



333 Bush Street  
 San Francisco, CA 94104  
 (415) 263-5400  
[www.statefundca.com](http://www.statefundca.com)

Date: February 9, 2018

**TO: MEMBERS, BOARD OF DIRECTORS**

<b>I. AGENDA ITEM # AND TITLE :</b>	Open Agenda Item 19 – Financial Update: Year Ended December 31, 2017
<b>II. NAME AND PROGRAM:</b>	Peter Guastamachio, Chief Financial Officer
<b>III. ACTIVITY:</b>	<input checked="" type="checkbox"/> Informational <input type="checkbox"/> Request for Direction <input type="checkbox"/> Action Proposed <input type="checkbox"/> Exploratory
<b>IV. JUSTIFICATION:</b>	<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 \$1.3 billion were 14.2% less than the prior year.
- Combined ratio of 149.4% was higher than the same period last year which resulted in underwriting loss of \$658 million.
- Net income of \$40 million was \$151 million less than the same period in the prior year mainly due to the overall strengthening of LAE reserves by \$217M. Included in net income were realized capital gains of \$122 million.
- There was no significant change in Policyholders' surplus.

**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, 2017**

The following summarizes our statutory financial results for the year ended December 31, 2017. Our results reflect a decline in premiums earned and no significant change in 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, market pricing as well as the effects of the insurance profitability cycle.
  - Net premiums earned of \$1.3 billion were 14.2% lower than the prior year which can be attributed to continued competition and filed rate decreases of 8% and 9.5% effective September 2017 and 2016, respectively.
  - At the beginning of the year, State Fund improved its insurance functional allocation methodology which resulted to shifting expenses from LAE to Underwriting.
    - Underwriting expense ratio of 32.2% was 8 points higher than the same period last year.
    - The total LAE expenses of \$1B included the current LAE expense of \$349M, shift of \$448M from loss reserves, and additional \$217M strengthening for prior accident years.
  - Therefore the total expenses of \$1.4 billion were \$571 million higher than the same period in prior year. Also, our premiums were declining faster than expenses resulting in a higher combined ratio. Combined ratio of 149.4% was 19 points higher than the same period last year.
- Investment and other non-underwriting results
  - Net investment income of \$619 million was \$8 million lower than the same period in prior year.
  - Realized capital gains of \$122 million were \$53 million higher than the same period in prior year. This was the result of the liquidation of holdings from the termination of an equity portfolio manager.
  - Other expenses, mostly representing charge-offs of uncollectible premiums, were \$12 million higher than the same period in the prior year.
- Net income and policyholders' surplus
  - Net income of \$40 million was \$151 million lower than the same period in the prior year mainly due to the overall strengthening of LAE reserves.
  - There is no significant change in Policyholders' surplus.

**STATE COMPENSATION INSURANCE FUND**  
**Report on Statutory Financial Results**  
**Year Ended December 31, 2017**

Financial Results (\$ millions)	2016 Actual	2016 Actual Proforma*	2017 Actual	Actual vs. Prior Year \$ Diff	Actual vs. Prior Year % Diff
Net premiums earned (NPE)	1,527	1,527	1,310	(217)	-14.2%
Losses	1,130	1,130	521	(609)	-53.9%
Loss adjustment expenses	493	400	1,014	520	105.4%
UW expenses	382	467	433	51	13.5%
Underwriting results	(478)	(470)	(658)	(180)	-37.6%
Net investment income	627	618	619	(8)	-1.2%
Realized capital gain (loss)	69	69	122	53	76.5%
Other income (expense)	(31)	(31)	(43)	(12)	-37.9%
Income before dividends to policyholders	187	187	41	(146)	-78.3%
Dividends to policyholders (credits)	(5)	(5)	0	5	101.9%
Net income (loss)	192	192	40	(151)	-78.9%
<b>Standard Industry Ratios</b>					
Loss ratio (CY)	74.0%	74.0%	39.8%		-34.2%
LAE ratio (CY)	32.3%	26.2%	77.4%		45.1%
Loss and LAE ratio (CY)	106.3%	100.2%	117.2%		10.9%
UW expense ratio (CY)	23.9%	29.2%	32.2%		8.3%
Combined ratio (CY)	130.2%	129.4%	149.4%		19.2%

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 prior year.

Red represents worse than prior year.

\*New insurance functional allocation methodology applied