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Date: February 26, 2020

TO: MEMBERS, BOARD OF DIRECTORS

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 5 – Financial and President’s Report: 4Q 2019
II. NAME AND PROGRAM:	Vernon Steiner, President and CEO and Peter Guastamachio, Chief Financial Officer
III. ACTIVITY:	<input checked="" type="checkbox"/> Informational <input type="checkbox"/> Request for Direction <input type="checkbox"/> Action Proposed <input type="checkbox"/> Exploratory
IV. JUSTIFICATION:	<input checked="" type="checkbox"/> Standard/Required Item <input type="checkbox"/> Board Request – New Item <input type="checkbox"/> New Topic from Staff

V. EXECUTIVE SUMMARY:

- Net premiums earned of \$1.2 billion were 10.8% lower than prior year mainly due to filed rate decrease of 10% effective January 2019, and lower audited premium compared to last year.
- Combined ratio of 95.5% was 39.2 points lower than prior year, driven by loss and loss adjustment expense reserve release of \$536 million.
- Net income before dividends of \$699 million was \$513 million higher than prior year due to loss and loss adjustment expense reserves release of \$536 million.
- State Fund declared dividends to policyholders of \$160 million for policies that have incepted January 1, 2019 through December 31, 2019.
- Policyholders’ surplus went down by \$239 million since December 31, 2018, driven by a reclassification of \$1 billion into liabilities, following Statements of Statutory Accounting Principles (SSAP) No. 5R – “Liabilities, Contingencies and Impairments of Assets”, upon receipt of Pension and Other Post Employment Benefit (OPEB) total liabilities information from State Controller’s Office in 2019, partially offset by net income and unrealized capital gain.

VI. ANALYSIS /BACKGROUND:

- Statutory financial results are filed with the California Department of Insurance and the National Association of Insurance Commissioners on a quarterly basis.
- Highlights are also shared with the Board on a quarterly basis.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Year Ended December 31, 2019

The following summarizes our statutory financial results for the year ended December 31, 2019. Our results reflect a decrease in premiums earned and significant reserves release and a transfer from policyholders' surplus to liabilities.

- Underwriting results
 - Due to the nature of our business, our underwriting results are significantly impacted by the dynamics that affect California business including economic conditions, market pricing as well as the effects of the underwriting cycle.
 - Net premiums earned of \$1.2 billion were 10.8% lower than the prior year which can be attributed to our filed rate decrease of 10% effective January 2019, and lower audited premium compared to last year. 2018 audit premium was unusually high due to delays in 2017 that arose from the implementation of AB 2883.
 - The 2019 loss ratio was 39% and the loss adjustment expense (LAE) ratio was 16.9%. Together these ratios were 43.4 points lower than prior year primarily due to a combined \$536 million reserve release. \$400 million of the reserve release was from loss reserves and \$136 million from loss adjustment expense reserves. The reserve release was a result of both system wide improvements and several internal initiatives to improve outcomes, including reduction in opioids, our outcomes based on 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. We are extremely proud of our claims people for driving these results.
 - Underwriting expense ratio of 39.6% was 4.2 points higher than prior year due to lower net premiums written. Overall, the underwriting gain of \$53 million was 111.5% higher than prior year due to decrease in reserves for loss and loss adjustment expenses.
 - The combined ratio of 95.5% was 39.2 points lower than prior year driven by loss and loss adjustment expense reserve release of \$536 million.
- Investment and other non-underwriting results
 - Net investment income of \$627 million was \$4 million higher than prior year.
 - Realized capital gains of \$100 million were \$27 million higher than prior year primarily due to sales of stocks during favorable market condition.
 - Other expenses, mostly representing charge-offs of uncollectible premiums, were \$32 million higher than prior year. We believe this increase is also attributable to the implementation of AB 2883 which resulted in unusually high audited premium in 2018 and a delay in audits and billings, as mentioned earlier.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Year Ended December 31, 2019

- Net income and policyholders' surplus
 - Net income before dividends of \$699 million was \$513 million higher than prior year due to significant decrease in loss and loss adjustment expense reserves of \$536M.
 - State Fund declared additional dividends to policyholders of \$55 million for policies that have incepted August 20, 2019 through December 31, 2019 resulting to a total of \$160 million dividends declared for 2019 calendar year.
 - 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.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Year Ended December 31, 2019

Financial Results (\$ millions)	2018 Actual	2019 Actual	Actual vs. Prior Year \$ Diff	Actual vs. Prior Year % Diff
Net premiums earned (NPE)	1,334	1,190	(145)	-10.8%
Losses	961	464	(497)	-51.7%
Loss adjustment expenses (LAE)	364	201	(163)	-44.7%
Underwriting (UW) expenses	470	471	2	0.4%
Underwriting results	(460)	53	513	111.5%
Net investment income	622	627	4	0.7%
Realized capital gain (loss)	72	100	27	37.3%
Other income (expense)	(48)	(80)	(32)	-66.4%
Income before dividends to policyholders	187	699	513	274.9%
Dividends to policyholders (credits)	0	160	160	n/a
Net income (loss)	187	539	353	189.1%
Standard Industry Ratios				
Loss ratio	72.0%	39.0%		-33.0%
LAE ratio	27.3%	16.9%		-10.4%
Loss and LAE ratio	99.3%	55.9%		-43.4%
UW expense ratio	35.4%	39.6%		4.2%
Combined ratio	134.7%	95.5%		-39.2%

Numbers or ratios may not foot due to rounding.

Dash (-) represents a null value.

Zero (0) represents a calculated zero or number which rounds to zero

Green represents better than plan and prior year.

Red represents worse than plan and prior year.