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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Form 10-K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 0-25508

RTW, INC.
(Exact name of registrant as specified in its charter)

Minnesota	**41-1440870**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

8500 Normandale Lake Boulevard, Suite 1400
Bloomington, MN 55437
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (952) 893-0403

Securities registered pursuant to 12(b) of the Act: None

Securities registered pursuant to 12(g) of the Act:
Common Stock, no par value Series A Junior Participating Preferred Stock

Indicate by check mark if the registrant is a well-known, seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K: ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2)

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☑

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) Yes ☐ No ☑

As of March 10, 2006, 5,454,000 shares of Common Stock, no par value, were outstanding. As of June 30, 2005, assuming as fair value the last sale price of $9.95 per share on The Nasdaq Stock Market, the aggregate fair value of shares held by non-affiliates was approximately $41.5 million.

Documents incorporated by reference:

The Company's Proxy Statement for its annual meeting of shareholders to be held on June 14, 2006, a definitive copy of which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2005, is incorporated by reference in Part III of this Report on Form 10-K.

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PART I

ITEM 1. *BUSINESS*

Overview

RTW, Inc. (RTW) provides disability and absence management services, directed today primarily at workers' compensation to: (i) employers insured through our wholly-owned insurance subsidiary, American Compensation Insurance Company (ACIC) and its wholly-owned insurance subsidiary, Bloomington Compensation Insurance Company (BCIC); (ii) self-insured employers on a fee-for-service basis; (iii) state-sponsored assigned risk plans on a percent of premium basis; (iv) other insurance companies; and (v) to agents and employers on a consulting basis, charging hourly fees through RTW and its Absentia℠ division. ACIC offers guaranteed cost workers' compensation insurance to employers located primarily in Minnesota, Michigan and Colorado and is licensed in twenty-three states. BCIC began underwriting business in October 2005 and offers guaranteed-cost workers' compensation insurance to selected employers only in Minnesota. Collectively, "we," "our" and "us" refer to RTW, ACIC, BCIC and Absentia in this document.

We developed two proprietary systems to manage disability: (i) ID15®, designed to quickly identify those injured employees who are likely to become inappropriately dependent on disability system benefits; and (ii) The RTW Solution®, rapid intervention in and intensive management of potentially high-cost injuries, designed to lower employers' disability costs and improve productivity by returning injured employees to work as soon as safely possible. We support these proprietary management systems with state-of-the-art technology and talented employees dedicated to our vision of transforming people from absent or idle to present and productive. Our insurance subsidiaries are domiciled in Minnesota and operated primarily in Minnesota, Michigan and Colorado in 2005, 2004 and 2003. Absentia serviced customers in six states in 2004 and expanded to 18 states by December 31, 2005.

Our approach to managing disability reduces medical expenses and wage-replacement costs (including time away from the job). We: (i) focus our efforts on the 15% of the injured employees that drive 80% of the system costs; (ii) control costs by actively managing all participants in the system, including employers, employees, medical care providers, attorneys and the legal system; and (iii) return injured employees to work as soon as safely possible.

Industry

Today, we derive a substantial portion of our revenues from products and services related to managing workers' compensation. Workers' compensation benefits are mandated and regulated at the state level. Every state requires employers to provide wage-replacement and medical benefits to workplace accident victims regardless of fault. Virtually all employers in the United States are required to either: (a) purchase workers' compensation insurance from a private insurance carrier; (b) obtain coverage from a state managed fund; or (c) if permitted by their state, to be self-insured. Workers' compensation laws generally mandate two types of benefits for injured employees: (i) indemnity payments including temporary wage-replacement or permanent disability payments; and (ii) medical benefits that include payment for expenses related to injury diagnosis, treatment and rehabilitation, if necessary. On an industry-wide basis, medical benefits represent approximately 55% of benefits paid, while indemnity benefits account for the remaining 45%.

Estimated workers' compensation insurance premiums in 2005 are in excess of $40 billion nationwide. Approximately 75% of the premium volume is written through the traditional or private residual market, including commercial insurers and state-operated assigned risk pools established for high-risk employers. The balance is written through state funds, operated in states to increase competition and stabilize the market.

Indemnity benefits are established by state legislative action and rise as wages and state mandated benefits increase. Indemnity costs have increased at a rate consistent with wage inflation while medical expenses have been increasing at a double-digit pace across the United States. We believe the most significant factor affecting cost in the workers' compensation system results from incentives for injured employees to

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remain away from work, continuing to collect indemnity payments and receiving medical treatment beyond the point that is necessary.

We believe that we are more effective than traditional insurance companies and third party administrators in controlling medical and indemnity costs and returning employees to the workplace in a timely manner. Traditional efforts focus on workplace safety and medical cost containment and as a result, have reduced some expenses. These efforts have not had a significant effect on the overall system cost because they have not focused effectively on controlling wage replacement and lost productivity. Traditional insurance companies have moved toward a more comprehensive management approach in recent years including return-to-work initiatives and, while somewhat successful, they have not realized the cost reductions and claim closure outcomes that we have achieved.

Our Management Approach

We developed our approach to managing disability after observing two important characteristics of the system: (i) 15% of all injuries result in 80% of the system costs; and (ii) an employee off work for twelve weeks has a 50% likelihood of never returning to work. We developed ID15® to identify those claims likely to account for 80% of the system cost and The RTW Solution® to intervene quickly, reducing lost time and producing significant cost savings for our customers. We promptly identify (within 48 hours after being notified and with a 95% degree of accuracy) claims likely to result in significant expense and act quickly to control these costs before they are incurred or get out of hand. We intensely manage all aspects of the system: employers, injured employees, medical care providers and legal and judicial participants. We focus on controlling indemnity payments for lost wages by quickly and safely returning employees to work. As part of this strategy, we attempt to return employees to their original position or to place them in transitional, light-duty positions until they are able to resume their original jobs. By promptly returning employees to work, we substantially reduce not only indemnity payments, but also medical expense per injury. We also use other management techniques to control medical costs including contracting with provider networks, designating health care providers and performing medical fee schedule review, utilization review and doctor peer review.

We deliver our solutions to customers through operating teams. Each operating team is responsible for managing claims and is responsible for the loss experience of an employer or group of employers. Our operating teams include a mix of nurses, statutory claims administrators, assistant claims administrators and clerical support that are matched to the needs of the employer or group of employers. Operating teams meet regularly to discuss strategies for managing difficult claims and review strategies and procedures that have been successful in resolving disputes.

The following summarizes our approach to managing all participants in the disability system:

Customers. Prior to working with employers that we insure and customers to whom we provide non-insurance services, we fully explain our methods, processes, guidelines and philosophy regarding appropriate return to work and train the employer's personnel. In addition, as part of our underwriting process, we may conduct on-site risk assessments for prospective insured employers. Employers insured by ACIC and BCIC have historically agreed, as part of the insurance policy, to comply with our early intervention methods and to provide transitional, light-duty work for injured employees until such time as they are able to resume their normal positions. Compliance for insured employers who have these endorsements to their policies, is mandatory or we cancel their coverage. Our service customers have ultimate choice, but we encourage them to provide transitional work to reduce the cost of disability. To ensure that our early intervention model succeeds, we require the employer to promptly notify us of a claim's occurrence, typically within 48 hours of the injury.

Each operating team is responsible for managing its employers' workers' compensation and disability program(s). The operating team meets with each employer, manages all reported injuries and actively communicates with the employer on all open injuries. We may make workplace safety recommendations through our accident prevention team or retain a workplace safety-engineering firm to assist employers in remedying work conditions that create inappropriate risk. In addition, operating teams may recommend, for policies underwritten by ACIC or BCIC, cancellation or non-renewal for employers that fail to comply with our procedures.

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Employees. We focus on the person, not solely on the nature of the injury, in determining which claims are likely to result in higher costs and act quickly to control the related expenses. Within 48 hours of being notified of an injury, we evaluate several factors, including the type of injury, the presence of lost time, the employee's injury history and employee's psychosocial behaviors to determine whether the injury is likely to involve significant expense. In cases where there is high-cost potential, we intervene quickly, assisting the employee in obtaining appropriate medical care and developing a plan to get the employee back to work as soon as safely possible. Employers insured by ACIC and BCIC are required to provide transitional light-duty jobs for employees who cannot immediately return to their original positions. If the employee refuses transitional work, we may terminate indemnity payments, but are required to continue to provide appropriate medical benefits. For employers that we service through Absentia, we educate the employer on the benefit of return-to-work programs and work closely to find transitional light-duty opportunities for the employee.

Medical Care Providers. We actively assess, monitor and manage medical treatment and review medical expenses for each injury. We contact the employee's treating physician in cases that involve time off from work or injuries that could involve significant expense. In these cases, the physicians are asked to provide their diagnosis, plan of treatment and assess the employee's physical capabilities for transitional, light-duty work. We contract with and employ consulting physicians to assess questionable treatment plans for injured employees. These physicians discuss injured employee treatment plans with the employee's medical care providers. The goal is to ensure both an accurate diagnosis and appropriate treatment of the injury and understand the nature and extent that the diagnosis places limits on the employee's ability to return to work in either the original job or a transitional, light-duty position. We also monitor the health care provided to the injured employee to ensure that the employee receives proper treatment for the injury and that the employee does not receive services or procedures that are excessive, unnecessary or unrelated to the injury. In addition, when we believe the diagnosis of an injury or the proposed rehabilitation treatment is inappropriate, we will arrange for a second opinion with an independent medical examiner.

A medical cost management team reviews all bills submitted by medical care providers to determine if the amounts charged for the treatments are appropriate according to statutory and other negotiated fee schedules, including fee schedules negotiated through provider organizations.

In many states, including Minnesota, we cannot require that an injured employee go to a specific physician or seek treatment from a specific provider. Nevertheless, we attempt to assist the injured employee in selecting appropriate medical care providers. In Colorado and Michigan (for the first ten days after the injury), we can require that injured employees go to a physician within a designated network of medical care providers.

Legal and Judicial Participants. We seek to limit the number of disputes with injured employees by intervening early, educating, ensuring appropriate medical management and treating them with dignity and respect. As part of our process, we identify injuries that are not work related and deny those claims. We may also deny indemnity payments for a claim when we determine that no further payments are appropriate (for example, when an employee has been offered transitional, light-duty work and has refused it). In these and other circumstances, the employee may engage an attorney to represent his or her interests. Generally, if the parties are unable to resolve the matter, workers' compensation law mandates arbitration, subject to judicial review. For cases that involve adversarial proceedings, we engage one of several attorneys who are familiar with our philosophy and actively seek to resolve the dispute with the employee's attorney.

Customers

We target two specific groups of customers: (i) employers seeking workers' compensation insurance coverage for their operations in the states our insurance subsidiaries operate; and (ii) employers in need of non-insurance solutions that increase productivity and reduce the cost of disability and absence. Our insured customers have a history of workers' compensation claim costs higher than average in their industry and typically operate in manufacturing, retail, wholesale, health care and hospitality.

Our insured customer's average annual premium per policy increased 1.0% to $95,500 in 2005 from $94,600 in 2004 and $85,400 in 2003. Our ten largest customers accounted for $5.7 million or 10.8% of our

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premiums in force in 2005 compared to $5.7 million or 9.1% in 2004 and $5.7 million or 9.8% in 2003. No single customer accounted for more than 5% of in force premiums in 2005, 2004 or 2003. We renewed 65.9% of the policies scheduled to expire in 2005, whereas 78.6% and 66.0% were renewed in 2004 and 2003, respectively. Substantially all of ACIC's and BCIC's employers are in Minnesota, Colorado and Michigan. In addition to these states, we are also licensed in Connecticut, Missouri, Massachusetts, Illinois, Rhode Island, Kansas, Pennsylvania, Tennessee, Maryland, Arkansas, Iowa, Florida, New Jersey, Georgia, North Carolina, Texas, Indiana, South Dakota, Wisconsin and Oklahoma. We are evaluating opportunities to expand our insurance products on a limited basis beyond the states in which we currently operate.

We offer disability and absence management services through RTW and its Absentia division to a broad array of customers including self-insured employers, insurance companies, third-party administrators, agents and brokers, state agencies and municipalities. We currently offer these services to employers in 24 states and expect to further expand these non-insurance service offerings throughout the United States. Our service revenue increased to $4.4 million in 2005 from $633,000 in 2004 and $109,000 in 2003.

Products

Insurance Products. Our revenue is derived primarily from workers' compensation insurance premiums written by ACIC and BCIC. We began offering workers' compensation insurance products in April 1992 for ACIC and in October 2005 for BCIC. Substantially all of ACIC's and BCIC's workers' compensation products are guaranteed-cost insurance policies. Under a guaranteed-cost policy, an employer purchases an insurance policy underwritten by ACIC or BCIC and pays a premium based on projected aggregate annual payroll. We assume responsibility for the indemnity and medical costs associated with the employer's workers' compensation injuries and work closely with the employer in managing the employer's workers' compensation program.

In addition to standard guaranteed-cost policies, ACIC offers, on a limited basis, a deductible guaranteed-cost policy under which the employer is responsible for all medical and indemnity expenses up to a specific dollar amount, while we are responsible for medical and indemnity expenses over that level. We provide the same comprehensive management services for deductible guaranteed-cost policies and standard guaranteed-cost policies.

We determine the premium to be charged an employer based on several factors, including: (i) the expected dollar loss per $100 of payroll for the employer's industry; (ii) the employer's experience modifier, a measurement of the difference between the employer's past claims experience and its industry average; (iii) an upward or downward adjustment to the premium based on our assessment of the risks associated with providing coverage for the employer; and (iv) competitive market prices. An employer's expected dollar loss and experience modifier are each determined by an independent rating agency established or adopted by its state, based on a three-year average of the claims' experience of the employer and its industry.

Service Offerings. In 2004, we began a strategic initiative to offer disability management products and services directed at workers' compensation on a fee-for-service basis in order to diversify our offerings, providing us a non-risk source of revenue. This strategic initiative extends our workers' compensation and disability management services to self-insured employers and other alternative market non-risk customers. We charge a fee to these customers based on the expected number of claims managed or the time committed to the customer. We grew our services from offering solely third-party administration in 2003 to providing nine service offerings in 2005. At December 31, 2005, our annualized service revenues totaled more than $6.6 million related to this initiative. Annualized service revenue represents the estimated total value of service contracts that are in place at any point in time. In 2005, we put this business under a division of RTW that we named Absentia.

Sales and Marketing

We sell our workers' compensation insurance products to insured employers through independent insurance agencies and brokers, including several large national agencies. Agency commissions averaged 6.7% of gross premiums earned in 2005, compared to 7.1% in 2004 and 7.3% in 2003. Our ten highest producing

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agencies accounted for $21.4 million or 40.3% of premiums in force in 2005, compared to $26.1 million or 41.6% in 2004 and $22.9 million or 39.3% in 2003. No agency accounted for more than 7.1% of premiums in force in 2005, compared to 7.4% in 2004 and 6.0% in 2003. We continually market our insurance products to agencies in our core regions to keep them aware of developments in our business. Each region's underwriting team is responsible for establishing and maintaining agency relationships.

We sell our non-insurance services through sales personnel employed by us, through our independent agents and brokers and further leverage our vendor and other key relationships to introduce us to employers that need the services we offer.

Reinsurance

We purchase reinsurance to protect our insurance results from potential losses in excess of the level we are willing to accept. We share the risks and benefits of the insurance we underwrite with reinsurers through reinsurance agreements. Our primary reinsurance is excess of loss coverage that limits our per-occurrence exposure.

Under an "excess of loss" reinsurance policy, we pay a reinsurer a negotiated percentage of gross premiums earned. In return, the reinsurer assumes all risks relating to injuries over a specific dollar amount on a per occurrence basis. In Minnesota, we are required to purchase excess of loss coverage for our Minnesota policies from the Minnesota Workers' Compensation Reinsurance Association (WCRA). In states other than Minnesota, we purchase excess of loss coverage through private reinsurers.

The following table summarizes our reinsurance coverage (all losses ceded on a per occurrence basis):

	Covers Losses per Occurrence:	
	In Excess of:	Limited to:
Minnesota:		
2005 WCRA	$ 380,000	Statutory limit
Various reinsurers	$ 200,000	$380,000
2004 WCRA	$ 360,000	Statutory limit
Various reinsurers	$ 200,000	$360,000
2003 WCRA	$ 360,000	Statutory limit
Various reinsurers	$ 200,000	$360,000
Other States:		
2005 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism
2004 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism
2003 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism

We maintained our 2005 retention level in 2006 to reduce volatility in our operating results.

In 1998, we purchased excess of loss coverage through GE Reinsurance Corporation that provided reinsurance for claims occurring on or after July 1, 1998, for policies with effective dates prior to January 1, 2001, up to $275,000 in excess of $25,000 in all states, except Minnesota. In Minnesota, the coverage was $255,000 in excess of $25,000 for 1998, $265,000 in excess of $25,000 for 1999 and $275,000 in excess of $25,000 for 2000 and 2001. We purchased this coverage to reduce risk and volatility in our operating performance. Although this contract was terminated effective December 31, 2000, it remained effective in 2001 for policies in force at December 31, 2000 through expiration. Policies written or renewed with effective dates after January 1, 2001 were not covered under this lower level excess of loss reinsurance policy.

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We annually review the financial stability of our reinsurers. This review includes a ratings analysis of each reinsurer participating in an existing reinsurance contract or from whom we have a recoverable. Except for the WCRA, which is a mandatory Minnesota reinsurer and unrated by A.M. Best, the following list details our reinsurers and the current A.M. Best rating assigned to each as of March 3, 2006:

Reinsurer	A.M. Best Rating
Aspen Insurance UK Ltd	A
American Re-Insurance Company	A
Continental Casualty Company	A
Everest Reinsurance Company	A+
GE Reinsurance Corporation	A
General Reinsurance Corporation	A++
Max Re Ltd	A-
Platinum Underwriters Reinsurance, Inc.	A
SCOR Reinsurance Company	B++
Transatlantic Reinsurance Company	A+

Based on our review at December 31, 2005, we believe our reinsurance balances are collectible and expect our reinsurers to honor their obligations. Further, we are not aware of any developments with respect to these reinsurers that would result in uncollectible reinsurance balances. In the event that these reinsurers are unable to honor their obligations to us due to insolvency or otherwise, we will be required to pay these obligations ourselves and the result could have a material adverse effect on our future results of operations and financial condition.

Competition

The workers’ compensation industry is highly competitive. We compete with insurance companies, managed health care organizations and state-sponsored insurance pools for insured products and with third party administrators and specialized consulting organizations for fee-for-service business. These competitors may offer additional products and services to employers, including other forms of insurance, while we offer only workers’ compensation insurance products and disability and absence management services. As a consequence, these competitors may have certain advantages in pricing their products and services. In addition, certain competitors claim to offer a management approach and competencies similar to that offered by us. Many of our competitors have greater financial and operating resources than we have.

Competitive factors in the industry include premium rates, level of service and ability to reduce claims expense. We believe that our workers’ compensation insurance products and services are competitively priced. We also believe that our level of service and our ability to reduce claims are strong competitive factors that have enabled us to retain existing customers and attract new customers.

Insurance companies enter and exit states’ workers’ compensation markets depending on their assessment of current market conditions. Many insurance companies stopped underwriting workers’ compensation insurance during the early 1990’s due to rising costs that were not matched by reductions in statutory benefits or higher premium rates. In the mid to late 1990’s, we experienced increased market pressure as new insurance companies and single-line workers’ compensation insurance companies entered the market. In 2003, 2002 and 2001, many insurers withdrew from the markets in which we operate. In 2004 and 2005, we experienced two things: (i) large national carriers began retaining workers’ compensation risks that they did not retain in the three previous years; and (ii) insurers that had not been active for years and new carriers entered the markets in which we operate and began writing workers’ compensation insurance. Premiums rates flattened in 2004 and declined in 2005 as a result.

Insurance companies compete with us for insured customers that have lower past claims experience or lower experience “modifiers.” As a result, we experience increased competition on our renewing workers’

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compensation policies because we reduce our customers' experience modifiers. We expect to continue to experience this competition for our ACIC and BCIC customers.

Another competitive factor results from the fact that some insured employers will not purchase workers' compensation products from insurance companies with an A.M. Best (Best) rating less than "A". In addition, certain insurance companies that write umbrella policies will not provide coverage to an employer if a portion of the employer's underlying insurance policy, such as the workers' compensation portion, is written by an insurance company with a less than "A" rating. We believe that ACIC's "B+" Best rating may make it difficult for us to provide insurance products to certain employers.

ACIC's rating of "B+" (Very Good, Secure) on a scale of "A++" (Superior) to "F" (In Liquidation) was affirmed on April 19, 2005 and the outlook revised from "stable" to "positive". This represented an upgrade from a "B" rating assigned on April 1, 2004 and a "B-" rating assigned by Best in February 2002. Best assigns a rating after quantitatively and qualitatively evaluating financial condition and operating performance.

Data Management

We use several proprietary systems developed by us in our operations. These systems include:

First Install	System Description	Business Use
1995	Policy management system	Process insurance applications; issue and endorse policies
1996	Case and claims management and medical fee adjudicating systems	Manage claims, audit medical fees, pay claims, provide reports to policyholders and analyze claims data
1999	Client account management system	Billing, cash receipts, collections and agency commission systems

We continue to maintain and upgrade these systems. We also utilize third-party software to maintain financial information, prepare accounting reports and financial statements and pay vendors. We contract with a third-party provider of payroll services for payroll, benefits and human resource software services. We utilize other licensed software from national vendors to maintain our financial records, file statutory statements with insurance regulators and perform other general business.

Employees

We had 150 full-time employees at December 31, 2005. Approximately 74 worked in our administrative, marketing and financial functions and 76 served on, provided service to or managed approximately ten operating teams. None of our employees are subject to collective bargaining agreements. We believe our relationship with our employees is good.

Regulation

Our insurance subsidiaries are regulated by governmental agencies in the states in which we operate, and are subject to regulation in any state in which we provide workers' compensation products. State regulatory agencies have broad administrative power over all aspects of our workers' compensation business, including premium rates, benefit levels, policy forms, dividend payments, capital adequacy and the amount and type of our investments. These regulations are primarily intended to protect covered employees and policyholders rather than the insurance company. Both the legislation covering insurance companies and the regulations adopted by state agencies are subject to change.

Workers' compensation coverage is a creation of state law, subject to change by state legislature, and is influenced by the political processes in each state. Several states have mandated that employers receive coverage only from state operated funds. New laws affecting the workers' compensation system in Minnesota, Colorado, Michigan and any other state where we may operate, including laws that require all employers to participate in state sponsored funds or that mandate premium reductions, could have a material adverse effect on us.

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Trade Names, Trademarks and Service Marks

We use trade names, trademarks and service marks in our business. We have registered our trade names, trademarks and service marks with the United States Patent and Trademark Office in the past and intend to continue to do so in the future. We believe that the goodwill associated with many of our trade names, trademarks and service marks, particularly "ID15," "The RTW Solution" and "Absentia" are significant competitive assets in our business. We also operate our business in several states outside of Minnesota, using the RTW name in connection with the name of the State.

Company Information

Our website is http://www.rtwi.com. We make available, free of charge or through our website, our annual, quarterly and current reports and proxy statements, and any amendments to those filings, as soon as is reasonably possible after they are filed with the SEC. Information about each beneficial owner and the RTW Code of Business Ethics and Conduct are also available, free of charge, through our website. Information contained on our website is not part of this report.

Executive Officers of the Registrant

The following are our Chairman and executive officers at March 15, 2006:

Name	Age	Position
John O. Goodwyne	67	Chairman of the Board
Jeffrey B. Murphy	44	President, Chief Executive Officer and Director
Alfred L. LaTendresse	57	Executive Vice President, Chief Financial Officer and Secretary
Thomas J. Byers	50	Executive Vice President — Sales and Marketing
Keith D. Krueger	47	Vice President — Insured Products and Assistant Secretary
David M. Dietz	39	Vice President — Business Development
Patricia M. Sheveland	47	Vice President — Case and Claims Management

John O. Goodwyne joined our Board of Directors in December 2001 and became Chairman of the Board in December 2003. From 1974 to 2005, Mr. Goodwyne was the owner and President of J N Johnson Sales & Service Inc., a non-public local contractor for fire protection systems and distributor of fire extinguishers. In addition, since 1982, he has been owner and President of Low Voltage Contractors Inc., a non-public local contractor for installation and service of fire alarm, security and nurse call systems.

Jeffrey B. Murphy has served as President and Chief Executive Officer since December 2003 and was elected to the Board in March 2004. Mr. Murphy joined us in October 1994 as Controller, was promoted to Chief Financial Officer in February 2000 and became President and Chief Executive Officer in December 2003. Mr. Murphy was the Corporate Controller and held other management positions for Midcontinent Media, Inc., a non-public company, from 1989 to 1994 and served in various financial audit positions with Grant Thornton LLP from 1983 to 1989.

Alfred L. LaTendresse rejoined us in December 2001 as Executive Vice President and further assumed the roles of Chief Financial Officer, Treasurer and Secretary in December 2003. Mr. LaTendresse served as Chief Operations Officer and Chief Financial Officer for Headwater Systems, Inc., a non-public radio frequency identification technology company, from June 1999 to December 2001. Mr. LaTendresse initially joined us as Chief Financial Officer in 1990 and later added the roles of Secretary and Treasurer. Mr. LaTendresse departed from us in December 1998. Mr. LaTendresse served as a Director for us from July 1993 until January 1995 and from December 2001 to March 2004. Mr. LaTendresse is a member of the American Institute of Certified Public Accountants and the Minnesota Society of Certified Public Accountants.

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Thomas J. Byers joined us in October 2005 as Executive Vice President — Sales and Marketing. Mr. Byers previously served as Vice President, Sales and Marketing for DirectCompRx from 2004 to 2005. In addition, Mr. Byers has held executive positions as Vice President, Sales and Marketing and Director of Business Development for GatesMcDonald from 1999 to 2004 and as President of Anthem Comp Services, a subsidiary of Anthem Blue Cross Blue Shield from 1997 to 1999. Mr. Byers has been in the risk management and insurance industry since 1986. Prior to that time, he was a world-class professional athlete.

Keith D. Krueger joined us in September 1998 as the Director of Underwriting and Pricing for our Minnesota regional office. He was promoted to Director of Underwriting Services in our Home Office in October 1999 and served in this capacity until being promoted to Vice President — Underwriting and Sales in March 2002 (later renamed Vice President — Insured Products in December 2003). Mr. Krueger is also the President of ACIC and BCIC. Prior to joining RTW, Mr. Krueger was a Commercial Lines Underwriting Manager for Citizens Security Mutual Insurance from June 1997 to August 1998. From March 1995 to May 1997, Mr. Krueger was Vice President — Underwriting and Marketing for American West Insurance, a non-public company. He is a member of the American Institute for Property and Liability Underwriters and holds the CPCU designation.

David M. Dietz joined us in July 2002 as the Director of Self-Insured Services in our Home Office and was promoted to Vice President — Alternative Products (later renamed Absentia) in December 2003. Mr. Dietz became Vice President — Business Development in October 2005. Mr. Dietz came to us with fourteen years of experience in the insurance industry. Prior to joining RTW, Mr. Dietz served as Senior Vice President, Marketing and Technical Sales for Benfield Blanch, Inc. from September 2000 to July 2002. Mr. Dietz also served in various management roles for EBI Companies, Citizens Management, Inc., TIG Insurance and Sentry Insurance from 1989 to 2000.

Patricia M. Sheveland was promoted to Vice President — Case and Claims Management in January 2002. Ms. Sheveland joined us in April 1990 and has held various management positions of increasing importance, including General Manager of Operations in the Colorado regional office and Director of Operations for the Colorado, Michigan and Massachusetts regions. Prior to joining RTW, Ms. Sheveland worked as an Occupational Nurse for Kmart Corporation. She is a Registered Nurse.

ITEM 1A. *RISK FACTORS*

We derive a significant portion of our revenue from workers' compensation insurance premiums and net investment income, including gains and losses from sales of securities. An increasing portion of our revenue is derived from non-insurance disability and absence management services. We are subject to the challenges, risks, uncertainties and trends that affect the workers' compensation property and casualty insurance and the disability and absence management services sectors of our economy including the following:

- *Workers' compensation is a state regulated industry and therefore subject to change.* Workers' compensation is governed and regulated by state governmental agencies. We are subject to state regulation in any state in which we provide workers' compensation products and services, now and in the future. State regulatory agencies have broad administrative power with respect to all aspects of our business, including premium rates, benefit levels, policy forms, dividend payments, capital adequacy and the amount and type of investments. Legislation covering insurance companies and the regulations adopted by state agencies are subject to change and any change may adversely affect our operations;

- *Workers' compensation claims and related expenses can be volatile.* Workers' compensation is a long-tailed property and casualty insurance line. Claims for a given year are open on average for twelve to thirteen years and it is not unusual for workers' compensation insurers to have some claims open for thirty or more years. We have operated ACIC since 1992, BCIC since 2005 and therefore have relatively limited experience (fourteen years), and accordingly, are subject to volatility. See further discussion under "Claim and Claim Settlement Expenses";

- *Workers' compensation is subject to inflationary pressures.* Worker's compensation is subject to both medical and wage inflation. The cost of medical care has increased in excess of 10% per annum in

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recent years. This has resulted in reduced profitability in the workers' compensation insurance line. New medical procedures could evolve and new legal theories develop that could cause older claims to re-open and increase expense. See further discussion under "Claim and Claim Settlement Expenses";

- *Workers' compensation pricing is cyclical.* In 2005, premium rates on our renewing policies declined an average 2.4%. Rates increased 0.9%, 1.4%, 9.0% and 18.5% in 2004, 2003, 2002 and 2001, respectively. These increases came after many years of rate decreases that unfavorably affected the industry in the late 1990's. If we are unable to maintain rates or decrease our costs, our profit margin will be adversely affected. See further discussion under "Premiums in Force and Gross Premiums Earned";
- *Reinsurance costs for workers' compensation have increased.* Reinsurance costs in 2005 increased over the prior year, continuing a pattern of cost increases beginning in 2001. These higher costs, if not recovered through increased rates from our customers, will adversely affect our profit margin. See further discussion under "Premiums Ceded"; and
- *Profitable service revenue growth could be difficult.* The national market for disability and absence management services is highly competitive and includes national, regional and local providers. We do not have a national presence, limiting our ability to service national accounts. Any infrastructure changes to support growth in our non-insurance revenues could be expensive and diminish our earnings in the short-term.
- *Other risk factors.* The following additional important factors, among others, could affect our results and could cause our actual financial performance to differ materially from that expressed in any forward-looking statement contained herein: (i) our ability to retain renewing policies and write new business with a B+ (Very Good, Secure) rating from A.M. Best; (ii) the ability of our reinsurers to honor their obligations to us; (iii) our ability to provide our proprietary products and services to customers successfully; (iv) our ability to manage both our existing claims and new claims in an effective manner; (v) our experience with claims frequency and severity; (vi) general economic and business conditions; (xii) our ability to obtain and retain reinsurance at a reasonable cost; and (vii) interest rate changes.

ITEM 2. *PROPERTIES*

The following is a summary of properties leased by us at December 31, 2005:

Location and Description	Area Leased (in Square Feet)	Termination
Bloomington, Minnesota; Headquarters and Minnesota office space	26,301	September 2007
Denver, Colorado; Colorado office space	7,825	May 2010
Detroit, Michigan; Michigan office space	7,118	March 2007
Grand Rapids, Michigan; Michigan office space	4,571	April 2006

ITEM 3. *LEGAL PROCEEDINGS*

RTW v. Carolina Casualty: On April 12, 2005, RTW, Inc. commenced a Declaratory Judgment action in the United States District Court for the District of Minnesota against Carolina Casualty Insurance Company. In the lawsuit, RTW is seeking a Court determination that RTW is not liable for any part of a $1.9 million judgment entered against an insured of Carolina Casualty in District Court in Utah. Carolina Casualty counterclaimed against RTW alleging that RTW owes it $1.9 million, plus interest and attorneys fees.

On December 12, 2002, a Colorado employee of a Colorado care company insured by RTW's subsidiary, American Compensation Insurance Company, was injured in an automobile accident in Utah. The injured

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employee brought a separate underlying suit against Carolina Casualty's insured trucking company and driver for damages suffered as a result of the automobile accident.

While the underlying suit was pending, RTW administered and paid the workers' compensation claim of the insured employee. The total amount paid or accrued for future payment by RTW was $163,586. RTW then sought indemnification from Carolina Casualty under subrogation rights. In August 2004, Carolina Casualty's insured trucking company admitted full liability for the accident in the underlying suit.

In December 2004, Carolina Casualty agreed to pay and did pay RTW the full amount of RTW's subrogation claim. On January 14, 2005, after a jury trial on the injured employee's damages, the U.S. District Court in Utah entered a judgment of $1.9 million against Carolina Casualty's insured, which was equal to the injured employee's total damages, including $1,250,000 in general damages, less the $163,586 representing workers compensation benefits that had been paid, or accrued for future payments by RTW. Carolina Casualty subsequently settled the lawsuit with the injured worker for $1.8 million

In preparing the December 2004 settlement agreement for the workers' compensation subrogation claim, counsel appointed by Carolina Casualty for its insured inserted the provision that Carolina Casualty in its counterclaim alleged required full indemnification by RTW of any amounts that Carolina Casualty pays the injured employee as a result of the liability of Carolina Casualty's insured.

After Carolina Casualty's attorneys requested indemnification pursuant to this provision, RTW commenced the Declaratory Judgment suit described above. A similar Utah declaratory action initiated by Carolina Casualty and its insured has been dismissed and all matters will now proceed solely in United States District Court for the District of Minnesota.

RTW believes that it has good and meritorious defenses to the indemnification claims of Carolina Casualty. Discovery has been completed and RTW has filed a summary judgment motion for a declaration that it has no liability to Carolina Casualty. In opposing RTW's motion, Carolina Casualty apparently dropped its claim for indemnification with respect to the $1,250,000 portion of the judgment relating to general damages and requested that judgment be entered finding the claimed indemnity provision otherwise binding and enforceable. A hearing on the summary judgment motion has been scheduled before the Court for April 19, 2006 and a decision is expected sometime within 90 days of that date.

Other litigation: In the ordinary course of administering our workers' compensation programs, we are routinely involved in the adjudication of claims resulting from workplace injuries. We are not involved in any other legal or administrative claims that we believe are likely to have a material adverse effect on our financial condition or results of operations.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

None.

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PART II

ITEM 5. *MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS*

QUARTERLY STOCK PRICE COMPARISON AND DIVIDENDS

Our shares are traded publicly on The Nasdaq Stock Market under the symbol RTWI. The table below sets forth the range of high and low sale prices for our stock for each quarter during the past two years. We had approximately 1,800 shareholders of our common stock at the close of trading on March 7, 2006.

Fiscal Year:	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005				
High	$ 12.37	$ 10.86	$ 11.40	$ 12.08
Low	8.27	8.44	9.35	9.05
2004				
High	$ 7.12	$ 7.01	$ 7.29	$ 9.48
Low	5.83	5.76	5.71	6.40

We have never paid cash dividends on our common stock. We intend to retain any and all income for use in our business and do not anticipate paying cash dividends in the foreseeable future. Any future determination as to payment of dividends will depend on our financial condition and results of operations and such other factors deemed relevant by the Board of Directors.

RECENT SALES OF UNREGISTERED EQUITY SECURITIES

We had no unregistered sales of equity securities during the quarter ended December 31, 2005.

ISSUER REPURCHASES OF EQUITY SECURITIES

We did not repurchase any of our equity securities during the quarter ended December 31, 2005.

ITEM 6. *SELECTED FINANCIAL DATA*

The Consolidated Statements of Income data set forth below for each of the three years in the period ended December 31, 2005, and the Consolidated Balance Sheet data at December 31, 2005 and 2004 are derived from, and are qualified by reference to, the audited Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K. The Consolidated Statements of Income data set forth below for the two years in the period ended December 31, 2002, and the Consolidated Balance Sheet data at December 31, 2003, 2002 and 2001, are derived from audited Consolidated Financial Statements not included herein. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Total revenues	$ 59,011	$ 58,687	$ 51,383	$ 67,023	$ 95,570
Income (loss) from operations	10,079	8,072	6,635	10,325	(15,761)
Income (loss) before income taxes	10,079	8,072	6,587	10,162	(16,272)
Net income (loss)	5,998	9,941	6,999	14,319	(25,215)
Basic income (loss) per share	1.11	1.90	1.37	2.78	(4.89)
Diluted income (loss) per share	1.06	1.81	1.32	2.78	(4.89)
Total assets	228,471	220,507	202,168	223,834	218,307
Notes payable	—	—	—	1,250	4,500
Total shareholders' equity	50,578	45,531	35,587	29,810	14,222
Other information (unaudited):					
Premiums in force at year end	52,900	62,700	58,100	54,200	83,700
Annualized service revenue	6,600	5,000	—	—	—

Annualized service revenue represents the estimated total value of service contracts that are in place at any point in time.

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ITEM 7. *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

RTW, INC.

**Management's Discussion and Analysis of
Financial Condition and Results of Operations**

OVERVIEW

The Company — RTW, Inc. (RTW) provides disability and absence management services, directed today primarily at workers' compensation to: (i) employers insured through our wholly-owned insurance subsidiary, American Compensation Insurance Company (ACIC) and its wholly-owned insurance subsidiary, Bloomington Compensation Insurance Company (BCIC); (ii) self-insured employers on a fee-for-service basis; (iii) state-sponsored assigned risk plans on a percent of premium basis; (iv) other insurance companies; and (v) to agents and employers on a consulting basis, charging hourly fees through RTW and its Absentia℠ division. ACIC offers guaranteed cost workers' compensation insurance to employers located primarily in Minnesota, Michigan and Colorado and is licensed in twenty-three states. BCIC began underwriting business in October 2005 and offers guaranteed-cost workers' compensation insurance to selected employers only in Minnesota. Collectively, "we," "our" and "us" refer to RTW, ACIC, BCIC and Absentia in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We developed two proprietary systems to manage disability: (i) ID15®, designed to quickly identify early those injured employees who are likely to become inappropriately dependent on disability system benefits; and (ii) The RTW Solution®, rapid intervention in and intensive management of potentially high-cost injuries, designed to lower employers' disability costs and improve productivity by returning injured employees to work as soon as safely possible. We support these proprietary management systems with state-of-the-art technology and talented employees dedicated to our vision of transforming people from absent or idle to present and productive. Our insurance subsidiaries are domiciled in Minnesota and operated primarily in Minnesota, Michigan and Colorado in 2005, 2004 and 2003. Absentia serviced customers in six states in 2004 and expanded to 18 states by December 31, 2005.

On April 14, 2005, A.M. Best Co. (Best) affirmed the financial strength rating of "B+" (Very Good, Secure) for ACIC and revised its outlook to "positive" from "stable". The rating reflects our improved capitalization and profitability over the last three years. ACIC increased its statutory capital and surplus to $43.6 million at December 31, 2005 and $38.5 million at December 31, 2004 from $33.0 million at December 31, 2003 as a result of profitability in 2005 and 2004. We believe that our "B+" rating from A.M. Best may create a barrier in certain circumstances for us as there are agents and employers that will only do business with insurers rated "A-" or better.

Additional information about RTW is available on our website at www.rtwi.com.

Significant Accounting Policies — Our significant accounting policies are summarized in Note 1 — "Summary of Significant Accounting Policies" included in the accompanying Notes to Consolidated Financial Statements. Our significant accounting policies include those policies related to our accounting for: (i) premiums earned; (ii) unpaid claim and claim settlement expenses, including reserves for incurred but not reported claims and the related reinsurance recoverables; (iii) deferred policy acquisition costs; (iv) income taxes and deferred income taxes; and (v) investments. These accounting policies are discussed within each section of this "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Service revenue includes revenues for services that are: (i) billed as a percent of premium of insurance policies issued by non-affiliated third-party insurers, including state-assigned risk plans; (ii) billed based on the number and type of claims serviced; (iii) billed on an hourly basis based on direct activity; or (iv) billed based on contract duration. Service revenue earned as a percent of premium is recognized over the life of the underlying insurance policy. All other service revenue is recognized over the term of the contract. The excess

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of billed service revenue over earned amounts is recognized as a liability and included in "Accrued expenses and other liabilities" on our Consolidated Balance Sheet.

Off-Balance Sheet Arrangements — We do not have any off-balance sheet arrangements.

Financial Summary — This financial summary presents our discussion and analysis of the consolidated financial condition and results of operations of RTW, Inc. This review should be read in conjunction with the Consolidated Financial Statements at December 31, 2005.

The following table provides an overview of our key operating results (000's, except per share amounts):

	Year Ended December 31,		
	2005	2004	2003
Gross premiums earned	$ 59,872	$ 63,370	$ 54,431
Premiums earned	49,420	53,682	46,290
Service revenue	4,398	633	109
Total revenues	59,011	58,687	51,383
Claim and claim settlement expenses	30,807	35,536	27,256
Income before income taxes	10,079	8,072	6,587
Net income	5,998	9,941	6,999
Diluted income per share	$ 1.06	$ 1.81	$ 1.32

We reported net income of $6.0 million in 2005 compared to net income of $9.9 million in 2004 and $7.0 million in 2003. We reported diluted income per share of $1.06 in 2005 compared to diluted income per share of $1.81 in 2004 and $1.32 in 2003. The primary factors affecting our 2005 operating results included the following:

- Gross premiums earned decreased 5.5% to $59.9 million in 2005 from $63.4 million in 2004 primarily due to a decrease in average premiums in force to $57.9 million for 2005 from $61.5 million in 2004. See further discussion under "Premiums In Force and Gross Premiums Earned";

- Premiums earned decreased 7.9% to $49.4 million in 2005 from $53.7 million in 2004. Premiums earned in 2005 reflect the decrease in gross premiums earned from 2004, and an increase in final audit premiums earned in 2005 compared to 2004, offset by an increase in premiums ceded as our cost of excess of loss reinsurance increased in 2005;

- Service revenue from our Absentia division grew to $4.4 million in 2005 from $633,000 in 2004;

- Total revenues included $4.6 million of net investment income and $580,000 of net realized investment gains in 2005 compared to $3.7 million of net investment income and $705,000 of net realized investment gains in 2004;

- Claim and claim settlement expenses decreased to 62.3% of premiums earned for 2005 from 66.2% for 2004. We benefited from improving our claim management capabilities and closing old claims, realizing favorable development of $5.5 million in 2005 compared to $7.0 million in 2004. Claim and claim settlement expenses also decreased in 2005 due to the decrease in gross premiums earned in 2005 compared to 2004. See further discussion under "Claim and Claim Settlement Expenses"; and

- Income tax expense in 2005 includes adjustments for changes in estimates from prior periods that have affected the year-to-year comparison of income tax expense. Income tax benefit for 2004 includes a $3.6 million benefit resulting from the reversal of the remaining valuation allowance on our income tax asset at December 31, 2004. See further discussion under "Income Taxes."

We expect to grow 2006 premiums in force opportunistically as we expand to areas outside our traditional markets. We also anticipate that premium rates will decrease slightly in 2006 as the markets in which we operate continue to become more competitive. We will focus on insurance profitability by: (i) writing new business in niches that are less sensitive to soft market pricing; (ii) aggressively managing and closing claims;

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(iii) reviewing policy profitability at renewal and removing unprofitable accounts; and (iv) aggressively managing policy acquisition costs.

We expect to increase non-insurance revenue significantly in 2006 as we continue to provide services to employers insured through the Minnesota Assigned Risk Plan and add new customers. General and administrative expenses will increase as we: (i) continue to hire and position for the future; and (ii) grow service revenue.

In the following pages, we take a look at the 2005, 2004 and 2003 operating results for items in our Consolidated Statements of Income and also explain key Consolidated Balance Sheet accounts in greater detail.

RESULTS OF OPERATIONS

Total revenues: Our total revenues include premiums earned, net investment income, net realized investment gains (losses) and service revenue. The following table summarizes the components of our revenues and premiums in force (000's):

	Year Ended December 31,		
	2005	2004	2003
Gross premiums earned	$ 59,872	$ 63,370	$ 54,431
Premiums ceded	(10,452)	(9,688)	(8,141)
Premiums earned	49,420	53,682	46,290
Net investment income	4,613	3,667	4,299
Realized investment gains (losses):			
Realized investment gains	584	708	685
Realized investment losses	(4)	(3)	—
Net realized investment gains	580	705	685
Service revenue	4,398	633	109
Total revenues	$ 59,011	$ 58,687	$ 51,383

	2005	2004	2003
Premiums in force by region at year-end:			
Minnesota	$ 32,300	$ 37,800	$ 32,000
Colorado	8,300	10,600	13,000
Michigan	12,300	14,300	13,100
Total premiums in force	$ 52,900	$ 62,700	$ 58,100

Premiums In Force and Gross Premiums Earned: Premiums on workers' compensation insurance policies are our largest source of revenue. Premiums earned are the gross premiums earned by us on in force workers' compensation policies, net of the effects of ceded premiums under reinsurance agreements.

The premium we charge a policyholder is a function of the policyholder's payroll, industry and prior workers' compensation claims experience. In underwriting a policy, we receive policyholder payroll estimates for the ensuing year. We record premiums written on an installment basis matching our billing to the policyholder and earn premiums on a daily basis over the life of each insurance policy based on the payroll estimate. We record the excess of premiums billed over premiums earned for each policy as unearned premiums on our balance sheet. When a policy expires, we audit policyholder payrolls for the policy period and adjust the estimated payroll to its actual value. The result is a "final audit" adjustment recorded to premiums earned when the adjustment becomes known. Final audit premiums recognized during the period include billed final audit premiums plus (or minus) the change in estimate for premiums on unexpired and expired unaudited policies.

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Our premiums in force decreased to $52.9 million at December 31, 2005 from $62.7 million at December 31, 2004 and $58.1 million at December 31, 2003. Premiums in force in our Minnesota, Colorado and Michigan regions decreased $5.5 million, $2.3 million and $2.0 million, respectively, at the end of 2005 compared to the end of 2004. Average premiums in force decreased to $57.9 million in 2005 from $61.5 million in 2004 but increased from $53.6 million in 2003. Premiums in force decreased in 2005 as we focused on maintaining adequate pricing and declined business where we could not get a price that gave us an appropriate opportunity to earn a profit. We are in the midst of a soft cycle in the insurance market. We write to achieve an expected profit, no matter what our competitors do. In 2004 and 2003, we were able to grow our business while gaining appropriate pricing on our policies written. Our average annual premium per policy increased to $95,500 in 2005 from $94,600 in 2004 and $85,400 in 2003.

Our gross premiums earned decreased 5.5% to $59.9 million in 2005 from $63.4 million in 2004. This decrease resulted primarily from: (i) the decrease in average premiums in force, offset by; (ii) a slight increase in final audit premiums which increased gross premiums earned by $1.4 million in 2005 compared to $1.2 million in 2004.

Our gross premiums earned increased 16.5% to $63.4 million in 2004 from $54.4 million in 2003. This increase resulted primarily from: (i) the increase in average premiums in force, offset by; (ii) an increase in final audit premiums which increased gross premiums earned by $1.2 million in 2004 compared to a $323,000 increase in 2003.

Premium rates on renewing policies decreased an average of 2.4% in 2005, compared to increases of 0.9% and 1.4% in 2004 and 2003, respectively. The 2005 decrease reflects heightened price competition due to the soft insurance market cycle in the markets in which we write premiums.

Premiums Ceded: Reinsurance agreements enable us to share certain risks with other insurance companies. We purchase reinsurance to protect us from potential losses in excess of the level we are willing to accept. We expect the companies to which we have ceded reinsurance to honor their obligations. In the event that these companies are unable to honor their obligations to us, we will be required to pay the underlying obligations ourselves. We are not aware of any developments with respect to any of our reinsurers that would result in our current reinsurance balances becoming uncollectible.

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Under our excess of loss reinsurance policies, we pay reinsurers to limit our per-incident exposure and record this cost to premiums ceded as a reduction of gross premiums earned. In Minnesota, we are required to purchase excess of loss coverage for our Minnesota policies from the Minnesota Workers' Compensation Reinsurance Association (WCRA). We purchased reinsurance for 2005 in our states other than Minnesota from four reinsurers. The following table summarizes our reinsurance coverage (all losses ceded on a per occurrence basis):

	Covers Losses per Occurrence:	
	In Excess of:	Limited to:
Minnesota:		
2005 WCRA	$380,000	Statutory limit
Various reinsurers	$200,000	$380,000
2004 WCRA	$360,000	Statutory limit
Various reinsurers	$200,000	$360,000
2003 WCRA	$360,000	Statutory limit
Various reinsurers	$200,000	$360,000
Other States:		
2005 Various reinsurers	$200,000	$20 million, excluding acts of terrorism
2004 Various reinsurers	$200,000	$20 million, excluding acts of terrorism
2003 Various reinsurers	$200,000	$20 million, excluding acts of terrorism

Premiums ceded to reinsurers increased to $10.5 million in 2005 from $9.7 million in 2004. As a percent of gross premiums earned, premiums ceded increased to 17.5% in 2005 from 15.3% in 2004. The increase in premiums ceded reflects a rate increase for excess of loss reinsurance coverage in all regions in 2005. The rates we are charged are lower for Minnesota risks compared to our other states risks.

Premiums ceded to reinsurers increased to $9.7 million in 2004 from $8.1 million in 2003. The increase in premiums ceded resulted primarily from: (i) our cost for excess of loss reinsurance coverage increased substantially in all regions in 2004; (ii) gross premiums earned in 2004 increased from 2003; and (iii) the 2004 results include a $129,000 decrease in excess of loss premiums ceded, resulting from a change in estimated reinsurance cost for the WCRA compared to a $92,000 increase in excess of loss premiums ceded in 2003.

2006 Outlook: The 2006 outlook for premiums in force, gross premiums earned and premiums ceded include the following factors:

- We expect increased price competition in the markets in which we operate, which will exert downward pressure on premium pricing on new and renewal policies as national and regional carriers focus on writing and retaining workers' compensation insurance. We expect to add new agency relationships in 2006 and terminate some that are not performing well. We expect growth in premiums in force in 2006 as we expand our underwriting niche, write multi-state policies and begin leveraging unused licenses;

- Our 2006 gross premiums earned will move in the same direction as our premiums in force, lagging slightly as premiums are earned over the term of the insurance policy; and

- We continue to limit our exposure to large losses by purchasing excess of loss reinsurance for losses in excess of $200,000 in all our regions in 2006. The cost of excess of loss reinsurance has decreased slightly or remained the same for all regions in 2006; however, because of a shift in premiums earned to higher reinsurance cost states, we expect premiums ceded under excess of loss policies to increase as a percent of gross premiums earned in 2006 when compared to the results attained for 2005.

Net Investment Income and Net Realized Investment Gains (Losses): Net investment income includes earnings from our investment portfolio, reduced by expenses incurred in managing the portfolio. Our net

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realized investment gains (losses), displayed separately on our accompanying Consolidated Statements of Income, include gains and losses from sales of securities.

We currently invest entirely in U.S. domiciled investment-grade taxable and tax-exempt fixed maturity investments and classify our investments as available-for-sale. Our primary investment objective is to maintain a diversified, high-quality, fixed-investment portfolio structured to maximize our after-tax net investment income without taking inappropriate credit risk. For further discussion of investments, see the "Investments" section of this Management's Discussion and Analysis.

At December 31, 2003, we were invested entirely in U.S. domiciled investment-grade taxable fixed maturity investments. We added U.S. domiciled investment-grade tax-exempt fixed maturity investments in 2004 to take advantage of the tax benefits of those securities and interest rate spreads. We held cash and cash equivalents totaling $21.9 million and $39.4 million at December 31, 2005 and 2004, respectively. In order to reduce the near term interest rate risk on the portfolio, we built our cash position throughout 2003 and 2004 by holding cash received on mortgage-backed security prepayments and through sales of securities expecting interest rates would rise in 2005. During 2005, we began to invest a portion of our cash and cash equivalents into longer maturing, fixed-rate securities. We intend to hold our available-for-sale investments to maturity.

Net investment income increased to $4.6 million in 2005 from $3.7 million in 2004. In late 2004, yields on short maturity instruments began to improve. This improvement continued throughout 2005 and resulted in a relatively "flat" yield curve. The yield curve change benefited our yields on cash and cash equivalents. Later in the year, we further enhanced our net investment income realized on cash and cash equivalents by structuring a cash ladder to improve yields without taking undue risk. Total invested assets (investments, cash and cash equivalents) increased from $126.3 million at December 31, 2004 to $129.1 million at December 31, 2005. Our book investment yield, excluding cash and cash equivalents, decreased to 3.9% at December 31, 2005 from 4.0% at December 31, 2004. As maturities occurred and pay-downs on mortgage backed securities occurred, we decreased our average maturity and duration to minimize interest rate risk. The investment yields realized in future periods will be affected by yields attained on new investments.

Net investment income decreased to $3.7 million in 2004 from $4.3 million in 2003. This decrease in net investment income resulted from the decrease in our average book interest rates during 2004 and was partially offset by the increase in assets invested, to $86.9 million in 2004 from $77.1 million in 2003. Interest rates at December 31, 2004 were at approximately the same levels as December 2003. Approximately $7.5 million of mortgage-backed securities in our investment portfolio were repaid earlier than expected due to consumer mortgage refinancing and normal repayment patterns that occurred in 2004. An additional $11.3 million of other securities matured during 2004. The funds that became available could not be reinvested at comparable rates, causing the book investment yield to decline from 2003. Our book investment yield, excluding cash and cash equivalents, declined to 4.0% at December 31, 2004 from 4.6% at December 31, 2003.

In 2005, 2004 and 2003, we sold certain securities within the portfolio to take advantage of favorable interest rates and realized net investment gains totaling $580,000, $705,000 and $685,000, respectively.

2006 Outlook: We expect that income from our investment portfolio for 2006 will be affected by the following:

- We expect interest rates to increase in 2006. The timing of any such rate increases is unknown at this time. We intend to invest our excess cash into higher yielding investments in 2006 as rates increase;
- We expect that short-term interest rates on cash and cash equivalents will increase in 2006 as the Federal Reserve Board increases its rates;
- Our investment in tax-exempt municipal bonds will reduce net investment income and favorably affect net income as investment yields will be lower on a pre-tax basis but will be higher on a tax-adjusted basis;
- Cash flows for 2006 are expected to be affected by decreases in cash flows resulting from claim payments on claims from 2005 and prior years offset by cash flows from our premiums and service revenue;

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- Recognition of realized investment gains and losses will depend on sales of our investments, if any, to meet our short-term cash requirements or as we reposition our portfolio to further manage our portfolio returns. We do not anticipate selling any securities in 2006; and

- New and renegotiated reinsurance treaties may affect our future cash flow and future net investment income.

Service Revenue: Service revenue includes revenues for services that are: (i) billed as a percent of premium of insurance policies issued by non-affiliated third-party insurers; (ii) billed based on the number and type of claims serviced; (iii) billed on an hourly basis based on direct activity; or (iv) billed based on contract duration. Our customers include the Minnesota Workers' Compensation Assigned Risk Plan (ARP), self-insured employers, other insurance companies, insurance agents and local governmental units. Service revenue grew to $4.4 million in 2005 from $633,000 in 2004 and $109,000 in 2003. Annualized service revenue was $6.6 million at December 31, 2005. Annualized service revenue represents the estimated total value of service contracts that are in place at any point in time.

2006 Outlook: Service revenue will increase significantly in 2006 due to the following:

- In March 2004, we were awarded a three-year contract to service 25% of the ARP. We are paid a fee based on a percent of the premium we service and began servicing new ARP business on July 1, 2004 and renewal ARP business on September 1, 2004. During 2005, we continued to ramp up our servicing of this contract, achieving a full "25%" share in September 2005. The total annual premium in the ARP at December 31, 2005 is approximately $85.1 million, which decreased from $100.7 million at December 31, 2004. We expect the total annual premium in the ARP to continue to decrease slightly during 2006, which will exert downward pressure on our related revenue, offset by being at a full "25%" servicing rate for the entire year; and

- We continue to market our alternative products aggressively inside and outside the regions in which we currently operate. We expect service revenue will increase as new customers become aware of and purchase these services. The ultimate effect on service revenue is unknown at this time.

Total Expenses: Our expenses include claim and claim settlement expenses, policy acquisition costs, general and administrative expenses and income taxes.

Claim and Claim Settlement Expenses: Claim expenses refer to medical and indemnity benefits that we paid or expect to pay to claimants for past events we insured. The costs of investigating, resolving and processing these claims are referred to as claim settlement expenses. We record these expenses, net of amounts recoverable under reinsurance contracts, to claim and claim settlement expenses in the accompanying Consolidated Statements of Income.

Claim and claim settlement expenses are our largest expense and result in our largest liability. We establish reserves that reflect our estimates of the total claim and claim settlement expenses we will ultimately have to pay under our workers' compensation insurance policies. These include claims that have been reported but not yet settled and claims that have been incurred but not yet reported to us. For further discussion of reserve determination, see the "Unpaid Claim and Claim Settlement Expenses" and "Reinsurance Recoverables" sections of this Management's Discussion and Analysis.

The number of estimated ultimate claims by accident year decreased to approximately 9,500 in 2005 from 11,800 in 2004 and 9,600 in 2003, correlating directly to the decrease in gross earned premiums. The gross and net average estimated cost per claim (which includes both claim and claim settlement expenses) totaled approximately $5,200 and $4,400 in 2005 compared to $5,100 and $4,200 in 2004 and $5,000 and $4,200 in 2003, respectively. The 2005 and 2004 increases in gross and net average estimated cost per claim, when compared to the 2003 data, is primarily the result of increases in claim severity, offset by our improved ability to manage cases and claims. The trend of increasing severity is attributable to a combination of factors that include increasing medical and indemnity costs (reimbursements to injured workers for lost wages) per claim and a decline in the number of claims being reported over the last several years. The declining frequency

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of claims contributes to the increasing severity trend because the frequency decline has been concentrated in less expensive claims (claims involving less time-off from work and less severe injuries).

At December 31, 2005, the number of claims reported but unpaid (open claims) and the approximate average gross and net reserves on the claims occurring in the following accident years were:

	Open Claims	Average Gross Reserve	Average Net Reserve
2005	1,032	$ 28,800	$ 23,800
2004	223	$ 104,200	$ 62,400
2003	95	$ 116,700	$ 67,400

The average gross and net reserves per claim are less in 2005 than in 2004 and 2003 as the open claims include newly reported claims from the last half of 2005, including many with much lower severity that have not had time to close, as well as new claims that are incurred but not yet reported. The remaining open claims from 2004 and 2003 are primarily claims with significant injury characteristics resulting in the increase in outstanding average gross and net reserves per claim.

2005 Compared to 2004: Claim and claim settlement expenses decreased to $30.8 million in 2005 from $35.5 million in 2004. As a percent of premiums earned, claim and claim settlement expenses decreased to 62.3% in 2005 from 66.2% in 2004. These changes are due to the following:

- The decrease in gross premiums earned as discussed above under "Premiums In Force and Gross Premiums Earned;"
- The 2005 results include a $5.5 million decrease in prior accident years' reserves for unpaid claim and claim settlement expenses compared to the 2004 results, which include a $7.0 million decrease in prior accident years' reserves. Our estimate for unpaid claim and claim settlement expenses decreased in 2005 due to the following: (i) our ability to manage and close claims has improved over our historical experience; (ii) the re-underwriting of our book of business has resulted in claims with profiles different than experienced historically; and (iii) our estimate of the liability for unpaid claim and claim settlement expenses is volatile due to our relatively limited fourteen-year historical claim data and our small claim population; and
- Claim costs continued to reflect increasing medical and indemnity costs in accident year 2005 as compared to accident year 2004 resulting from inflationary pressures.

2004 Compared to 2003: Claim and claim settlement expenses increased to $35.5 million in 2004 from $27.3 million in 2003. As a percent of premiums earned, claim and claim settlement expenses increased to 66.2% in 2004 from 58.9% in 2003. These changes are due to the following:

- The increase in gross premiums earned as discussed above under "Premiums In Force and Gross Premiums Earned;"
- The 2004 results include a $7.0 million decrease in prior accident years' reserves for unpaid claim and claim settlement expenses compared to the 2003 results, which include a $6.7 million decrease in prior accident years' reserves. Our estimate for unpaid claim and claim settlement expenses decreased in 2004 due to the following: (i) our ability to manage and close claims has improved over our historical experience; (ii) the re-underwriting of our book of business has resulted in claims with profiles different than experienced historically; and (iii) our estimate of the liability for unpaid claim and claim settlement expenses is volatile due to our relatively limited historical claim data and our small claim population; and
- Claim costs continued to reflect increasing medical and indemnity costs in accident year 2004 as compared to accident year 2003 resulting from inflationary pressures.

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2006 Outlook: We expect that claim and claim settlement expenses will be affected by the following factors:

- Claim costs will continue to be affected by: (i) increases in medical and indemnity costs resulting from inflationary changes; (ii) severity experienced in current and future periods in our policyholder base; (iii) changes resulting from increases in operating efficiency and effectiveness realized through enhancements to our internal processes and procedures, including changes to our proprietary computer systems; and (iv) legislative changes that affect benefits payable under workers' compensation laws;

- Increases (decreases) in premium rates will have a direct affect on gross premiums earned without a corresponding effect on claim and claim settlement expenses, ultimately affecting claim and claim settlement expense as a percent of premiums earned. Legislative changes in estimated loss costs, increased competition and changes in customer loss experience may offset or eliminate the effect of any rate improvement; and

- Continued application of our claims management technology and methods to all open claims.

The ultimate effect of the above factors on claim and claim settlement expenses is unknown at this time.

Policy Acquisition Costs: Policy acquisition costs are costs directly related to writing an insurance policy and include commissions, state premium taxes, underwriting personnel costs and expenses, sales and marketing costs and other underwriting expenses, less ceding commissions received from our reinsurers. Ceding commissions are amounts that reinsurers pay to us for placing reinsurance with them.

The following table summarizes policy acquisition costs (000's):

	Year Ended December 31,		
	2005	2004	2003
Commission expense	$ 3,986	$ 4,489	$ 4,000
Premium tax expense	1,153	1,147	997
Other policy acquisition costs	2,815	2,769	3,381
Direct policy acquisition costs	7,954	8,405	8,378
Ceding commission on excess of loss reinsurance	(2,498)	(2,360)	(1,500)
Total policy acquisition costs	$ 5,456	$ 6,045	$ 6,878

Under certain of our excess of loss reinsurance policies, the reinsurer returns a portion of the premiums we cede as ceding commissions to reimburse us for our cost of placing and managing policies. Ceding commissions received under excess of loss reinsurance policies totaled $2.5 million in 2005 compared to $2.4 million in 2004 and $1.5 million in 2003. These ceding commissions reduced our policy acquisition costs. Excluding the effect of ceding commissions, policy acquisition costs were $8.0 million in 2005, $8.4 million in 2004 and $8.4 million in 2003. As a percent of gross premiums earned, direct policy acquisition costs were 13.3% in 2005 compared to 13.3% in 2004 and 15.4% in 2003. The changes in 2005, 2004 and 2003 reflect the following:

- Gross premiums earned decreased in 2005 compared to 2004 resulting in a corresponding decrease in policy acquisition costs;

- Commission expense decreased to 6.7% of gross premiums earned in 2005 from 7.1% in 2004 and 7.3% in 2003. The decreased commission rates are the result of the decrease in our new business in 2005 relative to 2004 and 2003 and the focus on reducing the commissions we pay. In all of our markets, we believe the commission rates we pay are marketplace competitive;

- Premium tax expense paid to states was 1.9% of gross premiums earned in 2005, 1.8% of gross premiums earned in 2004 and 1.8% of gross premiums earned in 2003; and

- Other policy acquisition costs consist of personnel and overhead costs, various state and regulatory assessments related to second injury funds and mandatory state pools, payroll audit vendor costs and

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the net effect of assigned risk plan activity in the states in which we operate. Other policy acquisition costs were affected by the following: (i) in 2005, we recorded a $169,000 increase in other policy acquisition costs reflecting a re-allocation of prior year mandatory reinsurance pool expenses, compared to a $468,000 increase recorded in 2004 and a $1.5 million increase recorded in 2003; and (ii) a general change related to the increase or decrease in gross premiums earned. Excluding the mandatory pool re-allocation discussed above, other policy acquisition costs as a percentage of gross premiums earned were 4.4% in 2005, 3.6% in 2004 and 3.6% in 2003.

2006 Outlook: We expect that policy acquisition costs in 2006 will be affected by the following:

- Our commission expense will continue to be affected by how much new business we write relative to renewal business as we pay higher commissions on new policies;
- Premium tax accrual rates will remain relatively constant at approximately 2.0% in 2006; and
- Other underwriting expenses will continue to be affected by pool reimbursements offset by pool disbursements, the effect of which is not known at this time.

General and Administrative Expenses: Our general and administrative expenses include personnel costs, office rent, certain state administrative charges based on premiums and other costs and expenses not specific to claim and claim settlement expenses or policy acquisition costs. All costs associated with our service business are included in general and administrative expenses.

General and administrative expenses increased to $12.7 million in 2005 from $9.0 million in 2004 and $10.6 million in 2003. As a percent of total revenues, general and administrative expenses increased to 21.5% in 2005 from 15.4% in 2004 and 20.7% in 2003. These changes reflect the following:

- General and administrative expenses increased in 2005 from 2004 levels. Significant changes include: (i) we added staff and other general and administrative expenses to deliver the services associated with the service revenue increase to $4.4 million in 2005 from $633,000 in 2004; (ii) bonus expense was $1.5 million in 2005 compared to $1.3 million in 2004; and (iii) bad debt expense was $450,000 in 2005 compared to a benefit of $108,000 in 2004, principally due to customer bankruptcies in our Michigan region; and;
- General and administrative expenses decreased in 2004 from 2003 levels. Significant changes include: (i) the reversal of a previously recorded contingent reinsurance commission resulting in $375,000 in expense in 2003; (ii) bonus expense was $1.3 million in 2004 compared to $941,000 in 2003; (iii) bad debt expense was $400,000 lower in 2004; and (iv) we operated with fewer average headcount in 2004 compared to 2003.

2006 Outlook: We expect that general and administrative expenses will be affected by the following:

- Our contract to manage the ARP business and continued growth in our service revenue will require staff additions and increase our general and administrative expense;
- We will make appropriate investments in infrastructure to position us for future growth of our service revenue and to continue to support and enhance our core insurance operations;
- Although we have no current plans to open additional offices in 2006, if growth opportunities warrant opening a new office, we will evaluate the opportunity as presented; and
- All expenses will continue to be aggressively managed and reduced where appropriate.

Income Taxes: We incur federal income taxes on our combined service organization (RTW and Absentia) operations and insurance operations (ACIC and BCIC). We incur state income taxes on the results of our service organization’s operations and incur premium taxes in lieu of state income taxes for our insurance operations. In certain instances, we may incur state income taxes on our insurance operations. Additionally, certain provisions of the Internal Revenue Code adversely affect our taxable income by accelerating recognition and payment of income taxes. Adjustments to book income generating current tax liabilities

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include limitations on the deductibility of unpaid claim and claim settlement expenses, limitations on the deductibility of unearned premium reserves and limitations on deductions for bad debt reserves.

In assessing our deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. We consider recent operating results, the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2001, we established a $14.5 million valuation allowance (allowance) against deferred tax assets resulting in a corresponding increase in income tax expense. This allowance decreased by $7.9 million to $6.6 million at December 31, 2002 as a result of the income we earned in 2002 and federal tax refunds totaling $3.8 million resulting from a change in Federal tax law. This allowance was further decreased by $3.0 million in 2003 to $4.0 million as a result of the income we earned in 2003 and our analysis of projected taxable income. We eliminated the deferred tax valuation allowance and recorded a $4.0 million benefit to income taxes in 2004. Income tax expense for 2005 does not include a benefit from reducing the valuation allowance since it was fully utilized in prior years. We expect our deferred tax assets at December 31, 2005 to be realized as a result of future income and the reversal of existing taxable temporary differences.

After adjusting for the valuation allowance benefit recorded in 2004 and 2003, income tax expense was $4.1 million for 2005 compared to $2.2 million for 2004 and $2.6 million for 2003. As a percent of income before income taxes, the income tax expense before any benefit from reducing the allowance was 40.5% of the income before income taxes in 2005 compared to 26.9% in 2004 and 40.2% in 2003. The income tax expense percentages for 2005, 2004 and 2003 have been affected by: (i) our income from operations; (ii) the amount of municipal bond income we have earned; (iii) adjustments for changes in estimates from prior periods that have affected the year-to-year comparison of income tax expense; and (iv) changes in taxable net income from our insurance subsidiaries which are subject to only federal income taxes.

2006 Outlook: Income tax expense will vary based on: (i) our results of operations; (ii) the amount of tax-exempt income we earn; and (iii) the growth of our service revenue. The ultimate change is unknown at this time.

INVESTMENTS

Our portfolio of fixed maturity securities at December 31, 2005 included U.S. government securities (51.5%), mortgage-backed securities (20.2%), municipal securities (17.0%), commercial paper (9.5%) and asset-backed securities (1.8%). Our portfolio is managed by an independent investment manager to maximize our after-tax net investment income without taking inappropriate credit risk. In 2005, 2004 and 2003, we sold certain securities within the portfolio to take advantage of favorable interest rates and realized net investment gains totaling $580,000, $705,000 and $685,000, respectively. We conservatively manage our fixed maturity portfolio, investing only in investment grade (BBB or better rating from Standard and Poor's) securities of U.S. domiciled issuers. All securities in our portfolio were rated AAA, AA or A1+ at December 31, 2005. We do not invest in derivative securities.

Operating cash flows consist of the deficit or excess of premiums collected over claim and claim settlement expenses paid, reduced by payments for reinsurance premiums, as well as service revenue collected and other operating expenses paid. Investment cash flows consist of income on existing investments and proceeds from sales and maturities of investments. Our investment portfolio increased $20.3 million to $107.3 million at December 31, 2005 from $87.0 million at December 31, 2004. During 2003 and 2004, interest rates declined, leading to significant mortgage refinancing by consumers, resulting in significant prepayment or early redemption of our mortgage-backed securities. In order to reduce the near-term interest rate risk on the portfolio, we built our cash position throughout 2004 by holding cash received on mortgage-backed security pre-payments and through sales of securities, expecting that interest rates would rise in 2005. During 2005, we began to invest a portion of our cash and cash equivalents into longer maturing, fixed-rate securities. Cash and cash equivalents were $21.9 million at December 31, 2005 compared to $39.4 million at December 31, 2004. We expect that cash will decrease and investments will increase in 2006 as we continue to invest available cash into additional fixed-income securities.

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We record investments on our balance sheet at fair value, with the corresponding appreciation or depreciation from amortized cost recorded in shareholders' equity as accumulated other comprehensive income, net of taxes. Because value is based on the relationship between the portfolio's stated yields and prevailing market yields at any given time, interest rate fluctuations can have a swift and significant impact on the carrying value of these securities. As a result of classifying our securities as available-for-sale, and thus carrying them at fair value, we expect to encounter adjustments in shareholders' equity as market interest rates and other factors change. At December 31, 2005, we had a $1.8 million net unrealized loss on investments at December 31, 2005 compared to a $572,000 net unrealized gain at December 31, 2004.

UNPAID CLAIM AND CLAIM SETTLEMENT EXPENSES AND REINSURANCE RECOVERABLES

Unpaid claim and claim settlement expenses relate solely to our insurance operations. Our Absentia division and service business does not bear claim risk for its customers and carries no unpaid claim and claim settlement expenses.

At December 31, 2005, net reserves totaled $76.8 million and included the liability for unpaid claim and claim settlement expenses of $160.1 million net of reinsurance recoverables on unpaid claim and claim settlement expenses of $83.3 million. The net reserve at December 31, 2004 totaled $78.4 million and included the liability for unpaid claim and claim settlement expenses totaling $156.1 million net of reinsurance recoverables on unpaid claim and claim settlement expenses of $77.7 million.

Accounting for workers' compensation insurance operations requires us to estimate the liability for unpaid claim and claim settlement expenses (reserves) and the related reinsurance recoverables, (together, the "net reserves") at each balance sheet date. Our reserves at December 31, 2005 represent the estimated total unpaid cost of claim and claim settlement expenses that cover events that occurred in 2005 and prior years. These reserves reflect our estimates of the total costs of claims that were reported, but not yet paid, and the cost of claims incurred but not yet reported (IBNR). For reported claims, we establish reserves on a "case" basis. For IBNR claims, we calculate the difference between: (i) projected ultimate claim and claim settlement expenses as determined using generally accepted actuarial standards; and (ii) case reserves and carry the difference as an IBNR reserve. By using both estimates of reported claims and IBNR claims, we estimate the ultimate net reserves for unpaid claim and claim settlement expenses.

The amount by which estimated net reserves, measured subsequently by reference to payments and additional estimates, differ from those originally reported for a period is known as "development." Development is unfavorable (deficient) when losses ultimately settle for more than the levels at which they were reserved or subsequent estimates indicate a basis for reserve increases on open claims. Development is favorable (redundant) when losses ultimately settle for less than the amount reserved or subsequent estimates indicate a basis for reducing loss reserves on open claims. Favorable or unfavorable development of loss reserves is reflected in earnings in the year realized.

Both internal and independent external actuaries review our net reserves for adequacy on a periodic basis. These reviews assume that past experience, adjusted for the effects of current events and anticipated trends, is an appropriate basis for predicting future events. When reviewing net reserves, actuaries analyze historical data and estimate the effect of various factors on estimated ultimate reserves including: (i) trends in general economic conditions, including the effects of medical and wage inflation; (ii) estimates of trends in claims frequency and severity; (iii) our and industry historical loss experience; and (iv) legislative enactments, legal developments and changes in social and political attitudes. Variables in the reserve estimation process can be affected by both internal and external events, including changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. There is no precise method for subsequently evaluating the effect of any specific factor on the adequacy of reserves because the eventual redundancy or deficiency is affected by many factors. Additionally, there may be significant reporting lags between the occurrence of the loss and the time it is actually reported to the insurer. Due to our commencing operations in 1992, we have limited historical data to estimate our reserves for unpaid claim and claim settlement expenses and reinsurance recoverables on unpaid

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claim and claim settlement expenses. Accordingly, we supplement our experience with external industry data, as adjusted, to reflect anticipated differences between our results and the industry.

Estimating the effect that inflation will have on the ultimate cost of claims is a major risk factor in our workers' compensation reserve estimates. Future earnings will be affected by reserve development associated with any changes in our inflation assumptions. Estimates for the 2005 and 2004 accident years represent the majority (52% of the net reserves) of the uncertainty because these claims have the lowest proportionate amount of paid loss as of December 31, 2005. Our reserve estimates are most sensitive to changes in the assumption about inflation for the 2005 and 2004 accident years. Each one percent (1%) increase or decrease in the inflation rate for each of these accident years would increase or decrease our net loss reserve estimates at December 31, 2005 by approximately $477,000.

Our independent actuary provides us with an annual actuarial opinion regarding the acceptable range for adequate statutory reserves based on generally accepted actuarial guidelines. We record our net reserves by considering a range of estimates bounded by the high and low point of the range. Within that range, we record our best estimate. At December 31, 2005, we established recorded reserves in the upper end of the actuary's range based on our historical loss reserve development. The ultimate actual liability may be higher or lower than reserves recorded.

Our reserves are primarily undiscounted; however, we discounted reserves for selected claims that have fixed and determinable future payments at rates ranging from 3.5% to 8.0% in 2005 and 2004. The discount rates are subject to change as market interest rates change. We use the same rates for U.S. generally accepted accounting principles (GAAP) as we do for statutory accounting practices (SAP) in determining our liability. We also reduce the unpaid claim and claim settlement expenses for estimated amounts of subrogation.

We continually monitor loss development trends and data to establish adequate premium rates and to determine reasonable reserve estimates. Reserves that are based on estimates are inherently uncertain and represent a significant risk to the business. We attempt to mitigate this risk by continually improving and refining our workers' compensation claims processing practices and by continual monitoring through actuarial estimation methods.

After taking into account all relevant factors, we believe our reserves for unpaid claim and claim settlement expenses and reinsurance recoverables on unpaid claim and claim settlement expenses at December 31, 2005 are adequate to cover the ultimate net costs of claim and claim settlement expenses at that date. The ultimate cost of claim and claim settlement expenses may differ materially from the established reserves, particularly when claims may not be settled for many years. Establishing appropriate reserves is an inherently uncertain process and there can be no certainty that currently established reserves will prove adequate in light of subsequent actual experience. See Notes 1 and 5 in the accompanying Consolidated Financial Statements. The following two tables reconcile the beginning and ending insurance reserves, displayed individually for each of the last three years.

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The following table sets forth reserves on a gross (before reinsurance) basis (000's):

	Year Ended December 31,		
	2005	2004	2003
Gross Reserves for Claim and Claim Settlement Expenses:			
Gross reserves for claim and claim settlement expenses, beginning of year	$ 156,123	$ 150,044	$ 181,262
Provision increases (decreases) for claim and claim settlement expenses:			
Current year	43,936	53,563	42,777
Prior years	(3,231)	(4,654)	(21,846)
Total provision	40,705	48,909	20,931
Payments for claim and claim settlement expenses:			
Current year	11,748	12,666	11,077
Prior years	24,939	30,164	41,072
Total payments	36,687	42,830	52,149
Gross reserves for claim and claim settlement expenses, end of year	$ 160,141	$ 156,123	$ 150,044

The following table sets forth reserves on a net (after reinsurance) basis (000's):

	Year Ended December 31,		
	2005	2004	2003
Net Reserves for Claim and Claim Settlement Expenses:			
Net reserves for claim and claim settlement expenses, beginning of year	$ 78,401	$ 78,578	$ 89,440
Plus: Deferred retrospective reinsurance gain, beginning of year	49	49	49
Provision increases (decreases) for claim and claim settlement expenses:			
Current year	36,264	42,583	33,954
Prior years	(5,457)	(7,047)	(6,698)
Total provision	30,807	35,536	27,256
Payments for claim and claim settlement expenses:			
Current year	11,748	12,666	10,761
Prior years	20,637	23,047	27,357
Total payments	32,385	35,713	38,118
Less: Deferred retrospective reinsurance gain, end of year	(49)	(49)	(49)
Net reserves for claim and claim settlement expenses, end of year	$ 76,823	$ 78,401	$ 78,578

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The following gross loss reserve development table sets forth the change, over time, of gross reserves established for claim and claim settlement expenses at the end of the last ten years. The table is cumulative and, therefore, ending balances should not be added since the amount at the end of each calendar year includes activity for both current and prior years (000's):

	December 31, (000's)										
	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995
Loss Reserve Development:											
Gross reserves for unpaid claim and claim settlement expenses	$160,141	$156,123	$150,044	$181,262	$181,310	$128,841	$ 99,831	$ 97,269	$ 61,069	$49,256	$37,138
Paid (cumulative) as of:											
One year later		$ 24,937	$ 30,164	$ 41,072	$ 46,043	$ 49,241	$ 45,933	$ 37,062	$ 28,315	$20,529	$10,032
Two years later			43,436	61,363	17,086	74,681	67,442	56,031	42,889	29,841	15,306
Three years later				71,132	86,710	90,484	78,244	65,664	50,558	35,370	18,415
Four years later					93,348	98,689	85,754	70,631	54,835	38,880	19,964
Five years later						103,391	89,956	73,979	57,261	41,029	21,289
Six years later							93,045	76,311	59,012	41,980	22,117
Seven years later								78,476	60,352	42,728	22,702
Eight years later									61,637	43,511	23,020
Nine years later										44,208	23,448
Ten years later											23,809
Reserves re-estimated as of:											
End of year	$160,141	$156,123	$150,044	$181,262	$181,310	$128,841	$ 99,831	$ 97,269	$ 61,069	$49,256	$37,138
One year later		152,892	145,389	159,415	183,923	160,065	118,205	85,384	72,443	44,862	26,086
Two years later			147,117	160,147	166,738	168,222	130,120	95,696	64,499	48,233	22,295
Three years later				163,724	168,892	157,251	137,002	101,893	73,031	44,587	24,111
Four years later					174,451	161,905	129,819	107,522	75,554	50,552	23,054
Five years later						168,190	132,813	103,064	79,398	52,063	26,485
Six years later							138,782	105,705	76,610	54,327	27,237
Seven years later								110,136	77,921	53,047	28,411
Eight years later									80,855	54,250	28,533
Nine years later										55,491	29,107
Ten years later											29,627
Initial reserves in excess of (less than) re-estimated reserves											
Amount		$ 3,231	$ 2,927	$ 17,538	$ 6,859	$ (39,349)	$ (38,951)	$ (12,867)	$(19,786)	$ (6,235)	$ 7,511
Percent		2.1%	2.0%	9.7%	3.8%	(30.5)%	(39.0)%	(13.2)%	(32.4)%	(12.7)%	20.2%

The table above represents the development of balance sheet gross reserves for 1995 through 2005. The upper portion of the table shows the cumulative amount paid with respect to the previously recorded reserves as of the end of each succeeding year. The lower portion of the table shows the re-estimated amount of the previously recorded gross reserves, based on experience as of the end of each succeeding year. The estimate is either increased or decreased as more information becomes known about the frequency and severity of claims for individual years.

The "initial reserves in excess of (less than) re-estimated reserves" (Amount and Percent rows) represent the aggregate change in the estimates over all prior years. For example, the 1998 reserve developed a $12.9 million net deficiency over the course of the succeeding years.

In evaluating this information, it should be noted that each amount includes the total of all changes in amounts for prior periods. For example, the amount of redundancy (deficiency) to losses settled in 2002, but incurred in 1999, is included in the cumulative redundancy (deficiency) amounts in 1999, 2000 and 2001. This table does not present accident or policy year development data, which certain readers may be more accustomed to analyzing. Conditions and trends that have affected development of the reserves in the past

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may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies based on this table.

The following net loss reserve development table sets forth the change, over time, of net reserves established for claim and claim settlement expenses at the end of the last ten years. The table is cumulative and, therefore, ending balances should not be added since the amount at the end of each calendar year includes activity for both current and prior years (000's):

	December 31,										
	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995
Loss Reserve Development:											
Gross reserves for unpaid claim and claim settlement expenses	$160,141	$156,123	$150,044	$181,262	$181,310	$128,841	$ 99,831	$97,269	$ 61,069	$49,256	$37,138
Reinsurance recoverables	83,318	77,722	71,466	91,822	90,115	61,845	41,179	21,403	5,374	6,183	8,312
Net reserves for unpaid claim and claim settlement expenses	$ 76,823	$ 78,401	$ 78,578	$ 89,440	$ 91,195	$ 66,996	$ 58,652	$75,866	$ 55,695	$43,073	$28,826
Paid (cumulative) as of:											
One year later		$ 20,637	$ 23,047	$ 27,357	$ 30,285	$ 32,028	$ 35,932	$34,380	$ 27,737	$19,439	$ 8,595
Two years later			32,068	40,956	43,825	43,823	48,069	49,958	42,046	28,173	12,894
Three years later				46,673	50,871	49,531	54,360	56,376	49,671	33,438	15,521
Four years later					54,078	53,130	58,113	60,453	53,814	36,904	16,869
Five years later						55,342	60,690	63,278	56,140	38,919	18,020
Six years later							62,465	65,347	57,903	39,770	18,714
Seven years later								66,674	59,219	40,530	19,200
Eight years later									60,442	41,289	19,530
Nine years later										41,924	19,934
Ten years later											20,232
Reserves re-estimated as of:											
End of year	$ 76,823	$ 78,401	$ 78,578	$ 89,440	$ 91,195	$ 66,996	$ 58,652	$75,866	$ 55,695	$43,073	$28,826
One year later		72,944	71,531	82,742	82,839	74,727	74,181	67,753	66,674	39,988	20,751
Two years later			69,831	78,482	76,545	71,202	76,502	77,205	61,075	43,484	18,469
Three years later				78,037	77,055	71,911	75,321	78,391	68,065	41,451	19,796
Four years later					78,054	71,177	77,443	78,772	69,474	45,959	19,389
Five years later						73,660	75,588	80,522	69,595	47,147	21,254
Six years later							79,204	78,878	69,926	47,126	22,568
Seven years later								82,676	69,095	46,969	22,388
Eight years later									71,540	47,039	22,342
Nine years later										48,288	22,727
Ten years later											22,950
Initial reserves in excess of (less than) re-estimated reserves											
Amount		$ 5,457	$ 8,747	$ 11,403	$ 13,141	$ (6,664)	$(20,552)	$ (6,810)	$(15,845)	$ (5,215)	$ 5,876
Percent		7.0%	11.1%	12.7%	14.4%	(9.9)%	(35.0)%	(9.0)%	(28.4)%	(12.1)%	20.4%

The table above represents the development of balance sheet net reserves for 1995 through 2005. The top three rows of the table reconcile gross reserves to net reserves for unpaid claim and claim settlement expenses recorded at the balance sheet date for each of the indicated years.

The upper portion of the table shows the cumulative amount paid with respect to the previously recorded reserves as of the end of each succeeding year.

The lower portion of the table shows the re-estimated amount of the previously recorded net reserves, based on experience as of the end of each succeeding year. The estimate is either increased or decreased as

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more information becomes known about the frequency and severity of claims for individual years. For example, for the 1998 calendar year valued as of December 31, 2005, we paid $66.7 million of the currently estimated $82.7 million of claim and claim settlement expenses that were incurred through the end of 1998. Thus, the difference, an estimated $15.7 million of claim and claim settlement expenses incurred through 1998, remained unpaid as of December 31, 2005.

The "initial reserves in excess of (less than) re-estimated reserves" (Amount and Percent rows) represent the aggregate change in the estimates over all prior years. For example, the 1998 reserve developed a $6.8 million net deficiency over the course of the succeeding years. The net amount has been included in income and the changes have been recorded in the period identified. The cumulative net deficiencies in 2000 and 1999 are the result of reserve development inherent in the uncertainty in establishing reserves and anticipated loss trends. As discussed above, due to our relatively limited historical claim data and small claim population, our estimate of the liability for net reserves is difficult and volatile. As discussed further below, the reserve redundancy in 2001 is the result of accrual reversals resulting from changes in methods of assessing second injury funds, lower frequency in claims reported from the estimate at December 31, 2001, and reductions in amounts expected to be incurred for our participation in mandatory state and national assigned risk pools.

In evaluating this information, it should be noted that each amount includes the total of all changes in amounts for prior periods. For example, the amount of redundancy to losses settled in 2002, but incurred in 1999, will be included in the cumulative redundancy (deficiency) amounts in 1999, 2000, and 2001. This table does not present accident or policy year development data, which certain readers may be more accustomed to analyzing. Conditions and trends that have affected development of the reserves in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate redundancies or deficiencies based on this table.

The following table is derived from the net loss reserve development table and summarizes the effect of reserve re-estimates, net of reinsurance, on calendar year operations for the same ten-year period ended December 31, 2005. The total of each column details the amount of reserve re-estimates made in the indicated calendar year and shows the accident years to which the re-estimates are applicable. The amounts in the total accident year column represent the cumulative reserve re-estimate (increase) decrease for the indicated accident year (000's):

	Effect of Reserve Re-estimates on Calendar Year Operations:										Cumulative Re-estimates for each Accident Year
	2005	2004	2003	2002	2001	2000	1999	1998	1997	Pre-1997	
Accident Year:											
1992	$ (21)	$ 25	$ (30)	$ 2	$ (6)	$ (19)	$ 38	$ (15)	$ (37)	$ (110)	$ (173)
1993	12	(98)	14	261	(706)	(160)	7	(96)	(42)	741	(67)
1994	3	(174)	(77)	178	(633)	(459)	(68)	(574)	413	3,943	2,552
1995	(217)	(138)	139	(261)	31	(1,227)	430	(642)	1,948	4,604	4,667
1996	(1,026)	315	111	(159)	126	(2,643)	1,626	(2,169)	803		(3,016)
1997	(1,196)	901	(488)	(142)	(221)	(2,482)	3,566	(7,483)			(7,545)
1998	(1,353)	813	(1,419)	(320)	283	(2,462)	2,514				(1,944)
1999	182	211	(372)	1,622	(1,195)	(6,077)					(5,629)
2000	1,133	(1,121)	1,413	2,344	(5,410)						(1,641)
2001	1,484	1,756	4,003	4,831							12,074
2002	1,444	1,770	3,404								6,618
2003	1,255	2,787									4,042
2004	3,757										3,757
Total	$ 5,457	$ 7,047	$ 6,698	$8,356	$(7,731)	$(15,529)	$8,113	$(10,979)	$3,085	$ 9,178	$ 13,695

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The 2005 results include a $5.5 million decrease in prior years' reserves for unpaid claim and claim settlement expenses. Our estimate for unpaid claim and claim settlement expenses decreased in 2005 due to the following: (i) our ability to manage and close claims has improved over our historical experience; (ii) the re-underwriting of our book of business has resulted in claims with profiles different than experienced historically; and (iii) our estimate of the liability for unpaid claim and claim settlement expenses is volatile due to our relatively limited fourteen-year historical claim data and our small claim population.

The 2004 results include a $7.0 million decrease in prior years' reserves for unpaid claim and claim settlement expenses. Our estimate for unpaid claim and claim settlement expenses decreased in 2004 due to the following: (i) our ability to manage and close claims has improved over our historical experience; (ii) the re-underwriting of our book of business has resulted in claims with profiles different than experienced historically; and (iii) our estimate of the liability for unpaid claim and claim settlement expenses is difficult and volatile due to our relatively limited historical claim data and small claim population.

The 2003 results include a $6.7 million decrease in prior years' reserves for unpaid claim and claim settlement expenses. Our estimate for unpaid claim and claim settlement expenses decreased in 2003 due to the following: (i) the frequency of claims reported in 2002 and prior years was less than anticipated when we determined our liability in 2002; and (ii) our estimate of the liability for unpaid claim and claim settlement expenses is difficult and volatile due to our relatively limited historical claim data and small claim population.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity refers to our ability to generate sufficient cash flows to meet the short- and long-term cash requirements of our operations. Capital resources represent those funds deployed or available to be deployed to support our business operations.

Our primary sources of cash from operations are insurance premiums collected, reimbursements under reinsurance contracts, service revenue collected and net investment income. Our primary cash requirements consist of payments for: (i) claim and claim settlement expenses; (ii) reinsurance; (iii) policy acquisition costs; (iv) general and administrative expenses; (v) capital expenditures; and (vi) income taxes. We generate cash from or use cash in operations based on timing differences between the receipt of premiums and the payment of claim and claim settlement expenses. Selected reinsurance retention levels also use cash as a result of "pre-funding" premiums under the policies or provide cash upon reimbursement of claim payments. In 2005 and 2004, reinsurance reimbursements from our $25,000 to $300,000 excess of loss reinsurance agreement, which began in mid 1998 and ran-off in 2001, offset similar payments to claimants for those years. This trend will continue in 2006. We further expect that cash and cash equivalents will decrease from levels reported at December 31, 2005 as we take advantage of the anticipated increase in interest rates to purchase fixed maturity investments. Available cash is invested in either short-term cash and cash equivalents or longer-term available-for-sale securities pending future payments for such expenses as medical and indemnity benefits and other operating expenses. Cash and cash equivalents consist of cash, a money market fund that invests primarily in short-term U.S. Government securities, commercial paper with maturities of three months or less and overnight repurchase agreements secured by U.S. Treasury or U.S. Government Agency securities.

Cash provided by operating activities was $4.9 million for 2005. This is primarily a result of net income of $6.0 million and an increase of $4.0 million in unpaid claim and claim settlement expenses offset by an increase in amounts due from reinsurers of $4.9 million. Net cash used in investing activities was $23.0 million due primarily to $45.9 million in purchases of securities offset by $11.2 million in proceeds from sales of securities and $12.5 million in maturities of investments. Net cash provided by financing activities was $578,000 due to the exercise of stock options in 2005.

Our need for additional capital is primarily the result of regulations that require certain ratios of regulatory or statutory capital to premiums written in our insurance subsidiary as defined by state regulatory bodies and insurance rating agencies. Raising additional permanent capital would further reduce our ratio of premium to capital and provide a solid base for the future growth of our insurance subsidiary. As an alternative to raising additional permanent capital, certain reinsurance contracts could be used on an interim basis that

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would have the effect of reducing the ratio of premiums to capital and surplus in ACIC to satisfy state regulatory requirements.

Minnesota state insurance regulations limit distributions, including dividends, from our insurance subsidiary to us. Under Minnesota insurance law regulating the payment of dividends, in any twelve month period, ACIC can pay a dividend to us from its earned surplus (unassigned surplus) not to exceed the greater of 10% of ACIC's total surplus or ACIC's prior years' net income reduced for realized capital gains net of income taxes. At December 31, 2005, ACIC could pay a dividend to us totaling $4.1 million without the approval of the Minnesota Department of Commerce (See Note 9 of Notes to Consolidated Financial Statements). ACIC has never paid a dividend to us, and we intend to retain capital in the insurance subsidiaries.

On September 15, 1998, our Board of Directors approved a share repurchase program authorizing us to repurchase, from time to time, up to $4,000,000 of RTW, Inc. common stock. No shares were repurchased under this program in 2005 or 2004. We repurchased 18,619 shares in 2003 for approximately $37,000. We repurchased these shares on the open market or through private transactions based upon market conditions and availability. The repurchased shares will be used for employee stock option and purchase plans and other corporate purposes.

At December 31, 2005, investments with a market value of $15.8 million were held as statutory deposits and pledged as collateral. Investments held as statutory deposits and pledged as collateral do not currently have an adverse effect on our liquidity. We believe that cash flow generated by our operations and our cash and investment balances will be sufficient to fund continuing operations and capital expenditures for the next twelve months.

CONTRACTUAL OBLIGATIONS

Our contractual obligations consist solely of operating leases for our facilities. Future minimum (base) rental payments required under the leases, as of December 31, 2005, are as follows (000's):

2006	$ 1,022
2007	670
2008	125
2009	140
2010	59

INTEREST RATE RISK

Our fixed maturity investments are subject to interest rate risk. Increases and decreases in prevailing interest rates generally translate into decreases and increases in the fair value of these instruments. Also, fair values of interest rate sensitive instruments may be affected by the credit worthiness of the issuer, prepayment options, relative values of alternative instruments, the liquidity of the instrument and other general market conditions. We regularly evaluate interest rate risk in order to evaluate the appropriateness of our investments.

An increase of 100 basis points in prevailing interest rates would reduce the fair value of our interest rate sensitive instruments by approximately $3.3 million.

The effect of interest rate risk on potential near-term fair value was determined based on commonly used models. The models project the impact of interest rate changes on factors such as duration, prepayments, put options and call options. Fair value was determined based on the net present value of cash flows or duration estimates, using a representative set of likely future interest rate scenarios.

NAIC RISK-BASED CAPITAL STANDARDS

The National Association of Insurance Commissioners (NAIC) has risk-based capital standards to determine the capital requirements of a property and casualty insurance carrier based upon the risks inherent

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in its operations. These standards require computing a risk-based capital amount that is compared to a carrier's actual total adjusted capital. The computation involves applying factors to various financial data to address four primary risks: asset risk; insurance underwriting risk; credit risk; and off-balance sheet risk. These standards provide for regulatory intervention when the percent of total adjusted capital to authorized control level risk-based capital is below certain levels. Based upon the risk-based capital standards, our percent of total adjusted capital is in excess of authorized control level risk-based capital.

REGULATION

Our insurance subsidiaries are subject to substantial regulation by governmental agencies in the states in which we operate, and will be subject to such regulation in any state in which we provide workers' compensation products and services in the future. State regulatory agencies have broad administrative power with respect to all aspects of our business, including premium rates, benefit levels, policy forms, dividend payments, capital adequacy and the amount and type of investments. These regulations are primarily intended to protect covered employees and policyholders rather than the insurance company. Both the legislation covering insurance companies and the regulations adopted by state agencies are subject to change. At December 31, 2005, ACIC was licensed to do business in twenty-three states while BCIC was licensed only in Minnesota.

EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

In June 2005, the Financial Accounting Standards Board (FASB) finalized FASB Staff Position (FSP) Emerging Issues Task Force (EITF) Issue 03-1-a and issued re-titled FSP Statement of Financial Accounting Standard (SFAS) 115-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments". The FSP provides guidance on the recognition of impairments deemed other-than-temporary. FSP 115-1 is effective for other-than-temporary impairment analysis conducted in periods beginning after December 15, 2005. We believe that our current policy for other-than-temporary impairments complies with FSP 115-1. Accordingly, the adoption of this standard has not had a material effect on the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (i.e., the requisite service period), which is usually equal to the vesting period. In accordance with the transitional guidance given in the statement, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service period has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosure requirements. In April 2005, the Securities and Exchange Commission delayed the effective date of implementing SFAS No. 123R until fiscal years beginning after June 15, 2005. We are required to adopt SFAS 123R in the first quarter of 2006. We do not expect the adoption of SFAS No. 123R will have a material effect on our financial statements.

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts" (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments". SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by election of a feature or coverage within a contract. SOP 05-1 is effective for internal replacements occurring in the fiscal year beginning after December 15, 2006, with earlier adoption encouraged. The Company only issues workers' compensation insurance policies, which are a statutory coverage and are not subject to internal

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replacement or modification in product benefits, features, right or coverages. The Company does not expect the impact of adoption SOP 05-1 to have a significant effect on operations, financial condition or liquidity.

FORWARD-LOOKING STATEMENTS

Information included in this Report on Form 10-K which can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “anticipate,” “estimate,” or “continue” or the negative thereof or other variations thereon or comparable terminology constitutes “forward-looking information” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. The following important factors, among others, in some cases have affected and in the future could affect our actual results and could cause our actual financial performance to differ materially from that expressed in any forward-looking statement: (i) our ability to retain renewing policies and write new business with a B+ (Very Good, Secure) rating from A.M. Best; (ii) our ability to extend our workers’ compensation services to self-insured employers and other alternative markets and to operate profitably in providing these services; (iii) our ability to continue to maintain or increase rates on insured products in the markets in which we remain or alternatively non-renew or turn away improperly priced business; (iv) the ability of our reinsurers to honor their obligations to us; (v) our ability to accurately predict claim development; (vi) our ability to provide our proprietary products and services to customers successfully; (vii) our ability to manage both our existing claims and new claims in an effective manner; (viii) our experience with claims frequency and severity; (ix) medical inflation; (x) competition and the regulatory environment in which we operate; (xi) general economic and business conditions; (xii) our ability to obtain and retain reinsurance at a reasonable cost; (xiii) changes in workers’ compensation regulation by states, including changes in mandated benefits or insurance company regulation; (xiv) interest rate changes; and (xv) other factors as noted in our other filings with the Securities and Exchange Commission. This discussion of uncertainties is by no means exhaustive but is designed to highlight important factors that may affect our future performance.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Information with respect to Disclosures about Market Risk is contained in the Section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Interest Rate Risk” under Item 7 of this Annual Report on Form 10-K and is incorporated herein by reference.

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ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
RTW, Inc.
Minneapolis. Minnesota

We have audited the accompanying consolidated balance sheets of RTW, Inc. (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of RTW, Inc. at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

February 14, 2006
Minneapolis, Minnesota

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RTW, INC.

Consolidated Balance Sheets
December 31, 2005 and 2004

	2005	2004
	(In thousands, except share data)	
ASSETS		
Investments at fair value, amortized cost of $109,021 and $86,382	$ 107,250	$ 86,954
Cash and cash equivalents	21,914	39,379
Accrued investment income	857	783
Premiums receivable, less allowance of $192 and $90	3,382	3,792
Reinsurance recoverables:		
On unpaid claim and claim settlement expenses	83,318	77,722
On paid claim and claim settlement expenses	751	1,401
Deferred policy acquisition costs	889	1,112
Furniture and equipment, net	1,444	1,228
Other assets	8,666	8,136
Total assets	$ 228,471	$ 220,507
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid claim and claim settlement expenses	$ 160,141	$ 156,123
Unearned premiums	8,341	10,497
Accrued expenses and other liabilities	9,411	8,356
Total liabilities	177,893	174,976
Commitments and contingencies	—	—
Shareholders' equity:		
Undesignated stock, no par value; authorized 4,750,000 shares; none issued or outstanding	—	—
Series A Junior Participating Preferred Stock, no par value; authorized 250,000 shares; none issued or outstanding	—	—
Common stock, no par value; authorized 12,500,000 shares; issued and outstanding 5,441,000 and 5,322,000 shares	21,365	21,071
Retained earnings	30,364	24,082
Accumulated other comprehensive (loss) income	(1,151)	378
Total shareholders' equity	50,578	45,531
Total liabilities and shareholders' equity	$ 228,471	$ 220,507

See notes to consolidated financial statements.

BOWNE INTEGRATED TYPESETTING SYSTEM Site: BOWNE OF MINNESOTA Phone: (612) 330-0900 Operator: BOC99999T Date: 30-MAR-2006 08:24:49.65
Name: RTW, INC.
C03761.SUB, DocName: 10-K, Doc: 1, Page: 39 [B/E] CRC: 45418 EDGAR 2
BOC C03761 039.00.00.00 4/2

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RTW, INC.

Consolidated Statements of Income
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
		(In thousands, except share and per share data)	
Revenues:			
Gross premiums earned	$ 59,872	$ 63,370	$ 54,431
Premiums ceded	(10,452)	(9,688)	(8,141)
Premiums earned	49,420	53,682	46,290
Net investment income	4,613	3,667	4,299
Realized investment gains (losses):			
Realized investment gains	584	708	685
Realized investment losses	(4)	(3)	—
Net realized investment gains	580	705	685
Service revenue	4,398	633	109
Total revenues	59,011	58,687	51,383
Expenses:			
Claim and claim settlement expenses	30,807	35,536	27,256
Policy acquisition costs	5,456	6,045	6,878
General and administrative expenses	12,669	9,034	10,614
Total expenses	48,932	50,615	44,748
Income from operations	10,079	8,072	6,635
Interest expense	—	—	48
Income before income taxes	10,079	8,072	6,587
Income tax expense (benefit)	4,081	(1,869)	(412)
Net income	$ 5,998	$ 9,941	$ 6,999
Income per share:			
Basic income per share	$ 1.11	$ 1.90	$ 1.37
Diluted income per share	$ 1.06	$ 1.81	$ 1.32
Weighted average shares outstanding:			
Basic shares outstanding	5,399,000	5,233,000	5,114,000
Diluted shares outstanding	5,663,000	5,487,000	5,296,000

See notes to consolidated financial statements.

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RTW, INC.

Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2005, 2004 and 2003

	Common Stock	Comprehensive Income (Loss)	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
			(In thousands)		
Balance at January 1, 2003	$20,619		$ 6,971	$ 2,220	$ 29,810
Comprehensive income (loss):					
Net income	—	$ 6,999	6,999	—	6,999
Other comprehensive income (loss), net of tax:					
Change in unrealized investment gains	—	(1,247)	—	(1,247)	(1,247)
Comprehensive income		$ 5,752			
Retirement of common stock	(37)		—	—	(37)
Stock options exercised	19		—	—	19
Issuance of shares under ESPP	43		—	—	43
Balance at December 31, 2003	20,644		13,970	973	35,587
Comprehensive income (loss):					
Net income	—	$ 9,941	9,941	—	9,941
Other comprehensive income (loss), net of tax:					
Change in unrealized investment gains	—	(595)	—	(595)	(595)
Comprehensive income		$ 9,346			
Stock options exercised	362		171	—	533
Issuance of shares under ESPP	65		—	—	65
Balance at December 31, 2004	21,071		24,082	378	45,531
Comprehensive income:					
Net income	—	$ 5,998	5,998	—	5,998
Other comprehensive income (loss), net of tax:					
Change in unrealized investment losses	—	(1,529)	—	(1,529)	(1,529)
Comprehensive income		$ 4,469			
Stock options exercised	195		284	—	479
Issuance of shares under ESPP	99		—	—	99
Balance at December 31, 2005	$21,365		$ 30,364	$ (1,151)	$ 50,578

See notes to consolidated financial statements.

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RTW, INC.

Consolidated Statements of Cash Flows
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
		(In thousands)	
Cash flows from operating activities:			
Net income	$ 5,998	$ 9,941	$ 6,999
Adjustments to reconcile net income to net cash provided by operating activities:			
Net realized investment gains	(580)	(705)	(685)
Depreciation and amortization	686	952	1,191
Deferred income taxes	599	(2,576)	(828)
Changes in assets and liabilities:			
Reinsurance recoverables	(4,946)	(6,803)	21,611
Unpaid claim and claim settlement expenses	4,018	6,079	(31,218)
Unearned premiums, net of premiums receivable	(1,746)	1,007	2,105
Other, net	889	177	5,200
Net cash provided by operating activities	4,918	8,072	4,375
Cash flows from investing activities:			
Maturities of investments	12,450	11,324	5,650
Purchases of available-for-sale investments	(45,915)	(41,446)	(32,903)
Proceeds from sales of available-for-sale investments	11,190	21,625	27,618
Purchases of furniture and equipment	(696)	(444)	(175)
Disposals of furniture and equipment	10	—	22
Net cash (used in) provided by investing activities	(22,961)	(8,941)	212
Cash flows from financing activities:			
Payments on notes payable	—	—	(1,250)
Stock options exercised	479	533	19
Issuance of common stock under ESPP	99	65	43
Retirement of common stock	—	—	(37)
Net cash provided by (used in) financing activities	578	598	(1,225)
Net (decrease) increase in cash and cash equivalents	(17,465)	(271)	3,362
Cash and cash equivalents at beginning of year	39,379	39,650	36,288
Cash and cash equivalents at end of year	$ 21,914	$ 39,379	$ 39,650
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ —	$ —	$ 27
Income tax payments	$ 2,839	$ 1,033	$ 115

See notes to consolidated financial statements.

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RTW, INC.

Notes to Consolidated Financial Statements
Years Ended December 31, 2005, 2004, and 2003

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — RTW, Inc. (RTW) provides disability and absence management services, directed today primarily at workers' compensation to: (i) employers insured through our wholly-owned insurance subsidiary, American Compensation Insurance Company (ACIC) and its wholly-owned insurance subsidiary, Bloomington Compensation Insurance Company (BCIC); (ii) self-insured employers on a fee-for-service basis; (iii) state-sponsored assigned risk plans on a percent of premium basis; (iv) other insurance companies; and (v) to agents and employers on a consulting basis, charging hourly fees through RTW and its Absentia℠ division. ACIC offers guaranteed cost workers' compensation insurance to employers located primarily in Minnesota, Michigan and Colorado and is licensed in twenty-three states. BCIC began underwriting business in October 2005 and offers guaranteed-cost workers' compensation insurance to selected employers only in Minnesota. Collectively, "we," "our" and "us" refer to RTW, ACIC, BCIC and Absentia in these Notes to Consolidated Financial Statements.

We benefit from our ability to reduce workers' compensation and disability system costs and provide employers the ability to control their workers' compensation, disability and absence programs. Our insurance subsidiaries are domiciled in Minnesota and operated primarily in Minnesota, Michigan and Colorado in 2005, 2004 and 2003. Absentia serviced customers in six states in 2004 and expanded to 18 states by December 31, 2005. In 2002, we non-renewed all insurance policies in our Missouri and Massachusetts regions and completed our run-off of policies in these regions by February 2003.

The following explains the accounting policies we use to arrive at some of the more significant amounts in our financial statements.

Accounting Principles — We prepare our financial statements in accordance with U.S. generally accepted accounting principles (GAAP).

Consolidation — Our consolidated financial statements include the accounts of RTW, ACIC and BCIC. We eliminate all inter-company accounts and transactions in consolidation.

Use of Estimates — We make estimates and assumptions that affect our reported assets and liabilities, our disclosure of contingent assets and liabilities at the financial statement date and our recorded revenues and expenses during the reporting period. Our most significant estimates are those relating to our reinsurance recoverables on unpaid claim and claim settlement expenses, unpaid claim and claim settlement expenses, income taxes, deferred income taxes and an accrual for premium adjustments. We continually review our estimates and assumptions and make adjustments as necessary. Our actual results could vary significantly from the estimates we make.

Investments — We invest entirely in fixed maturity investments and classify our investments as available-for-sale.

Available-for-Sale Investments: Our available-for-sale investments are carried at fair value with changes in unrealized gains or losses, net of deferred taxes, reported as other comprehensive income. The fair values of our investments are determined based upon quoted market prices as obtained through commercial pricing services or brokers who provide estimated fair values.

Realized Investment Gains and Losses: Realized investment gains and losses are identified separately in our Consolidated Statements of Income. Cost of investments sold is determined by the specific identification method.

We continually monitor the difference between investment cost and fair value for each of our securities. If any security experiences a decline in value that is determined to be other than temporary, we reduce the

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

security's carrying value for the decline and record a realized loss in the Consolidated Statements of Income. No securities were reduced for declines in fair value in 2005, 2004 or 2003.

Cash and Cash Equivalents — We consider all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Fair Value of Financial Instruments — A number of our significant assets and liabilities (including reinsurance recoverables, deferred policy acquisition costs, furniture and equipment and unpaid claim and claim settlement expenses) are not considered financial instruments for disclosure purposes. Our premiums receivable and other assets and liabilities that are considered financial instruments are generally of a short-term nature. The carrying values of these instruments approximate their fair values. The carrying values and fair values of investments are disclosed in Note 3.

Deferred Policy Acquisition Costs — The costs directly related to writing an insurance policy are referred to as policy acquisition costs and consist of commissions, state premium taxes and other direct underwriting expenses. Although these costs arise when we issue a policy, we defer certain costs, principally commissions and state premium taxes. These costs are amortized to expense as premium revenue is recognized and are reported net of ceding commissions in the Consolidated Statements of Income.

If deferred policy acquisition costs were to exceed the sum of unearned premiums net of reinsurance and related anticipated investment income less expected claim and claim settlement expenses, we would immediately expense the excess costs.

Depreciation — We depreciate furniture and equipment on a straight-line basis over the estimated useful life of the asset (five to ten years). Furniture and equipment are recorded at cost less accumulated depreciation of $5.1 million and $4.7 million at December 31, 2005 and 2004, respectively.

Income Taxes — We compute all income tax amounts using the liability method. Under this method, deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts using presently enacted tax rates. Deferred tax assets are recognized for tax credit and net operating loss carry-forwards, reduced by a valuation allowance which is established when it is "more likely than not" that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates or regulations is recognized as income in the period that includes the enactment date.

Unpaid Claim and Claim Settlement Expenses — Claim expenses refer to amounts that we paid or expect to pay to claimants for insured events that have occurred. The costs of investigating, resolving and processing claims are referred to as claim settlement expenses. We record these expenses, net of amounts recoverable under reinsurance contracts, as "Claim and claim settlement expenses" in the Consolidated Statements of Income.

Our "Unpaid claim and claim settlement expenses" represent reserves established for the estimated total unpaid cost of claim and claim settlement expenses for insured events that occurred on or prior to each balance sheet date. The reserves are primarily undiscounted; however, we discounted selected claims that have fixed or determinable future payments by $342,000 in 2005 and $344,000 in 2004 using discount factors ranging from 3.5% to 8.0%. These reserves reflect our estimates of the total cost of claims that were reported, but not yet paid, and the cost of claims incurred but not yet reported. Our estimates consider such variables as past loss experience, current claim trends and prevailing social, economic and legal environments. We have a limited amount of historical data to use in estimating our reserves for unpaid claim and claim settlement expenses because we commenced operations in 1992. As a result, we supplement our experience with external industry data, as adjusted to reflect anticipated differences between our results and the industry. We reduce the unpaid claim and claim settlement expenses for estimated amounts of subrogation.

BOWNE INTEGRATED TYPESETTING SYSTEM Site: BOWNE OF MINNESOTA Phone: (612) 330-0900 Operator: BOC99999T Date: 30-MAR-2006 08:24:49.65
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We believe our reserves for unpaid claim and claim settlement expenses are adequate to cover the ultimate costs of claim and claim settlement expenses. The ultimate cost of claim and claim settlement expenses may differ from the established reserves, particularly when claims may not be settled for many years. Reserves for unpaid claim and claim settlement expenses and assumptions used in their development are continually reviewed. We record adjustments to prior estimates of unpaid claim and claim settlement expenses, which may be material, in operations in the year in which the adjustments are made.

Premiums Earned — Premiums on workers' compensation insurance policies are our largest source of revenue. The premium we charge a policyholder is a function of its payroll, industry and prior workers' compensation claims experience. In underwriting a policy, we receive policyholder payroll estimates for the ensuing year. We record premiums written on an installment basis, matching billing to the policyholder, and earn premiums on a daily basis over the life of each insurance policy based on the payroll estimate. We record the excess of premiums billed over premiums earned for each policy as unearned premiums on our Consolidated Balance Sheet. When a policy expires, we audit employer payrolls for the policy period and adjust the estimated payroll and the policyholder's premium to its actual value. The result is a "final audit" adjustment recorded to premiums earned when the adjustment becomes known. We also estimate the final audit amount to be billed on unexpired and expired unaudited policies and record a final audit receivable included in premiums receivable on the Consolidated Balance Sheet. Final audit premiums recognized during the period include billed final audit premiums plus (or minus) the change in estimate for final audit premiums on unexpired and expired unaudited policies.

Stock-Based Compensation — Had we calculated compensation expense for our option grants under the 1994 Stock Plan and stock issuances under the Employee Stock Purchase Plan (ESPP) based on the fair value method described in Statement of Financial Accounting Standard (SFAS) No. 123, "Accounting for Stock-Based Compensation," our net income and basic and dilutive net income per share would approximate the following pro forma amounts (in 000's, except per share data):

	2005	2004	2003
Net income:			
As reported	$ 5,998	$ 9,941	$6,999
Pro forma	5,813	9,507	6,814
Basic income per share:			
As reported	1.11	1.90	1.37
Pro forma	1.08	1.82	1.33
Dilutive income per share:			
As reported	1.06	1.81	1.32
Pro forma	1.03	1.73	1.29

The weighted average fair value of options granted under the ESPP and 1994 Stock Plan during 2005, 2004 and 2003 is estimated at $1.84, $2.13 and $1.48, respectively, on the date of grant using the Black-Scholes option-pricing model with the following assumptions: no dividend yield; volatility of 26.1% to 33.8% in 2005, 41.0% to 73.8% in 2004 and 115.3% to 131.5% in 2003; risk-free interest rates ranging from 1.1% to 4.2%; and an expected life of 1 to 54 years.

Effect of Recent Accounting Pronouncements — In June 2005, the Financial Accounting Standards Board (FASB) finalized FASB Staff Position (FSP) Emerging Issues Task Force (EITF) Issue 03-1-a and issued re-titled FSP Statement of Financial Accounting Standard (SFAS) 115-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments". The FSP provides guidance on the recognition of impairments deemed other-than-temporary. FSP 115-1 is effective for other-than-temporary impairment analysis conducted in periods beginning after December 15, 2005. We believe that our current

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policy on other-than-temporary impairments complies with FSP 115-1. Accordingly, the adoption of this standard has not had a material effect on the consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award, i.e., the requisite service period, which is usually equal to the vesting period. In accordance with the transitional guidance given in the statement, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service period has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosure requirements. In April 2005, the Securities and Exchange Commission delayed the effective date of implementing SFAS No. 123R until fiscal years beginning after June 15, 2005. We are required to adopt SFAS 123R in the first quarter of 2006.

We intend to use the modified prospective transitional method upon adoption. Under the modified prospective method, there would be no compensation charge for vested awards that are outstanding on the effective date of SFAS No. 123R. Unvested awards that are outstanding on the effective date would be charged to expense over the remaining vesting period. Accordingly, we anticipate that we will recognize approximately $114,000, $87,000 and $18,000 of incremental compensation costs in 2006, 2007 and 2008 respectively related to unvested awards outstanding at December 31, 2005.

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts" (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments". SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by election of a feature or coverage within a contract. SOP 05-1 is effective for internal replacements occurring in the fiscal rear beginning after December 15, 2006, with earlier adoption encouraged. The Company only issues workers' compensation insurance policies, which are a statutory coverage and are not subject to internal replacement or modification in product benefits, features, right or coverages. The Company does not expect the impact of adoption SOP 05-1 to have a significant effect on operations, financial condition or liquidity.

NOTE 2 —INCOME PER SHARE

Basic income per share (IPS) is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted IPS is computed by dividing net income by the weighted average number of common shares and dilutive securities outstanding for the period. Dilutive securities consist of stock options. Dilutive securities are considered outstanding from the date of grant, after applying the treasury stock method for determining the dilutive effect.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

The following is a reconciliation of the numerators and denominators of basic and diluted income per share:

	2005	2004	2003
Net income (000's)	$ 5,998	$ 9,941	$ 6,999
Basic weighted average shares outstanding	5,399,000	5,233,000	5,114,000
Effect of dilutive stock options	264,000	254,000	182,000
Diluted weighted average shares outstanding	5,663,000	5,487,000	5,296,000
Basic income per share	$ 1.11	$ 1.90	$ 1.37
Diluted income per share	$ 1.06	$ 1.81	$ 1.32

NOTE 3 —INVESTMENTS

Valuation of Investments — The following tables present amortized cost, gross unrealized gains and losses and estimated fair values of our available-for-sale securities (000's):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2005				
U.S. government securities	$ 56,138	$ 63	$ (960)	$ 55,241
Commercial paper	10,167	—	—	10,167
Asset-backed securities	2,009	—	(60)	1,949
Mortgage-backed securities	22,049	45	(403)	21,691
Municipal securities	18,658	—	(456)	18,202
Total investments	$ 109,021	$ 108	$ (1,879)	$ 107,250

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2004				
U.S. government securities	$ 41,439	$ 654	$ (133)	$ 41,960
Asset-backed securities	2,011	11	(19)	2,003
Mortgage-backed securities	24,006	234	(37)	24,203
Municipal securities	18,926	42	(180)	18,788
Total investments	$ 86,382	$ 941	$ (369)	$ 86,954

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The gross unrealized losses and fair value of our investments aggregated by the length of time that individual securities have been in a continuous unrealized loss position are as follows (000's):

	Less Than Twelve Months		Greater Than Twelve Months			
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
2005						
U.S. government securities	$42,018	$ (734)	$ 8,987	$ (226)	$ 51,005	$ (960)
Mortgage-backed and asset- backed securities	16,377	(342)	4,127	(121)	20,504	(463)
Municipal securities	5,207	(62)	12,995	(394)	18,202	(456)
Total investments	$63,602	$ (1,138)	$26,109	$ (741)	$ 89,711	$ (1,879)

	Less Than Twelve Months		Greater Than Twelve Months			
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
2004						
U.S. government securities	$40,912	$ (118)	$1,048	$ (15)	$ 41,960	$ (133)
Mortgage-backed and asset- backed securities	26,206	(56)	—	—	26,206	(56)
Municipal securities	18,788	(180)	—	—	18,788	(180)
Total investments	$85,906	$ (354)	$1,048	$ (15)	$ 86,954	$ (369)

The gross unrealized loss in all cases is the result of an increase in interest rates and is not the result of deterioration in the credit quality of the issuers. We believe that the unrealized losses on our fixed maturity securities do not represent other than temporary impairments. All long-term issues carry a credit quality of AAA, AA or A1+ (Standard & Poors). We have the ability and intent to hold all of these securities to recovery, which in certain circumstances may extend to maturity. We consider all relevant facts and circumstances in evaluating whether the impairment of a security is other than temporary. Relevant facts and circumstances we consider include: (i) the length of time the fair value has been below cost; (ii) the financial position and access to capital of the issuer, including the current and future effect of any specific events; and (iii) our ability and intent to hold the security until it recovers in value. To the extent we determine that a security is deemed to be other than temporarily impaired, the difference between amortized cost and fair value would be charged to earnings.

Deposits — Included in investments are U.S. government securities and cash on deposit with various regulatory authorities, as required by law, with a fair value of $15.8 million and $16.2 million at December 31, 2005 and 2004, respectively.

Additionally, included in investments are U.S. government securities pledged as collateral against a letter of credit provided to an insurer, with a fair value of $2.0 million and $1.9 million at December 31, 2005 and 2004, respectively.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

Fixed Maturities by Maturity Date — The following table presents the amortized cost and fair value of investments by contractual maturity at December 31, 2005. Actual maturities may differ from those stated as a result of calls and prepayments (000's):

Maturing In:	Amortized Cost	Estimated Fair Value
One year or less	$ 14,885	$ 14,843
Over one year through five years	49,762	48,745
Over five years through ten years	17,187	16,893
Over ten years	5,138	5,078
Mortgage-backed securities with various maturities	22,049	21,691
Total investments	$ 109,021	$ 107,250

Net Investment Income — Net investment income includes income from the following sources (000's):

	2005	2004	2003
Fixed maturity investments	$ 4,099	$ 3,383	$4,346
Cash and cash equivalents	672	344	128
Other	15	110	—
Investment income	$ 4,786	$ 3,837	$4,474
Investment expense	(173)	(170)	(175)
Net investment income	$ 4,613	$ 3,667	$4,299

NOTE 4 — REINSURANCE

Our consolidated financial statements reflect the effects of ceded reinsurance transactions. We purchase reinsurance to protect us from potential losses in excess of the level we are willing to accept. Our primary reinsurance is excess of loss coverage that limits our per-incident exposure.

We report reinsurance related balances on a "gross" basis on the Consolidated Balance Sheet, resulting in reinsurance recoverable amounts on unpaid and on paid claim and claim settlement expenses recorded as assets. We estimate amounts recoverable from reinsurers in a manner consistent with the claim liability associated with the reinsured policy.

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The following table summarizes our reinsurance coverage (all losses ceded on a per occurrence basis):

	Covers Losses per Occurrence:	
	In Excess of:	**Limited to:**
Minnesota:		
2005 WCRA	$ 380,000	Statutory limit
Various reinsurers	$ 200,000	$380,000
2004 WCRA	$ 360,000	Statutory limit
Various reinsurers	$ 200,000	$360,000
2003 WCRA	$ 360,000	Statutory limit
Various reinsurers	$ 200,000	$360,000
Other States:		
2005 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism
2004 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism
2003 Various reinsurers	$ 200,000	$20 million, excluding acts of terrorism

For claims occurring after June 30, 1998, we further limited our per incident exposure by purchasing excess of loss coverage for losses from $25,000 to the lesser of $300,000 or the WCRA selected retention level in Minnesota and from $25,000 to $300,000 in other states from a single reinsurer. This agreement was finalized after its effective date and activity occurring from July 1, 1998 through September 30, 1998 was recorded on a retrospective basis resulting in the deferral of a gain totaling $2.0 million at December 31, 1998. We amortized $400,000 of the deferred gain as a reduction of claim and claim settlement expenses in each of 2002, 2001 and 2000 and $740,000 in 1999, resulting in an un-amortized deferred gain of $49,000 at December 31, 2005. The deferred gain is being amortized into income using the effective interest rate inherent in the amounts paid to the reinsurer and the estimated timing and amounts of recoveries from the reinsurer. Activity occurring on or after October 1, 1998 is recorded prospectively. This contract was terminated effective December 31, 2000; however, the policy was effective in 2001 for policies in force at December 31, 2000 through expiration, not to exceed fifteen months after the effective termination date. Policies written or renewing after December 31, 2000 are not covered under this lower level excess of loss reinsurance policy.

Reinsurance contracts do not relieve us from our obligations to policyholders. We expect reinsurers to which we have ceded reinsurance to honor their obligations. Failure of these reinsurers to honor their obligations could result in losses to us. We do not anticipate any such losses and accordingly, no provision for amounts deemed uncollectible are included in our financial statements. We attempt to minimize our exposure to significant losses from reinsurer insolvency by monitoring the financial condition of our reinsurers. The reinsurance recoverable on unpaid claim and claim settlement expenses associated with reinsurers are as follows (000's):

	2005	2004
Excess of loss reinsurance through various reinsurers	$ 83,318	$ 77,722

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

The effect of ceded reinsurance on premiums written and claim and claim settlement expenses are as follows (000's):

	2005	2004	2003
Premiums written:			
Direct	$ 57,716	$ 64,687	$ 56,481
Ceded	(10,452)	(9,688)	(8,141)
Net premiums written	$ 47,264	$ 54,999	$ 48,340
Claim and claim settlement expenses:			
Direct	$ 40,705	$ 48,909	$ 20,932
Ceded	(9,898)	(13,373)	6,324
Net claim and claim settlement expenses	$ 30,807	$ 35,536	$ 27,256

During 2003, we re-evaluated and lowered our estimate for excess of loss unpaid claim and claim settlement expenses by $15.1 million, which inured to the benefit of our reinsurers. Excluding the effect of this benefit, our ceded losses to reinsurers would have been $8.8 million.

The reinsurance recoverable on paid claim and claim settlement expenses consists primarily of receivables from paid claim and claim settlement expenses that were submitted but not yet reimbursed by reinsurers at December 31, 2005 and 2004.

NOTE 5 — UNPAID CLAIM AND CLAIM SETTLEMENT EXPENSES

As described in Note 1, we establish unpaid claim and claim settlement expense reserves on reported and unreported claims for insured losses. Establishing appropriate reserves is an inherently uncertain process. Furthermore, estimating ultimate reserves is difficult due to our relatively limited historical claim data and small claim population. Estimates are further complicated by the extended periods of time that elapse between the date losses occur and the date losses are reported and ultimately settled. Reserve estimates are regularly reviewed and updated, using the most current information available. Any resulting adjustments, which may be material, are reflected in current operations.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

The following table represents a reconciliation of beginning and ending unpaid claim and claim settlement expense reserves for each of the last three years (000's):

	2005	2004	2003
Balance at January 1	$ 156,123	$ 150,044	$ 181,262
Less reinsurance recoverables	(77,722)	(71,466)	(91,822)
Plus deferred gain on retrospective reinsurance	49	49	49
Net balance at January 1	78,450	78,627	89,489
Incurred related to:			
Current year	36,264	42,583	33,954
Prior years	(5,457)	(7,047)	(6,698)
Total incurred	30,807	35,536	27,256
Paid related to:			
Current year	11,748	12,666	10,761
Prior years	20,637	23,047	27,357
Total paid	32,385	35,713	38,118
Net balance at December 31	76,872	78,450	78,627
Plus reinsurance recoverables	83,318	77,722	71,466
Plus deferred gain on retrospective reinsurance	(49)	(49)	(49)
Balance at December 31	$ 160,141	$ 156,123	$ 150,044

Changes in estimates of unpaid claim and claim settlement expenses for prior years decreased the provision for claim and claim settlement expenses by $5.5 million, $7.0 million and $6.7 million in 2005, 2004 and 2003, respectively.

Our estimate for unpaid claim and claim settlement expenses decreased in 2005 due to the following: (i) we improved our effectiveness in managing open claims, closing them earlier than originally anticipated; and (ii) our estimate of the liability for unpaid claim and claim settlement expenses is difficult and volatile due to our relatively limited historical claim data and small claim population.

Our estimate for reinsurance recoverables increased in 2005 due to: (i) increasing our large loss development factors based on changes in industry data offset by; (ii) payments and the related recoveries on prior year ceded claim and claim settlement expenses.

Our estimate for unpaid claim and claim settlement expenses decreased in 2004 due to the following: (i) the frequency of claims reported in 2004 for 2003 and prior years was less than anticipated when we determined our liability in 2003; and (ii) our estimate of the liability for unpaid claim and claim settlement expenses is difficult and volatile due to our relatively limited historical claim data and small claim population.

Our estimate for reinsurance recoverables increased in 2004 due to the growth in our gross premiums earned in 2004 offset by payments and the related recoveries on prior year ceded claim and claim settlement expenses.

We recovered $5.0 million, $6.6 million and $15.3 million from reinsurers during 2005, 2004 and 2003 respectively.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

NOTE 6 — NOTES PAYABLE

In March 2000, we borrowed $8.0 million under a term loan agreement to fund the repurchase of common stock from certain of our shareholders. We paid $1.0 million in principal on the term loan in 2000, an additional $2.5 million in 2001, $3.3 million in 2002 and the remaining $1.2 million in 2003. We paid interest at an adjusted LIBOR rate on the term loan (adjusted LIBOR was 4.66% at December 31, 2002). The term loan was paid in full in September 2003.

NOTE 7 — INCOME TAXES

Income tax expense (benefit) consists of the following (000's):

	2005	2004	2003
Current:			
Federal	$ 3,161	$ 651	$ 288
State	321	56	128
Total current tax expense	3,482	707	416
Deferred:			
Federal	599	(2,576)	(828)
State	—	—	—
Total deferred tax expense (benefit)	599	(2,576)	(828)
Income tax expense (benefit)	$ 4,081	$ (1,869)	$ (412)

Our income tax benefit differs from the federal statutory rate as follows (000's):

	2005	2004	2003
Federal income tax expense at 35%	$ 3,528	$ 2,825	$ 2,305
Increase (reduction) in income tax expense (benefit) resulting from:			
State income taxes, net of federal income tax benefit	209	36	79
Tax-exempt investment income	(162)	(123)	—
Deferred income tax valuation allowance	—	(4,040)	(3,060)
Tax expense (benefit) related to prior periods	495	(495)	—
Other	11	(72)	264
Income tax expense (benefit)	$ 4,081	$ (1,869)	$ (412)

Income tax expense for 2005 and 2004 included adjustments for differences between our tax provision computation and final tax expense based on our filed tax returns.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

Differences between the tax basis of assets and liabilities and their reported amounts in the Consolidated Balance Sheets that will result in taxable or deductible amounts in future years are called temporary differences. The tax effects of temporary differences that give rise to net deferred tax assets, included within other assets, are as follows (000's):

	2005	2004
Unpaid claim and claim settlement expenses	$ 5,023	$ 5,293
Accrued second injury funds	37	74
Unearned premiums	1,639	2,067
Retrospective reinsurance	17	17
Net unrealized loss on securities	620	—
Other	461	326
Deferred tax assets	7,797	7,777
Net unrealized gain on securities	—	(194)
Deferred policy acquisition costs	(764)	(937)
Depreciation	(204)	(240)
Other	(208)	—
Deferred tax liabilities	(1,176)	(1,371)
Net deferred tax asset	$ 6,621	$ 6,406

In assessing our ability to realize the future benefit of deferred tax assets, we consider recent operating results, the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies. The valuation allowance decreased to $4.0 million in 2003 based on our projected taxable income and available tax planning strategies. In 2004, we eliminated the remaining allowance as we expect the entire deferred tax asset will be realized as a result of income and the reversal of existing taxable temporary differences in the future

Income taxes receivable were approximately $381,000 and $733,000 at December 31, 2005 and 2004, respectively, and are included in other assets.

NOTE 8 — EMPLOYEE BENEFITS AND PLANS

Stock Based Compensation — We account for our stock-based compensation plans, the RTW, Inc. 1995 Employee Stock Purchase Plan and Trust (ESPP), the 1994 Stock Plan and the 2005 Stock Plan, using Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," and related Interpretations. Under APB 25, compensation cost for stock options is measured as the excess, if any, of the quoted market price of our stock at the date of the grant over the amount an employee must pay to acquire the stock.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

1995 Employee Stock Purchase Plan — The ESPP provides employees the opportunity to purchase shares of our stock at 85% of the fair value based on the lesser of the beginning or ending share price for each plan year as set forth in the plan. In 2003, the shares reserved for distribution under the plan were increased from 100,000 to 150,000 shares. In 2004, the ESPP was amended to allow the issuance of stock within 10 years of any increase in the number of shares authorized to be issued under the plan. In 2005, the shares reserved for distribution under the plan were further increased from 150,000 to 200,000 shares. The ESPP terminates in 2013 and will be carried out in phases, each consisting of one year or a different period of time approved by the Board of Directors. Any employee completing two weeks of service prior to commencing a phase of the plan may participate. Employees may elect to contribute from $10 to 10% of monthly salary to the plan through payroll withholdings. The following summarizes shares purchased and purchase prices for each phase in the most recent three years completed through 2005:

Phase:	Shares Purchased	Purchase Price
Beginning April 2002, expiring April 2003	20,649	$ 2.07
Beginning April 2003, expiring April 2004	20,151	3.23
Beginning April 2004, expiring April 2005	17,279	5.72

The eleventh one-year phase began in April 2005 and expires in April 2006.

Our liability for employee contributions withheld at December 31, 2005 and 2004 for the purchase of shares in April 2006 and April 2005 under the ESPP was $116,000 and $71,000, respectively.

1994 Stock Plan — The 1994 Stock Plan provides for awards of incentive stock options (as defined in section 422 of the Internal Revenue code) and non-qualified stock options. In July 1998, the Board of Directors increased the shares reserved for distribution under the plan to 1,000,000. Option price, option term, vesting provisions and other limits and restrictions are determined at the time of grant by the Board of Directors or, if established, by a separate committee. The exercise price for all options granted was the market price of the common stock at the date of grant. The ability to award incentive stock options under this Plan terminated in June 2004.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

Options granted, exercised, canceled and outstanding under the 1994 Stock Plan are as follows:

	Qualified		Non-Qualified	
	Option Shares	Weighted Average Exercise Price	Option Shares	Weighted Average Exercise Price
Balance, January 1, 2003	137,071	$ 9.54	326,875	$ 2.60
Granted	155,500	2.19	12,500	3.13
Exercised	(8,000)	2.22	—	—
Canceled	(9,052)	9.62	(80,000)	2.20
Balance, December 31, 2003	275,519	5.60	259,375	2.75
Granted	209,948	6.14	79,302	6.14
Exercised	(43,468)	2.22	(133,500)	2.18
Canceled	(38,572)	6.21	(1,875)	5.33
Balance, December 31, 2004	403,427	6.19	203,302	4.42
Granted	—	—	62,500	9.02
Exercised	(59,267)	2.60	(43,000)	1.98
Canceled	(9,857)	5.52	(6,667)	6.45
Balance, December 31, 2005	334,303	$ 6.85	216,135	$ 6.18

Incentive stock options expire ten years from the date of grant and substantially all are subject to continued employment with us. Each of the non-qualified options expires ten years from the date of grant with the exception of certain options granted to the founder of the Company that expire five years from the date of grant. Options are generally subject to vesting provisions that restrict exercise of the option.

2005 Stock Plan — The 2005 Stock Plan was approved by the shareholders in June 2005 and provides for awards of incentive stock options (as defined in section 422 of the Internal Revenue code) and non-qualified stock options. Option price, option term, vesting provisions and other limits and restrictions are determined at the time of grant by the Board of Directors or, if established, by a separate committee. The exercise price for all options granted was the market price of the common stock at the date of grant.

Options granted, exercised, canceled and outstanding under the 2005 Stock Plan are as follows:

	Qualified	
	Option Shares	Weighted Average Exercise Price
Balance, January 1, 2005	—	—
Granted	15,000	$ 11.72
Exercised	—	—
Canceled	—	—
Balance, December 31, 2005	15,000	$ 11.72

Incentive stock options expire ten years from the date of grant and substantially all are subject to continued employment with us. Options are generally subject to vesting provisions that restrict exercise of the option.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

The following table summarizes the options outstanding and exercisable under both the 1994 Stock Plan and the 2005 Stock Plan at December 31, 2005:

	Options Outstanding			Options Exercisable	
		Weighted Average			
Exercise Price Range	Number of Options	Contractual Life	Exercise Price	Number of Options	Weighted Average Exercise Price
Incentive stock options:					
$14.00 - $38.67	35,305	2.3 years	$ 16.66	35,305	$ 16.66
8.75 - 11.72	50,000	5.8 years	10.89	35,000	10.54
6.00 - 6.18	172,698	8.1 years	6.13	155,419	6.15
2.19 - 4.50	91,300	6.6 years	2.76	91,300	2.76
$ 2.19 - $38.67	349,303	6.8 years	$ 7.00	317,024	$ 6.83
Non-qualified stock options:					
$31.75	5,000	1.1 years	$ 31.75	5,000	$ 31.75
6.00 - 9.87	135,135	8.7 years	7.46	66,579	7.11
1.98 - 3.13	76,000	6.3 years	2.21	76,000	2.21
$ 1.98 - $31.75	216,135	7.7 years	$ 6.17	147,579	$ 5.42

Employment Contracts — We entered into an employment agreement with our President and Chief Executive Officer, Jeffrey B. Murphy beginning December 17, 2003. Under the original agreement, Mr. Murphy received a base salary of $250,000, subject to review annually for increase by our Board of Directors. In addition to base salary, Mr. Murphy was eligible for bonuses, expense reimbursements and health, dental, life and disability insurance consistent with that provided to other officers and employees. Additionally, Mr. Murphy was granted 100,000 options at $6.00 per share which vest over four years on March 12, 2004. Mr. Murphy's annual base salary was increased to $275,000 effective April 1, 2005 with the remaining terms of his agreement continuing unchanged.

Combined Retirement Plan — We combine our 401(k) Retirement Plan and Employee Stock Ownership Plan (ESOP) into a single KSOP retirement plan. The KSOP retains the features of each separate component except for eligibility and vesting provisions. Under the plan, employees become eligible to participate in the plan on the first day of the month after beginning employment and attaining age 21.

401(k) Retirement Component — We sponsor a defined contribution retirement component under Section 401(k) of the Internal Revenue Code for eligible employees. Our contributions are discretionary and are based on contributions made by employees. Expense recognized for 2005, 2004 and 2003 was $224,000, $221,000 and $204,000, respectively.

Employee Stock Ownership Component — We maintain an ESOP for our qualified employees. Our contributions are discretionary. We may contribute cash or shares of our common stock. No contributions were made or expense recorded in 2005, 2004 or 2003.

Other Employee Benefit Plans — We maintained bonus plans in 2005, 2004 and 2003 under which all employees, including officers, were eligible for a bonus based on our operating results. These bonuses aggregated $1.5 million, $1.3 million and $941,000 in 2005, 2004 and 2003, respectively.

Note 9 — SHAREHOLDERS' EQUITY

On September 15, 1998, our Board of Directors approved a share repurchase program authorizing the repurchase of up to $4.0 million of RTW, Inc. common stock. We may repurchase shares on the open market

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

or through private transactions depending upon market conditions and availability. Through December 31, 2005 we repurchased approximately 395,000 shares for $2.8 million. We expect to use repurchased shares for employee stock option and purchase plans and other corporate purposes.

Shareholder Rights Plan — In April 1997, we adopted a shareholder rights plan and declared a dividend of one right for each outstanding share of common stock to shareholders of record at the close of business on June 30, 1997. The rights become exercisable only after any person or group (the Acquiring Person) becomes the beneficial owner of 15% or more of the voting power of our common stock. Shares held by our Chairman Emeritus, David C. Prosser, and his wife are excluded from the computation for determining whether a person is an Acquiring Person. Each right entitles its registered holder to purchase from us one one-hundredth share of a new Series A Junior Participating Preferred Stock, no par value, at a price of $85 per one one-hundredth share, subject to adjustment. If any Acquiring Person acquires beneficial ownership of 15% or more of our voting power, each right will entitle its holder (other than such Acquiring Person) to purchase, at the then current purchase price of the right, that number of shares of our common stock having a market value of two times the purchase price of the right, subject to certain possible adjustments. In addition, if we are acquired in a merger or other business combination transaction, each right will entitle its holder to purchase, at the then current purchase price of the right, that number of common shares of the acquiring company having a market value of two times the purchase price of the right. Following the acquisition of a beneficial ownership of 15% or more of our outstanding common stock by any Acquiring Person and prior to an acquisition by any Acquiring Person of 50% or more of our outstanding common stock, our Board of Directors may exchange the outstanding rights (other than rights owned by such Acquiring Person), in whole or in part, at an exchange ratio of one share of common stock, or one one-hundredth share of Preferred Stock (or equivalent securities) per right, subject to adjustment. We may redeem the rights, in whole, at $.001 per right, at any time prior to an acquisition by any Acquiring Person of 15% or more of our outstanding common stock and prior to the expiration of the rights. The rights expire on April 17, 2007, unless extended or earlier redeemed by us.

Dividend Restrictions — Dividends are paid as determined by our Board of Directors. No cash dividends have ever been paid by us.

Our ability to pay cash dividends to shareholders may depend upon the amount of dividends received from our insurance subsidiary. ACIC's ability to pay dividends is restricted by law and in certain cases may be subject to approval of the insurance regulatory authorities of Minnesota.

Under Minnesota insurance law regulating the payment of dividends by ACIC unless otherwise approved by the Commissioner of the Minnesota Department of Commerce (Commissioner), dividends must be paid solely from the adjusted earned surplus of ACIC. Adjusted earned surplus means the earned surplus as determined in accordance with statutory accounting practices (unassigned funds), less 25% of the amount of such earned surplus that is attributable to unrealized capital gains. Further, without approval of the Commissioner, ACIC may not pay a dividend in any calendar year which, when combined with dividends paid in the preceding twelve months, exceeds the greater of: (i) 10% of ACIC's statutory capital and surplus at the prior year end; or (ii) 100% of ACIC's statutory net gain from operations (not including realized capital gains) for the prior calendar year. For 2005, dividends in excess of $4.1 million would require prior consent of the Commissioner.

Statutory Surplus and Statutory Net Income — Our insurance subsidiaries are required to file financial statements with state regulatory agencies. The accounting principles used to prepare the statutory financial statements follow prescribed accounting practices that differ from GAAP. Consolidated statutory capital and

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surplus at December 31, 2005 and 2004, and consolidated statutory net income for the years ended December 31, 2005, 2004 and 2003 are as follows (000's):

	Statutory Capital and Surplus	Statutory Net Income
2005	$ 43,597	$ 4,295
2004	38,503	7,540
2003		6,103

NOTE 10 — COMMITMENTS AND CONTINGENCIES

Operating Leases — We conduct our operations in leased office facilities under operating lease agreements. The agreements provide for monthly base lease payments plus contingent rentals based on an allocable portion of certain operating expenses incurred by the lessor.

Future minimum (base) rental payments required under the leases, as of December 31, 2005, are as follows (000's):

2006	$ 1,022
2007	670
2008	125
2009	140
2010	59

Rent expense, including contingent rentals, was $1.1 million for both 2005 and 2004 and $1.0 million for 2003.

Litigation: On April 12, 2005, RTW, Inc. commenced a Declaratory Judgment action in the United States District Court for the District of Minnesota against Carolina Casualty Insurance Company. In the lawsuit, RTW is seeking a Court determination that RTW is not liable for any part of a $1.9 million judgment entered against an insured of Carolina Casualty in District Court in Utah. Carolina Casualty counterclaimed against RTW alleging that RTW owes it $1.9 million, plus interest and attorneys fees.

On December 12, 2002, a Colorado employee of a Colorado care company insured by RTW's subsidiary, American Compensation Insurance Company, was injured in an automobile accident in Utah. The injured employee brought a separate underlying suit against Carolina Casualty's insured trucking company and driver for damages suffered as a result of the automobile accident.

While the underlying suit was pending, RTW administered and paid the workers' compensation claim of the insured employee. The total amount paid or accrued for future payment by RTW was $163,586. RTW then sought indemnification from Carolina Casualty under subrogation rights. In August 2004, Carolina Casualty's insured trucking company admitted full liability for the accident in the underlying suit.

In December 2004, Carolina Casualty agreed to pay and did pay RTW the full amount of RTW's subrogation claim. On January 14, 2005, after a jury trial on the injured employee's damages, the U.S. District Court in Utah entered a judgment of $1.9 million against Carolina Casualty's insured, which was equal to the injured employee's total damages, including $1,250,000 in general damages, less the $163,586 representing workers compensation benefits that had been paid, or accrued for future payments by RTW. Carolina Casualty subsequently settled the lawsuit with the injured worker for $1.8 million

In preparing the December 2004 settlement agreement for the workers' compensation subrogation claim, counsel appointed by Carolina Casualty for its insured inserted the provision that Carolina Casualty in its

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counterclaim alleged required full indemnification by RTW of any amounts that Carolina Casualty pays the injured employee as a result of the liability of Carolina Casualty's insured.

After Carolina Casualty's attorneys requested indemnification pursuant to this provision, RTW commenced the Declaratory Judgment suit described above. A similar Utah declaratory action initiated by Carolina Casualty and its insured has been dismissed and all matters will now proceed solely in United States District Court for the District of Minnesota.

RTW believes that it has good and meritorious defenses to the indemnification claims of Carolina Casualty. Discovery has been completed and RTW has filed a summary judgment motion for a declaration that it has no liability to Carolina Casualty. In opposing RTW's motion, Carolina Casualty apparently dropped its claim for indemnification with respect to the $1,250,000 portion of the judgment relating to general damages and requested that judgment be entered finding the claimed indemnity provision otherwise binding and enforceable. A hearing on the summary judgment motion has been scheduled before the Court for April 19, 2006 and a decision is expected sometime within 90 days of that date.

In the ordinary course of administering our workers' compensation programs, we are routinely involved in the adjudication of claims resulting from workplace injuries. We are not involved in any other legal or administrative claims that we believe are likely to have a material adverse effect on our financial condition or results of operations.

NOTE 11 —ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

Our accumulated other comprehensive (loss) income includes only unrealized gains and losses on investments classified as available-for-sale. Changes in accumulated other comprehensive (loss) income and other comprehensive loss were as follows (000's):

	2005	2004	2003
Accumulated other comprehensive income, beginning of year	$ 378	$ 973	$ 2,220
Changes in comprehensive income arising during the year:			
Net unrealized investment losses	(1,763)	(220)	(1,234)
Less: Adjustment for net realized investment gains	580	705	685
Change in net unrealized investment losses	(2,343)	(925)	(1,919)
Income tax benefit	(814)	(330)	(672)
Other comprehensive loss for the year	(1,529)	(595)	(1,247)
Accumulated other comprehensive (loss) income, end of year	$ (1,151)	$ 378	$ 973

NOTE 12 —QUARTERLY RESULTS OF OPERATIONS (Unaudited)

Quarterly revenues are affected by: (i) premiums in force at the beginning of the quarter; (ii) new policies written in the quarter; (iii) final audit premiums recognized during the quarter; and (iv) our policy renewal rate in the quarter. Historically, a majority of new policies written and policy renewals have occurred in the first, second and fourth quarters.

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

The following tables present unaudited quarterly income for the eight quarters ended December 31, 2005:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
		(In thousands, except per share data)		
2005				
Premiums in force	$ 62,100	$ 58,500	$ 55,900	$ 52,900
Revenues:				
Gross premiums earned	$ 15,730	$ 15,002	$ 15,261	$ 13,879
Premiums ceded	(2,750)	(2,612)	(2,609)	(2,481)
Premiums earned	12,980	12,390	12,652	11,398
Net investment income	1,054	1,108	1,207	1,244
Net realized investment gains	135	445	—	—
Service revenue	595	940	1,366	1,497
Total revenues	14,764	14,883	15,225	14,139
Expenses:				
Claim and claim settlement expenses	8,900	8,518	8,563	4,826
Policy acquisition costs	1,425	1,542	1,288	1,201
General and administrative expenses	2,875	2,817	3,093	3,884
Total expenses	13,200	12,877	12,944	9,911
Income from operations	$ 1,564	$ 2,006	$ 2,281	$ 4,228
Net income	$ 1,049	$ 1,321	$ 1,521	$ 2,107
Basic income per share	$ 0.20	$ 0.24	$ 0.28	$ 0.38
Diluted income per share	$ 0.19	$ 0.23	$ 0.27	$ 0.37

We have reclassified certain first quarter amounts within our Consolidated Statements of Income during the six months ended June 30, 2005 to be consistent with the second quarter presentation. Total expenses, net income and income per share amounts were unchanged.

The following represent pre-tax adjustments recorded during 2005 that affected reported net income:

Net realized investment gains	$ 135	$445	$ —	$ —
Net changes in estimates for unpaid claim and claim settlement expenses on claims reported in prior periods	500	500	500	3,550
Bonus expense	(223)	(82)	(220)	(998)

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RTW, INC.

Notes to Consolidated Financial Statements — (Continued)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share data)			
2004				
Premiums in force	$ 59,500	$ 62,400	$ 63,200	$ 62,700
Revenues:				
Gross premiums earned	$ 14,962	$ 15,376	$ 16,676	$ 16,356
Premiums ceded	(2,320)	(2,208)	(2,515)	(2,645)
Premiums earned	12,642	13,168	14,161	13,711
Net investment income	838	925	929	975
Net realized investment gains	649	58	(2)	—
Service revenue	67	73	143	350
Total revenues	14,196	14,224	15,231	15,036
Expenses:				
Claim and claim settlement expenses	9,230	9,005	10,061	7,240
Policy acquisition costs	1,410	1,959	1,531	1,145
General and administrative expenses	2,148	1,889	2,185	2,812
Total expenses	12,788	12,853	13,777	11,197
Income from operations	$ 1,408	$ 1,371	$ 1,454	$ 3,839
Net income	$ 930	$ 943	$ 1,093	$ 6,975
Basic income per share	$ 0.18	$ 0.18	$ 0.21	$ 1.32
Diluted income per share	$ 0.17	$ 0.17	$ 0.20	$ 1.25

The following represent pre-tax adjustments recorded during 2004 that affected reported net income:

Net realized investment gains	$ 649	$ 58	$ (2)	$ —
Net changes in estimates for unpaid claim and claim settlement expenses on claims reported in prior periods	300	850	200	3,246
Pool reapportionment charge	—	(478)	—	—
Bonus expense	(100)	(150)	(200)	(845)
Change in recorded deferred income tax valuation allowance	—	—	—	4,040

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ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

ITEM 9A. *CONTROLS AND PROCEDURES*

a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer, Jeffrey B. Murphy, and Chief Financial Officer, Alfred L. LaTendresse, have reviewed the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based upon this review, these officers have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that the disclosure controls are also effective to ensure that information required to be disclosed in the Company's Exchange Act reports is accumulated and communicated to management, including the chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

b) Changes in Internal Controls

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred during our fiscal quarter ended December 31, 2005, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. *OTHER INFORMATION*

Employment Agreement with Jeffrey B. Murphy

On March 28, 2006, the Company and Mr. Jeffrey B. Murphy, President and Chief Executive Officer, entered into an employment agreement that has an initial term beginning March 28, 2006 through March 31, 2007. Under this agreement, Mr. Murphy receives an annual base salary of $350,000, subject to review annually for increase by the Board of Directors. In addition to base salary, Mr. Murphy is eligible for bonuses, expense reimbursements and health, dental, life and disability insurance consistent with that provided to other officers and employees. Additionally, the Company agreed to provide Mr. Murphy with a $2.0 million term life insurance policy for the benefit of his wife and family and granted him a stock option on 10,000 shares, vesting one third upon grant, an additional one third on the first anniversary of the agreement and an additional one third upon the second anniversary of the agreement. The agreement will be extended for one year unless, at least 60 days prior to the anniversary of the agreement, either Mr. Murphy or the Company delivers to the other written notice of the intent not to extend the term of employment. In the event the agreement is terminated or not renewed by the Company without cause or by Mr. Murphy for good reason, Mr. Murphy would be entitled, for a period of nine months, to receive his salary and participate in the Company's health plans and to receive up to $25,000 in outplacement service payments.

On March 28, 2006, the Board of Directors approved the following Executive Officer salaries effective April 1, 2006:

Name	Salary	Position
Alfred L. LaTendresse	$ 220,000	Executive Vice President, Chief Financial Officer and Secretary
Thomas J. Byers	$ 180,000	Executive Vice President — Sales and Marketing
Keith D. Krueger	$ 187,000	Vice President — Insured Products and Assistant Secretary
David M. Dietz	$ 177,000	Vice President — Business Development
Patricia M. Sheveland	$ 177,000	Vice President — Case and Claims Management

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Non-Employee Director Compensation

On March 28, 2006 the Company and David C. Prosser, Chairman Emeritus of the Company amended the compensation arrangement between the Company and Mr. Prosser. Beginning April 1, 2006, Mr. David Prosser will receive the same compensation as the other non-employee members of the Board of Directors, plus Company-paid insurance in the amount of $5,000 per year. In lieu of receiving an annual option grant to non-employee Directors, Mr. Prosser will receive the cash value of these options, payable in equal installments on the same vesting schedule as the non-employee Director stock option grants.

Also on March 28, 2006 the Company's Board of Directors and its Compensation Committee also approved amending the 1994 and 2005 Stock Plans of the Company to eliminate the 2,500 share annual option grants to Directors. The Company intends to grant annual stock options or restricted stock grants in a manner that the Board may determine annually.

RTW, Inc. Resumes Share Repurchase Program

On March 30, 2006 the Company announced that it was resuming its common stock share repurchase program. A copy of the press release titled "RTW, Inc. Resumes Share Repurchase Program" is attached as Exhibit 99.1.

PART III

ITEM 10. *DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT*

Information with respect to Directors is contained in the Section entitled "Election of Directors" in our 2006 Proxy Statement and is incorporated herein by reference.

Information with respect to Executive Officers is included in PART I of this Annual Report on Form 10-K.

ITEM 11. *EXECUTIVE COMPENSATION*

Information required under this item is contained in the Section entitled "Executive Compensation and Other Information" in our 2006 Proxy Statement and is incorporated herein by reference.

ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Information required under this item is contained in the Section entitled "Security Ownership of Principal Shareholders and Management" in our 2006 Proxy Statement and is incorporated herein by reference.

ITEM 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS*

Information required under this item is contained in the Section entitled "Certain Transactions" in our 2006 Proxy Statement and is incorporated herein by reference.

ITEM 14. *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

Information required under this item is contained in the Section entitled "Principal Accountant Fees and Services" in our 2006 Proxy Statement and is incorporated herein by reference.

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PART IV

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a) Documents filed as Part of this Report

(1) Financial Statements. The following Consolidated Financial Statements are set forth on pages 36 through 60, Item 8 of this Report.

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets — December 31, 2005 and 2004
Consolidated Statements of Income — Years Ended December 31, 2005, 2004 and 2003
Consolidated Statements of Shareholders' Equity — Years Ended December 31, 2005, 2004 and 2003
Consolidated Statements of Cash Flows — Years Ended December 31, 2005, 2004 and 2003
Notes to Consolidated Financial Statements — Years Ended December 31, 2005, 2004 and 2003

(2) Financial Statement Schedules for the Three Years Ended December 31, 2005

	Page
Report of Independent Registered Public Accounting Firm on Schedules for the Years Ended December 31, 2005, 2004 and 2003	S-1
Schedule I — Summary of Investments	S-2
Schedule II — Condensed Financial Information (Parent Company)	S-3
Schedule III — Supplemental Information Concerning Insurance Operations	S-7
Schedule IV — Reinsurance	S-8
Schedule V — Valuation and Qualifying Accounts	S-9

All other schedules are omitted because they are not applicable or the required information is presented in the Consolidated Financial Statements or the notes thereto.

(c) Listing of Exhibits (* indicates compensatory plan)

3.1	Amended Articles of Incorporation(10)
3.2	Amended Bylaws(1)
4.1	Form of Rights Agreement dated April 17, 1997 between RTW, Inc. and Norwest Bank Minnesota National Association(2)
10.1*	Employment agreement between RTW, Inc. and Jeffrey B. Murphy dated March 28, 2006
10.2*	Amended RTW, Inc. 1995 Employee Stock Purchase Plan(11)
10.3*	Amended RTW, Inc. 1994 Stock Plan(4)
10.4*	RTW, Inc. 2005 Stock Plan(12)
10.5	Contract between RTW and ACIC dated January 1, 1992(5)
10.6	Service Agreement between RTW and ACIC dated February 1, 1992(5)
10.7*	Description of the 2006 Performance Incentive Program
10.8	Reinsurance contract between ACIC and First Excess and Reinsurance Corporation (GE Reinsurance Corporation) effective July 1, 1998(3)
10.9	Endorsement No. 2 to the reinsurance contract between ACIC and General Reinsurance Corporation(3)
10.9.1	Description of the Reinsurance Agreement for 2002 between ACIC and General Reinsurance Corporation effective January 1, 2002(6)
10.9.2	Description of the Reinsurance Agreement for 2003 between ACIC and General Reinsurance Corporation effective January 1, 2003(7)

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10.9.3	Description of the Reinsurance Agreement for 2004 between ACIC and General Reinsurance Corporation effective January 1, 2004(8)
10.9.4	Description of the Reinsurance Agreement for 2005 between ACIC and General Reinsurance Corporation effective January 1, 2005(9)
10.9.5	Description of the Reinsurance Agreement for 2006 between ACIC and General Reinsurance Corporation effective January 1, 2006
10.10	Minnesota Workers' Compensation Reinsurance Association reinsurance agreement
10.11	Election form for the 2006 Minnesota Workers' Compensation Reinsurance Association reinsurance agreement
10.12	Description of the Reinsurance Agreement for 2003 between ACIC and Everest Re/ Platinum Re effective January 1, 2003(7)
10.13	Description of the Reinsurance Agreement for 2004 between ACIC and various reinsurers effective January 1, 2004(8)
10.14	Description of the Reinsurance Agreement for 2005 between ACIC and various reinsurers effective January 1, 2005(9)
10.15	Description of the Reinsurance Agreement for 2006 between ACIC and various reinsurers effective January 1, 2006
11	Statement re: Computation of Income Per Share
21	Subsidiaries of the Registrant: The Company has two subsidiaries, American Compensation Insurance Company (ACIC), a Minnesota corporation, and Bloomington Compensation Insurance Company, a Minnesota corporation
23	Consent of Independent Registered Public Accounting Firm
24	Power of Attorney, included in Signature page
31.1	Certification of President and Chief Executive Officer
31.2	Certification of Chief Financial Officer
32	Certification Pursuant to 18 U.S.C. § 1350, Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2003
99.1	Share Repurchase Program Resumption

(1) Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 33-89164).

(2) Incorporated by reference to the Company's Registration Statement on Form 8-A filed April 25, 1997 (File No. 0-25508).

(3) Incorporated by reference to the Company's 1998 Annual Report on Form 10-K.

(4) Incorporated by reference to the Company's Registration Statement on Form S-8 (Reg. No. 333-81408).

(5) Incorporated by reference to the Company's Registration Statement on Form SB-2 (Reg. No. 33-2003C).

(6) Incorporated by reference to the Company's 2001 Annual Report on Form 10-K/ A.

(7) Incorporated by reference to the Company's 2002 Annual Report on Form 10-K.

(8) Incorporated by reference to the Company's 2003 Annual Report on Form 10-K.

(9) Incorporated by reference to the Company's 2004 Annual Report on Form 10-K.

(10) Incorporated by reference to the Company's Form 10-Q for the quarter ended March 31, 2004.

(11) Incorporated by reference to the Company's Registration Statement on Form S-8 (Reg. No. 333-114030) (March 30, 2004)

(12) Incorporated by reference to the Company's Registration Statement on Form S-8 (Reg. No. 333-127107) (August 2, 2005)

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

RTW, INC.

By /s/ Jeffrey B. Murphy

Jeffrey B. Murphy
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: March 30, 2006

Signatures and Power of Attorney

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons on behalf of the Registrant, in the capacities, and on the dates, indicated. Each person whose signature appears below constitutes and appoints Jeffrey B. Murphy and Alfred L. LaTendresse as his true and lawful attorney-in-fact and agents, each acting alone, with full power of substitutions and re-substitution, for him and in his name, place, and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with the exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission.

Date	Signature and Title
March 30, 2006	By /s/ John O. Goodwyne
	John O. Goodwyne Chairman of the Board
March 30, 2006	By /s/ Jeffrey B. Murphy
	Jeffrey B. Murphy President, Chief Executive Officer and Director (Principal Executive Officer)
March 30, 2006	By /s/ Alfred L. LaTendresse
	Alfred L. LaTendresse Executive Vice President, Chief Financial Officer, Treasurer and Secretary (Principal Financial and Accounting Officer)
March 30, 2006	By /s/ David C. Prosser
	David C. Prosser Chairman Emeritus of the Board
March 30, 2006	By /s/ Gregory D. Koschinska
	Gregory D. Koschinska Director

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Date	Signature and Title
March 30, 2006	By /s/ William J. Deters
	William J. Deters Director
March 30, 2006	By /s/ John W. Prosser
	John W. Prosser Director
March 30, 2006	By /s/ Vina L. Marquart
	Vina L. Marquart Director

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON SCHEDULES

The Board of Directors and Shareholders
RTW, Inc.
Minneapolis, Minnesota

We have audited the consolidated financial statements of RTW, Inc. as of December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005, and have issued our report thereon dated February 14, 2006. Our audits also included the financial statement schedules listed in Item 15(a)(2) of this Report on Form 10-K. These schedules are the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits.

In our opinion, the financial statement schedules referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

Minneapolis, Minnesota
February 14, 2006

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SCHEDULE I

RTW, INC.

SUMMARY OF INVESTMENTS
December 31, 2005

Type of Investment	Amortized Cost	Fair Value	Amount at Which Shown in the Balance Sheet
		(In thousands)	
Fixed maturities:			
Available-for-sale:			
Municipal securities	$ 18,658	$ 18,202	$ 18,202
Commercial paper	10,167	10,167	10,167
Mortgage backed securities	22,049	21,691	21,691
Asset backed securities	2,009	1,949	1,949
United States government, government agencies and authorities	56,138	55,241	55,241
Total Investments	$ 109,021	$ 107,250	$ 107,250

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SCHEDULE II

RTW, INC.

Condensed Financial Information of the Registrant
Balance Sheets
December 31, 2005 and 2004

	2005	2004
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 142	$ 150
Furniture and equipment, net	1,444	1,228
Investment in and advances to subsidiary	53,406	46,452
Other assets	1,441	1,126
	$ 56,433	$ 48,956
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accrued expenses and other liabilities	$ 5,855	$ 3,425
Total liabilities	5,855	3,425
Shareholders' equity	50,578	45,531
	$ 56,433	$ 48,956

See notes to condensed financial statements.

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SCHEDULE II

RTW, INC.

Condensed Financial Information of the Registrant
Statements of Operations
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
		(In thousands)	
Revenues:			
Intercompany fee income	$ 17,469	$ 18,289	$ 16,617
Service fee revenue	4,398	633	109
Investment income	14	104	2
Total revenues	21,881	19,026	16,728
Expenses:			
General and administrative expenses	18,327	15,933	15,898
Income from operations	3,554	3,093	830
Interest expense	—	—	48
Income before income taxes and equity in undistributed net income of subsidiary	3,554	3,093	782
Income tax expense	1,650	879	91
Income before equity in undistributed net income of subsidiary	1,904	2,214	691
Equity in undistributed net income of subsidiary	4,094	7,727	6,308
Net income	$ 5,998	$ 9,941	$ 6,999

See notes to condensed financial statements.

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SCHEDULE II

RTW, INC.

Condensed Financial Information of the Registrant
Statements of Cash Flows
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
		(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Reconciliation of net income to net cash provided by (used in) operating activities:			
Net income	$ 5,998	$ 9,941	$ 6,999
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	470	458	551
Equity in net (income) from subsidiary	(4,094)	(7,727)	(6,309)
Deferred income taxes	41	57	—
Changes in assets and liabilities:			
Accrued expenses and other liabilities	2,389	1,070	(539)
Other, net	(1,844)	(1,278)	(1,270)
Net cash provided by (used in) operating activities	2,960	2,521	(568)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in and advances to subsidiary	(2,860)	(2,625)	1,725
Purchases of furniture and equipment	(696)	(444)	(175)
Disposals of furniture and equipment	10	—	22
Net cash (used in) provided by investing activities	(3,546)	(3,069)	1,572
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on notes payable	—	—	(1,250)
Stock options exercised	479	533	19
Issuance of common stock under ESPP	99	65	43
Retirement of common stock	—	—	(37)
Net cash provided by (used in) financing activities	578	598	(1,225)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(8)	50	(221)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	150	100	321
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 142	$ 150	$ 100
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid (received) during the year for:			
Interest	$ —	$ —	$ 27
Income tax payments (refunds)	$ 148	$ (357)	$ (9)

See notes to condensed financial statements.

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SCHEDULE II

RTW, INC.

Condensed Financial Information of the Registrant
Notes to Condensed Financial Statements
Years Ended December 31, 2005, 2004 and 2003

NOTE 1 — ACCOUNTING POLICIES

The accompanying condensed financial information should be read in conjunction with the consolidated financial statements and notes included in the RTW, Inc. (RTW) 2005 Annual Report on Form 10-K.

We have reclassified certain amounts within our Condensed Financial Information of the Registrant, Balance Sheets at December 31, 2004 to be consistent with the 2005 presentation.

NOTE 2 — RELATED PARTY TRANSACTIONS

RTW provides American Compensation Insurance Company (“ACIC”), and ACIC’s subsidiary Bloomington Compensation Insurance Company (“BCIC”), with management services, including preparing and submitting filings, maintaining books and records, collecting premiums, administering and adjudicating claims, and performing other administrative services. RTW receives 10% of ACIC’s and BCIC’s gross premiums earned each month for these services, which amounted to $6.0 million, $6.3 million and $5.4 million for the years ended December 31, 2005, 2004 and 2003, respectively. In addition, RTW receives 15% of ACIC’s and BCIC’s gross premiums earned for claims administration during the year in which the premiums are earned and a total of 4% of gross premiums earned in subsequent years which amounted to $11.5 million, $12.0 million and $11.2 million for the years ended December 31, 2005, 2004 and 2003, respectively.

RTW files a consolidated federal tax return with ACIC and BCIC. Taxes are allocated between the companies based on a tax allocation agreement under which allocation is made primarily on a separate return basis for taxes incurred with current credit for any net operating losses or other items utilized in the consolidated tax return. This allocation is settled annually after completing and filing the federal tax return.

Amounts due from ACIC and BCIC related to the above transactions are included in the balance sheet account caption “Investment in and advances to subsidiary” and totaled approximately $7.9 million and $3.9 million at December 31, 2005 and 2004, respectively.

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SCHEDULE III

RTW, INC.

SUPPLEMENTAL INFORMATION CONCERNING INSURANCE OPERATIONS December 31, 2005

Year	Deferred Policy Acquisition Costs	(Column C) Reserves for Unpaid Claim and Claim Settlement Expenses	Discount, If Any, Deducted in Column C(1)	Unearned Premiums	Earned Premiums	Investment Income and Net Realized Investment Gains	Claim and Claim Settlement Expenses Incurred Related to: Current Year	Prior Years	Amortization of Deferred Policy Acquisition Costs	Paid Claim and Claim Settlement Expenses	Other Operating Expenses	Premiums Written
						(In thousands)						
2005	$ 889	$ 160,141	$ 343	$ 8,341	$ 49,420	$ 5,352	$36,264	$(5,457)	$ 5,456	$ 32,385	$ 12,842	$ 47,264
2004	$ 1,112	$ 156,123	$ 344	$ 10,497	$ 53,682	$ 4,432	$42,583	$(7,047)	$ 6,045	$ 35,713	$ 9,204	$ 54,999
2003	$ 926	$ 150,044	$ 505	$ 9,180	$ 46,290	$ 5,157	$33,954	$(6,698)	$ 6,878	$ 38,118	$ 10,789	$ 48,340

(1) Certain claims with fixed or determinable future payments are discounted at rates ranging from 3.5% to 8.0%.

BOWNE INTEGRATED TYPESETTING SYSTEM Site: BOWNE OF MINNESOTA Phone: (612) 330-0900 Operator: BOC99999T Date: 30-MAR-2006 08:24:49.65
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[B/E] CRC: 57813 BOC C03761 075.00.00.00 5/1
C03761.SUB, DocName: 10-K, Doc: 1, Page: 75 EDGAR 2

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SCHEDULE IV

RTW, INC.

REINSURANCE
Years Ended December 31, 2005, 2004 and 2003

Description	Premiums Earned				Percentage of Amount Assumed to Net
	Direct	Ceded to Other Companies	Assumed from Other Companies	Net	
			(In thousands)		
2005					
PREMIUMS — Workers' Compensation	$59,872	$ 10,452	$ —	$49,420	0.00%
2004					
PREMIUMS — Workers' Compensation	$63,370	$ 9,688	$ —	$53,682	0.00%
2003					
PREMIUMS — Workers' Compensation	$54,431	$ 8,141	$ —	$46,290	0.00%

BOWNE INTEGRATED TYPESETTING SYSTEM Site: BOWNE OF MINNESOTA Phone: (612) 330-0900 Operator: BOC99999T Date: 30-MAR-2006 08:24:49.65
Name: RTW, INC. [B/E] CRC: 28859 EDGAR 2 BOC C03761 076.00.00.00 4/1
C03761.SUB, DocName: 10-K, Doc: 1, Page: 76

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SCHEDULE V

RTW, INC.

VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 2005, 2004 and 2003

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Write-offs	Balance at End of Period
	(In thousands)				
2005					
Allowance for Doubtful Accounts	$ 90	$ 450	$ —	$ 348	$ 192
2004					
Allowance for Doubtful Accounts	$ 225	$ (107)	$ —	$ 28	$ 90
2003					
Allowance for Doubtful Accounts	$ 220	$ 507	$ —	$ 502	$ 225

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<DESCRIPTION> Employment Agreement - Jeffrey B. Murphy
<TEXT>

Exhibit 10.1

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "Agreement") is made and entered into as of March 28, 2006, between **RTW, INC.,** a Minnesota corporation (the "Company"), and **Jeffrey B. Murphy** ("Employee").

The Company and Employee are desirous of setting forth the terms and conditions of the employment by the Company of Employee as its President and Chief Executive Officer.

In consideration of the mutual covenants and agreements herein contained and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties intending to be legally bound do hereby agree as follows:

1. **Term**. The Company agrees to employ Employee and Employee agrees to serve the Company for a term beginning on the date hereof and terminating on March 31, 2007 (the "Expiration Date") unless and until terminated in accordance with the terms of this Agreement (the "Original Term"). Upon the expiration of the Original Term of this Agreement, and on each successive anniversary thereafter, the term of employment under this Agreement will be extended for one additional year, unless at least 60 days prior to any such anniversary, either Employee or the Company delivers to the other written notice of the notifying party's desire not to extend the term of employment. Notice by the Company of its desire not to extend the term of employment as provided in this Section will constitute Termination without Cause and entitle Employee to the benefits of Section 9 below.

2. **Services to be Rendered by Employee**. Employee agrees to serve the Company as its President and Chief Executive Officer and, in addition, at no additional compensation, serve as a member of the Board of Directors of RTW, Inc., and in such other directorships, Board committee memberships and offices of the Company and its subsidiaries to which Employee may from time to time be elected or appointed by the Chairman of the Board and the shareholders. Employee will perform such duties and exercise such powers as from time to time may be assigned to him consistent with his position, knowledge and experience, either orally or in writing, by the Board of Directors of the Company and will carry out his duties under the ultimate general direction and control of the Board of Directors. In his capacity as President and Chief Executive Officer, Employee will perform all reasonable acts customarily associated with such position, or necessary or desirable to protect and advance the best interests of the Company, together with such other reasonable duties as may be determined and assigned to him by the Board of Directors. Employee will perform such acts and carry out such duties, and will in all other respects serve the Company, faithfully and to the best of his ability.

3. **Time to be Devoted by Employee**. Employee agrees to devote substantially all of his business time, attention, efforts and abilities to the business of the Company and to use his best efforts to promote the interests of the Company. Employee confirms that he has no business interests of any kind that will require a significant portion of his business time. Employee may attend, however, to personal business and investments, engage in charitable activities and community affairs, and serve on a reasonable number of corporate, educational and civic boards so long as those activities do not interfere with Employee's duties under this Agreement, and in the case of service on any other corporate boards, Employee obtains prior approval from the Board of Directors.

4. **Compensation Payable to Employee**. As compensation for all of Employee's services (including services as director, Board committee member and officer of the Company and its subsidiaries) during the term of employment hereunder, the Company will pay to Employee a base salary at the rate of Three Hundred Fifty Thousand Dollars ($350,000) per annum (the "Annual Salary"), payable in semi-monthly installments, which base salary will be pro-rated for any partial years. The Compensation Committee will review the base salary annually in discussion with Employee and make recommendations for approval to the Board of Directors. Employee will participate with other corporate officers in any incentive compensation plan as may be adopted by the Board of Directors from time to time.

5. **Expenses**. During the term of employment, the Company will reimburse Employee for reasonable travel and other expenses incurred in performing his duties according to Company policies then in effect. Payments to Employee under this paragraph will be made after the Employee presents expense vouchers in such detail as the Company may from time to time reasonably require.

6. **Benefits**. Employee's benefits will be the same as provided for any other executive officer except that the Company will additionally provide Employee with a $2.0 million term life insurance policy for the benefit of his wife and family. The policy will be of reasonable cost as determined by the Board of Directors and the cost will be included in Employee's W-2 at year end for tax purposes. Further, the Company will, at the Company's expense, maintain directors and officers' liability insurance coverage during the term of this Agreement with minimum limits of $5,000,000, unless the cost thereof is not economically feasible as determined by the Board of Directors.

7. **Stock Option(s)**.

7.1. Grant. In addition to options granted in conjunction with the Company's 2005 Incentive Program, the Company hereby further grants Employee ten-year stock options to purchase up to 10,000 shares of the Company's Common Stock (the "Option(s)"). The per share price to be paid by Employee upon exercise of the Option(s) is the closing price of the Company's Common Stock, as

reported by NASDAQ, on the date this agreement is executed. The Option(s) will be incentive stock options to the extent allowed by the Internal Revenue Code. The Compensation Committee will consider similar future grants as part of its duty in reviewing Employee's annual compensation.

7.2. Vesting. The Option(s) will become exercisable in three (3) installments of the Company's Common Stock ("Option Installment") as follows: (i) the first Option Installment representing 3,334 shares is immediately exercisable as of the date this agreement is executed, and (ii) two additional Option Installments of 3,333 shares will vest on each of the following two anniversary dates of this Agreement, if the Employee is still employed by the Company on such dates.

7.3. Exercise Period. The Option(s) will become void and expire as to all unexercised Option shares ten years from the effective date of this Agreement.

7.4. Additional Terms. The remaining terms of the Option(s) are as set forth in the Option Agreement(s) dated this date.

8. **Termination.**

8.1. General. This Agreement and Employee's employment may be terminated as set forth in Section 8.2. In the event of termination of employment for any of the following reasons, Employee must resign as a director and officer of the Company and any of its subsidiaries at or prior to the effective Date of Termination.

8.2. Events of Termination. The Agreement may be terminated as follows:

(i) By Employee, upon 60 days prior written notice to the Company;

(ii) By Employee for Good Reason (as defined in Section 8.4 (iii) of this Agreement) upon 60 days prior written notice to the Company;

(iii) By the Company for Cause (as defined in this Agreement), immediately upon written notice to Employee;

(iv) By the Company for any reason (without cause) and at any time, upon 60 days prior written notice to Employee; or

(v) By the Company at any time in the event of Employee's Disability (as defined in this Agreement.)

8.3. Death. This Agreement will automatically terminate upon Employee's death.

8.4. Definitions. For purposes of this Agreement, the following terms have the meanings set forth below:

(i) Disability. "Disability" means that if, in the reasonable judgment of the Board of Directors, the Employee's incapacity due to physical or mental illness, or otherwise, keeps him from performing satisfactorily all of his duties hereunder on a substantially full-time basis for a period of three months during the term of this Agreement.

(ii) Cause. The Company will have "Cause" to terminate Employee's employment hereunder upon Employee's:

(A) refusal or neglect to perform and discharge his duties and responsibilities hereunder;

(B) gross misconduct that is injurious to the Company;

(C) fraud, embezzlement or other act of dishonesty of Employee with respect to the Company;

(D) conviction of, or plea of guilty or nolo contendere entered by Employee to, a felony or crime involving moral turpitude or which conviction or plea is likely to have a material adverse effect upon the Company or upon Executive's ability to perform his duties hereunder;

(E) willful or prolonged absence from work by Employee (other than by reason of disability due to physical or mental illness); or

(F) willful commission of acts or making of false statements by Employee that reflect adversely, in material respects, upon the Company or its business, customers or other employees.

(iii) Good Reason. "Good Reason" means the Company, without express written consent,

(A) materially reduces Employee's principal duties, responsibilities, or authority as President and Chief Executive Officer, including requiring Employee to report to any person or body other than the Board of Directors of the Company;

(B) reduces Employee's annual base compensation as described in Section 4; or

(C) materially breaches this Agreement.

BOWNE INTEGRATED TYPESETTING SYSTEM Site: BOWNE OF MINNESOTA Phone: (612) 330-0900 Operator: BOC99999T Date: 30-MAR-2006 08:24:49.65
Name: RTW, INC. [E/O] CRC: 55612 BOC C03761 710.01.05.00 0/1
C03761.SUB, DocName: EX-10.1, Doc: 2, Page: 5 EDGAR 2
Description: Exhibit 10.1

The occurrence of an event described in this subparagraph 8.4(iii) will not constitute Good Reason unless, within 60 days thereof Employee provides the Company written notice stating that an event of Good Reason has occurred and describing that event, and the Company does not correct the same, if the same is correctable, within 30 days.

(iv) Date of Termination. The term "Date of Termination" means the earlier of:

(A) the Expiration Date, or

(B) if Employee's employment is terminated by his death, the date of his death, or

(C) if Employee's employment is terminated for any other reason, the date on which notice of termination is given either to Employee by the Company or to the Company by Employee unless another date is specified in the Notice of Termination.

9. **Consequences of Termination.**

9.1. Termination for Cause; Voluntary Resignation without Good Reason. If employment is terminated by the Company for Cause or by Employee without Good Reason, then Employee will be paid (i) his base salary to the date of termination and (ii) the unpaid portion of any bonus or incentive amount earned for the fiscal year ending prior to the termination of employment that Employee is entitled to receive under the terms of the annual incentive plan. Employee will not be entitled to receive any base salary or fringe benefits for any period after the date of termination, except for the right to receive benefits that have become vested under any benefit plan or to which Employee is entitled as a matter of law.

9.2. Termination without Cause; Resignation for Good Reason. If the Company terminates employment without Cause or does not extend the term of employment, or if Employee resigns employment for Good Reason, then:

(i) For a period of nine months after the effective date of the termination of employment;

(A) The Company will continue to pay Employee's then current base salary in accordance with the Company's normal payroll practice; and

(B) Employee will be entitled to continued participation in the health care coverage and life insurance benefit plans of the Company, as in effect on the date of termination. The Company will continue to pay its share of the health care and life insurance premiums for this coverage, and Employee will pay his share of the cost associated with that coverage as if he were still actively employed by the Company. If Employee cannot be covered under any of the Company's group plans or policies, the Company will reimburse Employee for his full cost of obtaining comparable alternative or individual coverage elsewhere, less any contribution that Employee would have been required to make under the Company's group plans or policies. If, during the aforesaid nine-month period, Employee is employed by a third party and becomes eligible for any health care coverage provided by that third party, the Company will not, thereafter, be obligated to provide Employee with the insurance benefits described in this clause (B). This nine -month coverage will run concurrently with COBRA and thereafter Employee will be responsible for the full cost of any such coverage for which he may be entitled by law.

(ii) The Company will pay the unpaid portion of any bonus or incentive amount earned by Employee for the fiscal year ending prior to the termination of employment that Employee is entitled to receive under the terms of the applicable incentive plan as well as any pro-rata bonus or incentive amount through the date of termination. Any pro rata bonus or other incentive amount due pursuant to this paragraph 9.2 (ii) will be due on the date the payments are made to other employees of the Company.

(iii) The Company will pay Employee $25,000 for out-placement and job search services.

9.3. Termination in the Event of Death or Disability. If employment terminates due to Employee's Death or if the Company terminates employment due to a Disability, then:

(i) The Company will continue to pay base salary to Employee's estate or to Employee for the remainder of the month in which the death occurs or in

which employment is terminated due to Disability, together with the unpaid portion of any bonus or incentive amount earned by Employee for the fiscal year ending prior to the termination of employment which he is entitled to receive under the terms of the applicable incentive plan as well as any pro-rata bonus or incentive amount through the date of termination; and in the event of termination due to Disability, Employee will continue to receive, during that month, all of the fringe benefits then being paid or provided to him; and

(ii) Employee will be entitled to receive all Disability and other benefits, such as continued health coverage or life insurance proceeds, provided in accordance with the terms and condition of the health care coverage, life insurance, disability, or other employee benefit plans of the Company and applicable law.

10. **Confidentiality**. Employee agrees while in the employ of the Company (otherwise than in the performance of his duties hereunder) and thereafter not to, directly or indirectly, make use of, or divulge to any person, firm, corporation, entity or business organization, and to use his best efforts to prevent the publication or disclosure of, any confidential or proprietary information concerning the business, accounts or finances of, or any of the methods of doing business used by, the Company or its affiliates or of the dealings, transactions or affairs of the Company or its affiliates or any of their respective customers that have or may have come to his knowledge during his employment by the Company.

11. **Notices**. All notices under this Agreement must be in writing and will be effective either (i) when delivered in person at the address set forth below, or (ii) three business days after deposit in a sealed envelope in the United States Mail, postage prepaid, by registered or certified mail, return receipt requested, addressed to the recipient as set forth below, whichever is earlier.

All notices to the Company must be sent to:

RTW, Inc.
8500 Normandale Lake Boulevard
Minneapolis, MN 55437
Attn: Chairman of the Board

All notices to Employee must be sent to:

Mr. Jeffrey B. Murphy

These addresses may be changed by notice given in accordance with this Section 11.

12. **Miscellaneous**. This Agreement may not be changed nor may any provision hereof be waived, except by an instrument in writing duly signed by the party to be charged. This Agreement will be interpreted, governed and controlled by the internal laws of the State of Minnesota, without reference to principles of conflict of law. This Agreement will terminate in the event of the liquidation and winding up of the business of the Company but will continue in effect in the event of the merger or sale of the Company into or to another entity or the transfer of substantially all of the assets of the Company to another entity. The provisions of Section 10 hereof will survive any termination of this Agreement. This agreement replaces in its entirety Employee's employment agreement dated as of March 12, 2004.

[Remainder of page intentionally left blank.]

IN WITNESS WHEREOF, this Agreement has been executed as of the day and year first above written.

COMPANY:

RTW, Inc.

By: /s/ John O. Goodwyne
John O. Goodwyne
Chairman of the Board

EMPLOYEE:

/s/ Jeffrey B. Murphy
Jeffrey B. Murphy
President and CEO

<DOCUMENT>
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<DESCRIPTION> Description of the 2006 Performance Incentive Program
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Exhibit 10.7

2006 Performance Incentive Programs

Employees of the Company are eligible to receive cash incentives based on the 2006 year-end results of RTW, Inc. and its Subsidiaries. All employees of the Company are eligible to participate in this program. Under the program, a portion of plan pre-tax earnings and pre-tax earnings in excess of planned results, excluding investment income, are contributed to a general pool and distributed in 2007. Incentive amounts will be distributed as a percentage (%) of salary and on a discretionary basis to employees. Any incentive program payment will be made annually after completing the year-end audit.

Executive officers, additionally, earn stock options based upon exceeding the Company's pre-tax, pre-cash incentive, pre-investment income earnings plan for 2006 and are eligible for an additional discretionary bonus. Executive officers are eligible for a fixed number of options, pro-rated on a sliding scale, in excess of the profit plan, up to a maximum level. Any stock option grant will be made annually after completing the 2006 year-end audit.

<DOCUMENT>
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C03761.SUB, DocName: EX-10.9.5, Doc: 4, Page: 1 EDGAR 2
Description: EX-10.9.5

Exhibit 10.9.5

Description of the Reinsurance Agreement for 2006 between ACIC and General Reinsurance Corporation effective January 1, 2006

The Company, on behalf of its subsidiaries American Compensation Insurance Company (ACIC) and Bloomington Compensation Insurance Company (BCIC), entered into a reinsurance contract for the fiscal year beginning January 1, 2006. The following summarizes the significant terms of this reinsurance contract.

LIABILITY OF THE REINSURER

The Reinsurer shall pay to ACIC and BCIC, with respect to Workers' Compensation and Employers' Liability Business, the amount of Net Loss for each Occurrence, as defined in the contract, in excess of ACIC's and BCIC's retention, but not exceeding the Limits of Liability of the Reinsurer as follows:

Loss Layer	Reinsurer	Comment
$5,000,000 excess $5,000,000	General Reinsurance Corporation	Non Minnesota losses
$10,000,000 excess $10,000,000	General Reinsurance Corporation	Non Minnesota losses. Net loss for any one employee shall not exceed $10,000,000
Excess of $20,000,000		Non Minnesota losses 100% retained by ACIC

COMMENCEMENT AND TERMINATION

The contract shall apply to new and renewal policies of ACIC and BCIC becoming effective at and after 12:01 A.M., January 1, 2006, and to policies in force at 12:01 A.M., January 1, 2006, with respect to losses resulting from Occurrences taking place at or after the aforesaid time and date.

The contract is for one year and automatically expires at 12:01 A.M. on January 1, 2007. The Reinsurer may also terminate the contract in the event of significant adverse events at ACIC or BCIC or in the event of a change in control of ACIC, BCIC or RTW, Inc.

REINSURANCE PREMIUM

ACIC and BCIC agreed to pay the Reinsurer based on subject premiums earned for each Loss Layer as shown above. These rates are similar to the rates that we paid in 2005.

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Exhibit 10.10

WORKERS' COMPENSATION REINSURANCE ASSOCIATION

REINSURANCE AGREEMENT

Effective January 1, 2006

Workers' Compensation Reinsurance Association Reinsurance Agreement

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Effective January 1, 2006

NATURE AND SCOPE OF AGREEMENT

A. The Purpose

The purpose of this Reinsurance Agreement (the “Agreement”) is to set forth the basic conditions of the reinsuring agreement between the Workers’ Compensation Reinsurance Association (“Association”) and the Member. This Agreement is authorized by the Association’s Enabling Act (Minnesota Statutes §§ 79:34—79.40), (the “Enabling Act”); its Plan of Operation (the “Plan”); and its Operating Rules.

Ref: Plan, Article VI.K.

B. Parties

This Agreement is solely between the Member and the Association. All affiliated insurers or self-insurers within a holding company system shall be considered a single entity for purposes of the exercise of all rights and duties of membership in the Association. Nothing in this Agreement shall establish any rights in favor of any third party. Nothing in this Agreement shall create any liability or responsibility on the part of the Association for actions of the Member or other members. Nothing in this Agreement shall limit the Member’s liability to employers, employees and others under Minn. Stat. Chs. 79 and 176 and other Minnesota law.

Ref: Minn. Stat. § 79.34. subd. 1.
Plan, Article VI.E.L., and VI.M.

C. Definitions

To the extent defined in the Plan or in Operating Rules, the words used in this Agreement shall have the meanings given them by the Plan and the Operating Rules.

Ref: Plan, Article I.

D. Agreement Incorporates by Reference the Plan and the Operating Rules

This Agreement incorporates by reference the Plan and the Operating Rules as they may from time to time be amended. The provisions of the Enabling Act, Plan, and Operating Rules shall be controlling over any conflicting provisions of this Agreement.

Ref: Plan, Article IX.E.

PART ONE:
Reinsurance Agreements

A. Liability of Association

The Association shall reinsure the Member’s Minnesota workers’ compensation liability and shall indemnify the Member for 100 percent of the amount of ultimate loss arising out of each occurrence compensable under Minn. Stat. Ch. 176 to the extent that the ultimate loss exceeds the Member’s retention limit in effect at the time of the loss occurrence and subject to the terms and conditions of the Enabling Act, the Plan, and the Operating Rules.

Ref: Minn. Stat. § 79.34, subd. 2.
Plan, Article VI.A.

B. Member’s Duties

The Member shall comply with all requirements of the Enabling Act, Plan, and Operating Rules. These requirements include, but are not limited to, the following: The Member shall reinsure its Minnesota workers’ compensation liability with the Association, pay all benefits for losses reinsured by the Association that are covered by the terms and conditions of the original policies issued to the Member’s insureds, belong to the Association, accept indemnification from the Association, and report to the Association claims for

benefits which may involve liability to the Association.

Ref: Minn. Stat. § 79.34, subds. 1 and 2.
Plan, Article III. and Article VI.A.

PART TWO:
Retention Limits

The Member shall select the low, high or super retention limit for each calendar year. The retention limits may be changed annually on January 1. The Member shall notify the Association by certified mail or fax of any change of its retention limit selection by December 1 of the year preceding the coverage year. All affiliated insurers or self-insurers within a holding company system shall select the same retention limit. If the Association is not notified of the Member's change of retention limit for the next coverage year by December 1, the Member shall be deemed to have chosen for the next coverage year the same retention limit (low, high, or super retention limit) which was in effect on December 1.

Ref: Minn. Stat. § 79.34, subds, 1 and 2.
Plan, Article VI.A.

PART THREE:
Reinsurance Provided by Association Exclusive

A Member selecting the high or super retention limit shall not purchase reinsurance for losses below its retention limit except in certain circumstances specified by statute. A Member selecting the low retention limit may purchase reinsurance from other organizations to provide indemnification for losses below its retention limit. A Member shall not issue large deductible policies in Minnesota for deductible amounts in excess of its selected retention limit.

Ref: Minn. Stat. § 79.34, subd. 2.
Minn. Dept. of Commerce, Bulletin 91-5

PART FOUR:
Coverage

A. General Scope

The reinsurance provided by the Association shall cover only benefits under Minn. Stat. Ch. 176 which are paid by the Member, provided that for losses incurred on or after January 1, 1984, the reinsurance provided shall cover benefits paid by the Member under the workers' compensation law of another state when the injured worker is eligible for benefits under Minn. Stat. § 176.041, subds. 2 or 3, but elects to receive benefits under the workers' compensation statute of such other state, as provided in Minn. Stat. § 79.34 subd. 7. Any amounts paid by a Member pursuant to Minn. Stat. §§ 176.183; 176.221, subd. 1; 176.225; and 176,82 shall not be included in ultimate loss and shall not be indemnified by the Association. Employers' liability coverage is not provided by the Association. The Association does not cover claims under the Federal Employers' Liability Act, the Jones Act, the Longshoremen's and Harbor Workers' Compensation Act, or any other federal law.

Ref: Minn. Stat. § 79.34, subds. 2 and 7.
Minn. Stat. § 176.041, subds. 2 and 3.
Plan, Article VI.

B. Per Occurrence Basis

Coverage shall be provided on a per occurrence basis, as determined by the Association, except as otherwise provided by statute, including, in the case of occupational disease, where coverage is provided on a per person per occurrence basis.

Ref: Minn. Stat. § 79.34, subd. 2.
Plan, Article I.N. and Article VI.

Effective January 1, 2006

C. Claims Expenses

Claims expenses, assessments, damages and penalties shall not be indemnified by the Association. Claims expenses include investigation and legal expenses, court costs, interest and penalties. Expenses subject to indemnification include expenditures incurred in the preparation and development of a rehabilitation plan submitted to the Department of Labor and Industry and in the provision of rehabilitation services rendered in accordance with such a rehabilitation plan.

Ref: Minn. Stat. § 79.34, subd. 2.
Plan, Article I.G.
Operating Rule for Clarification of the Definition of Claims Expenses

D. Assessments

Assessments, including Special Compensation Fund assessments under Minn. Stat. §§ 176.129 and 176.131 shall not be reimbursed by the Association.

Ref: Minn. Stat. §§ 176.129 and 79.34, subd. 2.
Plan, Article VI.

E. Effective Date

Coverage shall be effective as of 12:01 A.M. on the date that the Member's authority to either insure or self-insure workers' compensation liabilities is approved by the Minnesota Department of Commerce. In no case shall the Association be liable for benefits for occurrences taking place prior to October 1, 1979. The Association shall have no liability for death benefits where an injury prior to October 1, 1979, causes or contributes to death on or after October 1, 1979. Effective January 1, 1984, certain benefits paid pursuant to the workers' compensation laws of other states will be covered, as provided in Part Four A. of this Agreement.

Ref: Minn. Stat. § 79.34, subds. 1, 2 and 7.

PART FIVE:
Premiums

A. Annual Premium

The Member shall pay an annual premium, together with any premium surcharges, for the reinsurance coverage provided by the Association at the rate determined by the Board of Directors of the Association ("Board of Directors") and approved by the Minnesota Commissioner of Labor and Industry ("Commissioner"). Estimated premium shall be calculated in accordance with procedures established in the Operating Rule for Determination of Exposure Base. The estimated exposure base for a Member may be revised after six months of the coverage year if the member verifies that its current annualized six month exposure base is at least fifteen percent higher or lower than its estimated exposure base. When the actual exposure base figures for the billing year become available, the actual premium shall be calculated. A premium adjustment shall be made as provided in Part Five D. of this Agreement.

Ref: Minn. Stat. § 79.35(d).
Plan, Article VI.D.
Operating Rule for Determination of Exposure Base

B. Billing of Premium

The estimated premium shall be billed on an annual or quarterly basis, and shall be payable within 30 days of the date of mailing of the premium notice, with late payments subject to interest charges established by the Board of Directors.

Ref: Plan, Article VI.D.3.

C. Offset

The Association may offset indemnification payable to the Member against premium payable by the Member. Premiums payable shall not be offset by

the Member against indemnification claimed by the Member.

Ref: Plan, Article VI.D.3.C.

D. Annual Adjustment of Premium

The Association shall annually provide to the Member a statement indicating adjustments for previous years' premium. Amounts due the Association as a result of the adjustment shall be paid by the Member within 30 days of the date of mailing of the adjusted premium notice, with late payments subject to interest charges established by the Board of Directors. Amounts due the Member shall be credited to the Member's premium account with the Association, and any credit premium balance shall be refunded to the Member within 30 days, provided, however, that the Member has no additional premiums due and unpaid in the year the refund is to be made. If the Member has additional premiums due and unpaid in the year the refund is to be made, the Association may apply any credit premium balance against the due and unpaid premium.

Ref: Plan, Article VI.D.2.b.
Operating Rule for Determination of Exposure Base
Operating Rule for Annual and Audit
Premium Adjustment Refunds

E. Interim Adjustment of Premium

A Member who ceases doing business in Minnesota or a self-insurer Member who ceases to be an approved self-insurer may request an interim adjustment of estimated annual premium.

Ref: Operating Rule for Interim Adjustment
of Estimated Annual Premium

F. Surplus Distributions and Deficiency Assessments

The Board of Directors may declare a distribution of surplus or assessment of deficiencies in the form of member excess or deficient premiums or policyholder excess surplus or deficiencies as required by the Operating Rule for the Determination of Surplus. Such distributions or assessments may result from statutory changes, changes in the exposure base, or excess or deficient funds. Distributions of surplus and deficiency assessments shall be made as required by the Board of Directors in accordance with the Enabling Act, Plan and Operating Rule for the Determination of Surplus as they have been interpreted by the courts.

Ref: Minn. Stat. § 79.34, et seq.
Plan, Article VI.D.l.d. and VI.N.
Operating Rule for the
Determination of Surplus

G. Premiums for Unfunded Coverage

In the event that benefits paid or expected to be paid on any claims in a calendar year exceed the prefunded limit in effect at the time the loss was incurred, the Association shall calculate and charge to all Members an additional premium for that year sufficient to cover the payments in excess of the prefunded limit. The premium shall be charged and collected in the same manner as the annual premium.

Ref: Minn, Stat. § 79.35(d).

H. Premium Audits

The Association may inspect and audit any Member's records to determine the accuracy of the premium calculation. The Member shall timely provide all information requested and shall in all respects cooperate fully in providing information during the course of an audit.

Ref: Plan, Article VI.D.2.f.

Effective January 1, 2006

PART SIX:

Reimbursement Procedure for Indemnification of Ultimate Losses in Excess of a Member's Retention Limit

Requests for reimbursement shall be submitted in a form approved by the Association. The first request shall be submitted within six months after the Member's payments on a loss exceed the Member's Retention Limit. Thereafter the Member, if entitled to indemnification by the Association, shall file a reimbursement request form semiannually until the claim is closed. The request shall be submitted to the Association in accordance with the provisions of the Operating Rule for Reimbursement Procedures. The Member and the Association may, in the alternative, agree upon a semiannual reimbursement cycle, whereby all of the Member's reimbursement requests, regardless of loss occurrence date, are filed on the same cycle. If a claim settles on a full, final and complete basis, or the claim file is closed, a reimbursement request may be filed at any time. If payments for which reimbursement is due exceed $30,000 in the three months following a regularly scheduled reimbursement date, a reimbursement request may be filed in the following month. The reimbursement request shall itemize all payments of benefits since submission of the last reimbursement request.

Proper and complete reimbursement requests for indemnification of Ultimate Losses in excess of a Member's Retention Limit shall be promptly paid by the Association.

Ref: Plan, Article VI.
Operating Rule for Reimbursement Procedures

PART SEVEN:

Management of Claims and Losses

A. Claims

The Member shall have the primary responsibility for the investigation, management, and defense of all claims. The Member may settle and compromise disputed claims that are within the terms and conditions of the original policies issued by the Member and are consistent with the claims procedures established by the Association. If the Association, in its sole discretion, determines that the claims procedures or practices of a Member are inadequate to properly limit the liabilities of the Association, or may, in any way, jeopardize the interests of the Association, the Association may withhold reimbursements from the Member until it determines that the deficiencies in the claims procedures and practices have been resolved, or the Association may, with the approval of the Board of Directors and at the Member's expense, undertake directly or contract with another person, including another Member, to adjust or assist in the adjustment of a Claim or Claims which create a potential liability to the Association. Except as provided by Minn. Stat. § 79.35(g), the Association may charge the costs and expenses of these activities, including legal expenses, to the Member. The Member shall cooperate fully with the Association in such claims management. If the Board of Directors determines that the claims procedures or practices of a Member are inadequate to properly service the liabilities of the Association, or may, in any way, jeopardize the interests of the Association, the Association may also recommend to the Commissioner and the Commissioner of Commerce that an Insurer Member's license to transact workers' compensation insurance, or a Self-insurer Member's authorization to self-insure workers' compensation liability, pursuant to Minn. Stat. § 176.181, be revoked.

Ref: Minn. Stat. § 79.35(g).
Plan, Article VI.F.4.
Operating Rule for the Adjustment of Claims

Effective January 1, 2006

B. Claims Audits

The Association may inspect and audit the Member's records relating to all claims or related matters. The Member shall timely provide all information requested and shall in all respects cooperate fully in providing information during the course of an audit.

Ref: Minn. Stat. § 79.35(g).
Plan, Article VI.F.3.

C. Reporting Requirements

Members shall promptly notify the Association of any claim meeting any of the following reporting criteria.

1. Catastrophic Injury Criteria

   When a claimant has suffered a catastrophic injury as described in the following list, the Member shall notify the Association of the injury within 15 business days of notification of the injury to the Member.

   a) Central Nervous System Injury

      1) Spinal cord injury resulting in paraplegia or quadriplegia.

      2) Brain damage affecting cognition and/or such conditions as permanent disorientation, behavior disorder, personality change, seizure disorder, sensorimotor deficits, aphasia, or coma.

   b) Fatality, except for a no dependent exposure.

   c) Third-degree burns covering 10 percent of the body, or second-degree burns covering 30 percent of the body, or if significant medical costs can be anticipated.

   d) Amputations of a significant portion of one extremity or multiple amputations.

2. Serious Injury Criteria

   When a claimant has suffered a serious injury as described in the following list, the Member shall promptly notify the Association.

   a) Impairment of total vision by 50 percent or more.

   b) Peripheral nerve damage causing major muscle dysfunction or paralysis in an upper or lower extremity.

   c) Serious internal injuries resulting from blunt, penetrating, or crushing injuries to the chest or abdomen.

   d) Multiple fractures, or significant degloving injuries, involving more than one arm, hand, or leg, malunion, or significant shortening of the limbs.

   e) Fracture of both heel bones (bilateral os calcis).

   f) Occupational disease allegedly caused by working conditions or other job-related factors, including asbestosis, or chronic pulmonary disease, or other occupational disease which results in disability expected to last two years or more.

3. Claim Cost Criteria

   When a Member estimates that the total incurred cost (payments and reserves for future payments) of a claim exceeds 50 percent of the retention limit which was in effect during the year when the loss was incurred, the Member shall promptly notify the Association.

Ref: Plan, Article VI.B.1.
Operating Rule for Claim Reporting Procedure

D. Legal Proceedings

The Association may intervene in legal proceedings under Minnesota Statutes Chapters 79 and 176 and in any other legal proceedings where the result of the proceeding is considered likely to affect the interests of the Association. The Association shall notify the affected Member prior to intervening.

Ref: Minn. Stat. § 79.36(f).
Plan, Article VI.H.
Operating Rule for Intervention in Legal Proceedings

PART EIGHT:
Subrogation, Salvage, and Third Party Recoveries

The Member shall, to the extent permitted by law, prosecute or intervene in any and all claims against third parties arising out of any covered loss occurrence and all recoveries therefrom shall be applied to reduce the loss which the Association is required to reimburse to the Member; provided, however, that a Member may waive its subrogation rights in writing in advance of any loss occurrence.

If the Member fails or neglects to enforce any such claims, the Association may reduce the Member's reimbursement for such claim by the amount the Member would have recovered from such third parties. In the alternative, the Association may, in its sole discretion, enforce the Member's rights of subrogation against such third parties. The net proceeds recovered, if any, shall be distributed first to the Association to the extent of amounts paid or payable in the future by the Association for the claim. Any excess recovered by the Association shall be paid to the Member or other person entitled to the proceeds, as determined by the Board of Directors,

If the Member waives its subrogation rights after a claim has occurred without first obtaining the agreement of the Association, and the Association determines that it was not in its best interests to waive subrogation, the Association may refuse to indemnify the Member for that claim to the extent of amounts which the Association determines would have been recoverable through subrogation. The Association may withhold reimbursements to the Member for other claims to recover reimbursements already made on the claim where subrogation was waived.

Ref: Minn. Stat. § 79.36(g)
Plan, Article VI.E.3. and VI.G.
Operating Rule for the Adjustment of Claims
Operating Rule for Approval of Waivers of Subrogation

PART NINE:
Recoveries Under The Terrorism Risk Insurance Extension Act of 2005

The Association has been determined by the Department of the Treasury to be a separate insurer under the Terrorism Risk Insurance Act of 2002 as amended and extended by the Terrorism Risk Insurance Extension Act of 2005 (TRIEA). As such, the Association is eligible to directly submit claims in accordance with the provisions of the TRIEA for liabilities it incurs from its members as the result of "acts of terrorism" certified by the Secretary of the Treasury as provided in the TRIEA.

Any loss reimbursement that a Member receives from the United States Government under TRIEA as a result of a loss occurrence during the term of this Agreement shall inure to the benefit of the Association in the proportion that the Member's insured losses, as defined in the TRIEA, in that loss occurrence for coverage provided under this Agreement bear to the Member's total insured losses, as defined in the TRIEA, in that loss occurrence.

If a loss reimbursement received by the Member under the TRIEA is based on the Member's losses in more than one loss

occurrence, and the United States Government does not designate the amount allocable to each loss occurrence, the reimbursement shall be prorated between occurrences in the proportion that the Member's insured losses for coverage provided under this Agreement in each loss occurrence bears to the Member's total insured losses arising out of all loss occurrences to which the recovery applies.

PART TEN:
Resolution of Disputes

Any Member or other interested party aggrieved by any action or decision of the Board of Directors or the Association, or any agent of the Association, may file a written complaint with the Association concerning such action or decision within 30 days after the action was taken or the decision rendered. The complaint will be resolved by the Member Appeals Committee in accordance with the procedures it follows for the resolution of such disputes. Any Member aggrieved by a determination by the Member Appeals Committee may appeal such determination to the Commissioner within 30 days.

Any dispute between a Member (or Former Member or successor in interest of a Member) and the Association with respect to Article VI. of the Plan or any provisions in the Reinsurance Agreement or Operating Rules adopted by the Board of Directors relating to coverage, claim, or premium issues, as determined by the Association, shall be resolved by arbitration in accordance with the Commercial Arbitration Operating Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction over the parties and the dispute. A single neutral arbitrator shall be agreed upon by the Member and the Association. If the parties are unable to agree upon a single neutral arbitrator, three arbitrators shall be chosen, one by each party and the third by the two arbitrators so chosen. If either or both parties refuse or neglect to appoint an arbitrator or arbitrators within 30 days after receipt of written notice from the other party requesting the party to do so, the Commissioner may choose the arbitrator or arbitrators which the party or parties refuse or neglect to choose, and the two arbitrators so chosen shall choose the third. If the two arbitrators fail to select the third arbitrator within 30 days after the second of the first two arbitrators is chosen, the Commissioner shall choose the third arbitrator. Each party shall submit its case to the arbitrator or arbitrators within 30 days of the appointment of the arbitrator. The decision of the arbitrator or a majority of the arbitrators shall be a final determination, binding upon both the Member and the Association. The expense of the arbitrator or arbitrators and the arbitration shall be divided as follows: the prevailing party shall pay 25 percent and the remainder shall be paid by the other party. In the event that no one party clearly prevails, the arbitrator or arbitrators shall specify the percentage of expenses to be contributed by the parties. Any such arbitration shall take place in Minneapolis or Saint Paul, Minnesota, unless some other location is mutually agreed upon by the Member and the Association.

Ref: Minn. Stat. § 79.36(h).
Plan, Article VIII.

PART ELEVEN:
Insolvency

If the Member becomes insolvent, indemnification for losses payable by the Association shall be payable by the Association directly to the Member or its liquidator, receiver, or statutory successor or, if applicable, in accordance with Minn. Stat. § 176.185, subd. 8a..

If the Member or any other member becomes insolvent, any liability of the insolvent member to the Association shall be apportioned among the remaining members on the same basis as reinsurance premiums are charged. The Association shall have, on behalf of all of the remaining members, all rights allowed by law against the estate or funds of the insolvent member for sums due the Association, and any

amounts received by the Association as a result thereof shall be credited to the members on the same basis as reinsurance premiums are charged.

Ref: Minn. Stat. § 79.34, subd. 4.
Minn. Stat. § 176.185, subd. 8a.
Plan, Article III. A.2.

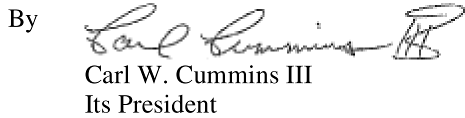
PART TWELVE:
Termination

The Commissioner or Commissioner of Commerce may, upon notice to a Member, take any appropriate action against a Member pursuant to procedures available to the Commissioner or Commissioner of Commerce, including revocation of the license of an Insurer to transact workers' compensation insurance or revocation of authorization of a Self-insurer to self-insure workers' compensation liability as authorized by law, for failure to pay Premiums to the Association when due, failure to comply with the Plan, Reinsurance Agreement, or Operating Rules, or failure to comply with Minnesota law. In the event that a political subdivision or group of political subdivisions that self-insure workers' compensation liability fails to pay Premiums to the Association when due, fails to comply with the Plan, Reinsurance Agreement, or Operating Rules, or otherwise fails to comply with the Enabling Act, the Association shall notify the Commissioner and the State Auditor. Revocation of authority to write workers' compensation insurance by an Insurer or to self-insure automatically terminates membership in the Association. An Insurer may voluntarily withdraw from membership in the Association only upon ceasing to be authorized by the Commissioner of Commerce to transact workers' compensation insurance in Minnesota. A Self-insurer may voluntarily withdraw from membership in the Association only when it stops self-insuring its workers' compensation liability, which voluntary withdrawal is effective on the date determined by the Commissioner of Commerce. Any unpaid Premiums which have been charged to a withdrawing or terminated Member shall be due and payable as of the effective date of withdrawal or termination, as determined by the Commissioner of Commerce. A Former Member shall continue to be bound by the Act, Plan, and any Reinsurance Agreement or Operating Rules with respect to the performance and completion of any unsatisfied liabilities and obligations to the Association.

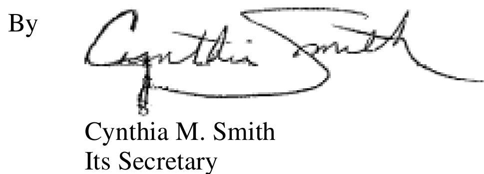
Ref: Minn. Stat. § 79.34, subd. 3.
Plan, Article III.A.l.

Adopted by action of the Board of Directors of the Workers' Compensation Reinsurance Association on the 21st day of December 2005, and approved by the Minnesota Commissioner of Labor and Industry on the 22nd day of December 2005.

WORKERS' COMPENSATION
REINSURANCE ASSOCIATION

By 
Carl W. Cummins III
Its President

ATTEST

By 
Cynthia M. Smith
Its Secretary

Effective January 1, 2006

<DOCUMENT>
<TYPE> EX-10.11
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<DESCRIPTION> Election Form for the 2006 Minnesota Workers' Compensation Reinsurance Associati
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Exhibit 10.11

2006
CERTIFICATE OF REINSURANCE
for the
Agreement of Reinsurance
between the
WORKERS' COMPENSATION REINSURANCE ASSOCIATION
and
RTW Inc

American Compensation Insurance Company 0030392
Bloomington Compensation Insurance Company 0012311

Coverage Period: January 1, 2006 — December 31, 2006 (12:01 a.m. Standard Time)

Retention Limit: $390,000

This certifies that the entities named above are Members of the Workers' Compensation Reinsurance Association (WCRA), and that the WCRA reinsures the Members' liability during the indicated coverage period for benefits pursuant to Minn. Stat. Ch. 176 in excess of the Members' retention limit for the period indicated above. This certificate provides for coverage in accordance with the terms and conditions of the Reinsurance Agreement approved by the Commissioner of the Minnesota Department of Labor and Industry on December 22, 2005. This certificate shall not be valid for any portion of the indicated period during which an entity is not a Member of the Association.

Workers' Compensation Reinsurance Association

Carl W. Cummins III
President and Chief Executive Officer
Dated: December 27, 2005

<DOCUMENT>
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Exhibit 10.15

Description of the Reinsurance Agreement for 2006 between ACIC, BCIC and GE Reinsurance Corporation and Max Re Ltd. effective January 1, 2006

The Company, on behalf of its subsidiaries American Compensation Insurance Company (ACIC) and Bloomington Compensation Insurance Company (BCIC), entered into reinsurance contracts for the fiscal year beginning January 1, 2006. The following summarizes the significant terms of these reinsurance agreements.

LIABILITY OF THE REINSURER

The Reinsurers shall pay to ACIC and BCIC, with respect to Workers' Compensation and Employers' Liability Business, the amount of Net Loss for each Occurrence, as defined in the contracts, in excess of the Company's retention, but not exceeding the Limits of Liability of the Reinsurer as follows:

Loss Layer	Reinsurer	Comment
$800,000 excess of $200,000	50.0% GE Reinsurance Corporation 50.0% Max Re Ltd.	*
$4,000,000 excess $1,000,000	100.0% GE Reinsurance Corporation	*

* All business written by the Company.
Recoveries from the MN WCRA will inure to the benefit of this treaty

COMMENCEMENT AND TERMINATION

The agreement shall apply to new and renewal policies of ACIC and BCIC becoming effective at and after 12:01 A.M., January 1, 2006, and to policies in force at 12:01 A.M., January 1, 2006, with respect to losses resulting from Occurrences taking place at or after the aforesaid time and date.

The contracts are for one year and automatically expire at 12:01 A.M. on January 1, 2007. The Reinsurers may also terminate the contracts in the event of significant adverse events at ACIC or BCIC or in the event of a change in control of ACIC, BCIC or RTW, Inc.

REINSURANCE PREMIUM

ACIC and BCIC agreed to pay the Reinsurer based on subject premiums earned for each Loss Layer as shown above. These rates are similar to the rates that we paid in 2005.

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Exhibit 11

RTW, INC. AND SUBSIDIARY
Statement Regarding Computation of Basic and Diluted Income Per Share

	2003	2004	2005
Basic weighted average shares outstanding	5,114,243	5,233,326	5,399,468
Stock warrants	—	—	—
Stock options			
Options at $10.75	—	—	200
Options at $9.87	—	—	453
Options at $9.50	—	—	323
Options at $8.81	—	—	6,276
Options at $8.75	—	—	106
Options at $6.50	—	613	4,528
Options at $6.45	—	479	3,664
Options at $6.18	—	11,976	53,569
Options at $6.00	—	10,415	41,128
Options at $5.33	41	239	—
Options at $4.50	259	1,498	2,513
Options at $3.80	2,189	10,916	15,679
Options at $3.13	—	6,700	8,661
Options at $2.60	4,507	10,140	5,085
Options at $2.42	30,535	9,574	—
Options at $2.20	6,915	13,477	15,683
Options at $2.19	53,098	73,726	53,390
Options at $2.00	1,005	476	—
Options at $1.98	83,592	103,317	51,883
Weighted average common and common share equivalents outstanding	5,296,384	5,486,872	5,662,609
Net income (loss) ($000's)	$ 6,999	$ 9,941	$ 5,998
Income per share:			
Basic income per share	$ 1.37	$ 1.90	$ 1.11
Diluted income per share	$ 1.32	$ 1.81	$ 1.06

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<DESCRIPTION> Consent of Independent Registered Public Accounting Firm
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Exhibit 23

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in Registration Statement No. 33-91368 of RTW, Inc. on Form S-8/S-3, Registration Statement No. 33-91372 of RTW, Inc. on Form S-8, Registration Statement No. 333-28585 of RTW, Inc. on Form S-8, Registration Statement No. 333-81408 of RTW, Inc. on Form S-8, Registration Statement No. 333-114030 of RTW, Inc. on Form S-8 and Registration Statement No. 333-127107 of RTW, Inc. on Form S-8 of our reports dated February 14, 2006, with respect to the consolidated financial statements and schedules of RTW, Inc. included in this Annual Report (Form 10-K) for the year ended December 31, 2005.

Minneapolis, Minnesota
March 30, 2006

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<DOCUMENT>
<TYPE>          EX-31.1
<FILENAME>      c03761exv31w1.htm
<DESCRIPTION>   Certification of President and Chief Executive Officer
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Exhibit 31.1

CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER

I, Jeffrey B. Murphy, President and Chief Executive Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of RTW, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):
   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: March 30, 2006

By /s/ Jeffrey B. Murphy

Jeffrey B. Murphy
President and Chief Executive Officer
(Principal Executive Officer)

<DOCUMENT>
<TYPE> EX-31.2
<FILENAME> c03761exv31w2.htm
<DESCRIPTION> Certification of Chief Financial Officer
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Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Alfred L LaTendresse, Chief Financial Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of RTW, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's Board of Directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: March 30, 2006

By /s/ Alfred L. LaTendresse

Alfred L. LaTendresse
Executive Vice President, Chief Financial Officer,
Treasurer and Secretary
(Principal Financial and Accounting Officer)

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<DOCUMENT>
<TYPE>        EX-32
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Exhibit 32

**CERTIFICATION PURSUANT TO 18 U.S.C. § 1350,
AS ADOPTED PURSUANT TO § 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of RTW, Inc. for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), the undersigned certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

RTW, Inc.

Dated: March 30, 2006	By /s/ Jeffrey B. Murphy
	Jeffrey B. Murphy President and Chief Executive Officer (Principal Executive Officer)
Dated: March 30, 2006	By /s/ Alfred L. LaTendresse
	Alfred L. LaTendresse Executive Vice President, Chief Financial Officer, Treasurer and Secretary (Principal Financial and Accounting Officer)

<DOCUMENT>
<TYPE> EX-99.1
<FILENAME> c03761exv99w1.htm
<DESCRIPTION> Share Repurchase Program Resumption
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Exhibit 99.1

Contact: Jeffrey B. Murphy, CEO or
Alfred L. LaTendresse, EVP and CFO
RTW, Inc.
(952) 893-0403

RTW, Inc. Resumes Share Repurchase Program

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MINNEAPOLIS — March 30, 2006 — RTW, Inc. (Nasdaq: RTWI), today announced that its Board of Directors approved resuming its common stock share repurchase program.

In September 1998, RTW's Board of Directors authorized the Company to repurchase shares, from time to time pursuant to the program, up to $4,000,000 of common stock. To date the Company has spent $2.8 million to repurchase 395,000 shares, most recently in 2003.

These repurchases will be made in the open market or through privately negotiated transactions in compliance with the SEC's Rule 10b-18, subject to market conditions, share price, trading volume and other factors. The repurchase program has no time limit and may be suspended from time to time or discontinued. The share repurchases will be made from available capital. As of March 30, 2006, RTW had approximately 5.5 million shares of common stock outstanding.

RTW is a leading provider of products and services to cost-effectively manage insured workers' compensation programs and self-insured absence programs, Based in Minneapolis, Minnesota, we provide disability and absence management services, primarily directed today at workers' compensation to: (i) employers insured through our wholly-owned insurance subsidiaries, American Compensation Insurance Company (ACIC) and Bloomington Compensation Insurance Company (BCIC); (ii) self-insured employers on a fee-for-service basis; (iii) state assigned risk plans on a percent of premium basis; (iv) other insurance companies; and (v) agents and employers on a consulting basis, charging hourly fees. We developed two proprietary systems to manage disability and absence: (i) ID15®, designed to quickly identify those injured employees who are likely to become inappropriately dependent on disability system benefits, including workers' compensation; and (ii) The RTW Solution®, designed to lower employers' disability costs and improve productivity by returning injured employees to work as soon as safely possible. We support these proprietary management systems with state-of-the-art technology and talented people dedicated to our vision of transforming people from absent or idle to present and productive. ACIC offers workers' compensation insurance to employers in Minnesota, Colorado and Michigan. BCIC offers workers' compensation insurance to selected employers in Minnesota. Through our Absentia℠ division, we have expanded non-insurance products and service offerings nationally. Our services are effective across many industries.

RTW, Inc. is traded on the Nasdaq National Market under the symbol RTWI. For more information

on RTW, Inc., please visit www.rtwi.com.

Safe Harbor Statement: Some of the statements made in this News Release, as well as statements made by us in periodic press releases and oral statements made by us to analysts and shareholders in the course of presentations about RTW, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. The following important factors, among others, have affected and in the future could affect our actual results and could cause our actual financial performance to differ materially from that expressed in any forward-looking statement: (i) our ability to retain renewing policies and write new business with a B+ (Very Good, Secure) rating from A.M. Best; (ii) our ability to continue to extend our workers' compensation and absence management services to self-insured employers and other alternative markets and to operate profitably in providing these services; (iii) our ability to maintain or increase rates on insured products in the markets in which we remain or alternatively non-renew or turn away improperly priced business; (iv) the ability of our reinsurers to honor their obligations to us; (v) our ability to accurately predict claim development; (vi) our ability to provide ID15, The RTW Solution and other proprietary products and services to customers successfully; (vii) our ability to manage both our existing claims and new claims in an effective manner; (viii) our experience with claims frequency and severity; (ix) medical inflation; (x) competition and the regulatory environment in which we operate; (xi) general economic and business conditions; (xii) our ability to obtain and retain reinsurance at a reasonable cost; (xiii) changes in workers' compensation regulation by states, including changes in mandated benefits or insurance company regulation; (xiv) interest rate changes; and (xv) other factors as noted in our filings with the Securities and Exchange Commission. This discussion of uncertainties is by no means exhaustive but is designed to highlight important factors that may affect our future performance.