

2019 FINANCIAL SUMMARY

RESULTS OF OPERATIONS

State Fund's results of operations for years ended December 31, 2019 and 2018 and its corresponding financial ratios are shown below:

(In millions)	2019	2018
Net premiums earned	\$1,190	\$1,334
Losses incurred	464	961
Loss adjustment expenses (LAE) incurred	201	364
Underwriting and administrative expenses	<u>472</u>	<u>469</u>
Net underwriting loss	53	(460)
Net investment and realized gain (loss)	726	695
Other income (loss)	<u>(80)</u>	<u>(48)</u>
Income before dividends	699	187
Dividends to policyholders	<u>(160)</u>	-
Net income	<u><u>\$539</u></u>	<u><u>\$187</u></u>
Loss ratio	39.0%	72.0%
LAE ratio	16.9%	27.3%
Underwriting expense ratio	<u>39.6%</u>	<u>35.4%</u>
Combined ratio	<u><u>95.5%</u></u>	<u><u>134.7%</u></u>

State Fund's premium declined in 2019 due to a rate decrease of 10% effective January 2019 and lower audited premium compared to last year. State Fund had a \$53 million underwriting gain in 2019 compared to a \$460 million underwriting loss in prior year. The 2019 underwriting gain was due to a combined \$536 million reserve release. \$400 million of the reserve release was from loss reserves and \$136 million was from loss adjustment expense reserves. The reserves release was a result of both system wide improvements and several internal initiatives to improve outcomes, including reduction in opioids, our outcomes based MPN launched in 2016, our specialized claims model launched in 2017 and a sharp focus on paying claims quickly that has led to improved closure rates.

Net investment income and realized gain on sale of equity increased by \$31 million primarily due to sales of stocks during favorable market condition. Net income before dividends of \$699 million was \$513 million higher than prior year due to the aforementioned release of loss and loss adjustment expense reserves of \$536 million. The board of directors declared a \$160 million dividend for 2019 which resulted in a net income of \$539 million for year-end 2019 versus \$187 million in 2018.

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FINANCIAL POSITION

State Fund's financial positions at December 31, 2019 are as follows:

(In millions)

Admitted Assets	2019	2018
Bonds, at amortized cost	\$19,094	\$19,028
Common stocks	1,037	952
Real estate	276	273
Cash and short-term investments	145	83
Total cash and invested assets	20,552	20,335
Other assets	423	428
Total admitted assets	<u>\$20,975</u>	<u>\$20,763</u>

Liabilities and Policyholders' Surplus

Losses and loss adjustment expenses reserves	\$11,880	\$12,596
Other liabilities	2,583	1,416
Total liabilities	14,463	14,012
Policyholders' surplus	6,512	6,751
Total liabilities and policyholders' surplus	<u>\$20,975</u>	<u>\$20,763</u>

State Fund maintained a balanced investment portfolio that was focused on both credit quality and investment yield (90% of the \$19 billion bond portfolio was rated NAIC 1, the NAIC's highest quality credit class). The weighted average credit quality of the overall bond portfolio was Aa3/AA- by Moody's and Standard & Poor's, respectively. Book yield at December 31, 2019 was 3.22%, decreased from 3.29% at December 31, 2018.

Management believes that its reserves are adequate, and State Fund's appointed Actuary, Guy Avagliano of Milliman, Inc., consulting actuaries, attested to the adequacy of State Fund's carried reserves as of December 31, 2019 and 2018.

State Fund operates in conformity with the California law imposed for risk-based capital (RBC). As of December 31, 2019 and 2018, policyholders' surplus exceeded the minimum RBC requirements. In addition, it passed all the Insurance Regulatory Information System (IRIS) tests at year-end 2019 and 2018.

Policyholders' surplus decreased by \$239 million since December 31, 2018. This is mainly due to the reclassification of \$1 billion of restricted surplus to recognize State Fund's share of Pension and Other Post Employment Benefit (OPEB) as liabilities in compliance with Statements of Statutory Accounting Principles (SSAP) No. 5R – "Liabilities, Contingencies and Impairments of Assets". The decrease in surplus was offset by the reserve release of \$536 million and the increase in adjustments to surplus of \$225 million which was mostly represented by unrealized capital gains.

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CASH FLOW

State Fund's statements of cash flow are summarized below:

(In millions)

	2019	2018
Premiums collected net of reinsurance	\$ 1,163	\$ 1,269
Net investment income	685	679
Miscellaneous income	23	21
Benefits and loss-related payments	(1,060)	(1,020)
Other underwriting expenses	(806)	(788)
	<u>5</u>	<u>161</u>
Net cash used in operations		
Proceeds from investments sold, matured, or repaid	4,186	2,990
Cost of investments acquired:	(4,149)	(3,221)
Net cash provided by (used in) investments	<u>37</u>	<u>(231)</u>
Net cash provided by financing and miscellaneous sources	<u>21</u>	<u>(36)</u>
Net change in cash, cash equivalents, and short-term investments	63	(106)
Cash, cash equivalents, and short-term investments, beginning of year	<u>82</u>	<u>188</u>
Cash, cash equivalents, and short-term investments, end of year	<u>\$ 145</u>	<u>82</u>

Primary sources of cash included cash flow from premiums, investment income and the sale or maturity of invested assets. Primary uses of cash included the purchase of long-term investments and the payments of benefits, loss related expenses, and other underwriting expenses.