multiple-employer plan.

12. Prior-Period Adjustment

The prior-period adjustment for calendar year 1999 is related to an error in processing a death claim and an income recognition issue related to investments.

13. Audit Adjustments

The unaudited financial statements presented in the Commissioner of Insurance's annual reports to the Governor and the Legislature have been adjusted to reflect recommended audit adjustments.

14. Subsequent Events

The State Life Insurance Fund's investments as of December 31, 2001, contained holdings in MCI Worldcom, Incorporated with a book value of \$934,561 and fair value of \$907,590. Subsequent to December 31, 2001, the company went into bankruptcy, reducing the value of this investment to zero.
