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Date: November 7, 2014

TO: MEMBERS, BOARD OF DIRECTORS

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 18 - Financial Update: 3 rd Quarter 2014
II. NAME AND PROGRAM:	
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:

- Estimated annual premiums of \$1.095 billion were 6% less than budget and 27% more than the same period in the prior year.
- Our combined ratio of 134% was 5 points higher than budget and 6 points higher than the same period in prior year.
- Net income of \$182 million was \$3 million lower than budget.
- Policyholders' surplus grew by \$142 million since December 31, 2013.

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
Nine Months Ended September 30, 2014

The following summarizes our statutory financial results for the nine months ended September 30, 2014. Our results reflect continued growth in premiums and policyholders' surplus.

- 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, unemployment and market pricing.
 - We continued a disciplined approach to underwriting. We wrote approximately 107,000 policies, which were 4% more than budget and were 7% more than the nine months ended September 30, 2013 (the same period in the prior year). Estimated annual premiums of \$1.095 billion were 6% less than budget and 27% more than same period in the prior year. The average premium per policy written was approximately \$10,000 or 10% less than budget and 20% more than the same period in the prior year.
 - Net premiums earned of \$1.137 billion were 21% more than budget and 49% more than the same period in prior year. The strong growth in premiums in 2014 is due to a continued hardening market and the impact of tiered pricing
 - Our loss and loss adjustment expenses (LAE) ratio of 111.8% was 10 points higher than budget and 14 points higher than the same period in the prior year. There are several reasons for this increase. State Fund has seen a higher frequency of large losses in accident year 2014. This resulted in a 79% loss ratio, 4 points higher than budget and prior year. During this nine month period, State Fund also strengthened LAE reserves by \$50 million for Medical Cost Containment and \$16 million for company's self-insurance program.
 - Our underwriting expense ratio of 22.2% was 5 points lower than budget and 9 points lower than the same period in the prior year. The improvement in this expense ratio was attributable to a combination of factors: disciplined expense controls, improved operating efficiencies in our underwriting systems, and strong growth in premiums.
 - Our combined ratio of 134% was 5 points higher than budget and 6 points higher than the same period in the prior year. Increases in loss and LAE are the underlying reasons for the increase in the combined ratio. The related underwriting loss for the quarter was \$382 million.

STATE COMPENSATION INSURANCE FUND
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- Investment and other non-underwriting results
 - Net investment income of \$494 million was 3% higher than budget and 4% lower than the same period in the prior year.
 - Realized capital gains of \$57 million were \$57 million more than budget and \$53 million more than the same period in the prior year.
 - Other expenses mostly represent charge-offs of uncollectible premiums, were \$14 million lower than budget and \$4 million lower than the same period in the prior year.
 - \$20 million of excess reserves for 2012 policyholders' dividends were released.
- Net income and policyholders' surplus
 - Net income of \$182 million was \$3 million lower than budget and \$122 million lower than the same period in the prior year.
 - Policyholders' surplus grew by \$142 million since December 31, 2013.

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Financial Results (\$ millions)	2013 Actual	2014 Budget	2014 Actual	Variance to Budget	Variance to Prior Year
Net premiums earned	764	942	1,137	21%	49%
Losses	573	706	898	27%	57%
Loss adjustment expenses (LAE)	172	255	373	46%	117%
Underwriting expenses	236	253	248	-2%	5%
Underwriting results	(217)	(273)	(382)	-40%	-76%
Net investment income	513	478	494	3%	-4%
Realized capital gain (loss)	4	-	57	57	53
Other income (expense)	(10)	(20)	(6)	14	4
Income before dividends to policyholders	290	185	162	-12%	-44%
Dividends to policyholders (credits)	(14)	-	(20)	-20	-6
Net income	304	185	182	-3	-122
Standard Industry Ratios					
Loss ratio	75.0%	75.0%	79.0%	4%	4%
LAE ratio	22.5%	27.1%	32.8%	6%	10%
Loss and LAE ratio	97.5%	102.1%	111.8%	10%	14%
Underwriting expense ratio	30.8%	26.8%	22.2%	-5%	-9%
Combined ratio	128.3%	128.9%	134.0%	5%	6%

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 or prior year.

Red represents worse than plan or prior year.