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Date: February 6, 2015

TO: MEMBERS, BOARD OF DIRECTORS

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 5 - Financial Update: Year Ended December 31, 2014
II. NAME AND PROGRAM:	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:

- Estimated annual premiums of \$1.465 billion were up 24% over the prior year. Our combined ratio of 143% was 15 points higher than budget and 16 points higher than the prior year.
- Net income for year-end was \$37 million after reserve strengthening of \$266 million in loss and loss adjustment expense and declaration of a \$37 million dividend for 2014.
- Policyholders' surplus grew by \$22 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
Year Ended December 31, 2014

The following summarizes our statutory financial results for the year ended December 31, 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 139,000 policies, which were 6% more than the year ended December 31, 2013. Estimated annual premiums of \$1.465 billion were 24% more than the prior year. The average premium per policy written was approximately \$10,525 or 18% more than the prior year.
 - Net premiums earned of \$1.669 billion were 53% more than the prior year.
 - Our loss and loss adjustment expenses (LAE) ratio of 118% was 16 points higher than budget and 16 points higher than the prior year. There are several reasons for this increase. In the first quarter State Fund strengthened LAE reserves by \$50 million for Medical Cost Containment and in the second quarter we increased reserves by \$16 million for the company's self-insurance program. As part of State Fund's overall Enterprise Risk Management policy and State Fund's unique role in the market place, the Board has adopted a more conservative posture related to reserving. In keeping with that decision the Board further strengthened both LAE and loss reserves by \$100 million each in the fourth quarter.
 - Our underwriting expense ratio of 25% was 2 points lower than budget and 1 point lower than 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 growth in premiums.
 - Our combined ratio of 143% was 15 points higher than budget and 16 points higher than 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 year was \$681 million.
- Investment and other non-underwriting results
 - Net investment income of \$656 million was 4% lower than the prior year.
 - Realized capital gains of \$75 million were \$72 million more than the prior year.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Year Ended December 31, 2014

- Other expenses mostly represent charge-offs of uncollectible premiums, were \$5 million lower than the prior year.
- The Board of Directors approved \$37 million in 2014 policyholders' dividends. From an income statement perspective, this was offset by a \$41 million release of excess 2012 policyholders' dividends reserves.
- Net income and policyholders' surplus
 - Net income of \$37 million after reserve strengthening and dividends was \$242 million lower than the prior year.
 - Policyholders' surplus grew by \$22 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	1,094	1,296	1,669	29%	53%
Losses	820	972	1,372	41%	67%
Loss adjustment expenses (LAE)	295	351	602	72%	104%
Underwriting expenses	280	341	375	10%	34%
Underwriting results	(302)	(369)	(681)	-85%	-126%
Net investment income	684	634	656	4%	-4%
Realized capital gain (loss)	4	-	75	75	72
Other income (expense)	(22)	(28)	(17)	11	5
Income before dividends to policyholders	364	237	33	-86%	-91%
Dividends to policyholders (credits)	85	50	(4)	-54	-89
Net income	279	187	37	-150	-242
Standard Industry Ratios					
Loss ratio	75.0%	75.0%	82.2%	7%	7%
LAE ratio	27.0%	27.1%	36.1%	9%	9%
Loss and LAE ratio	102.0%	102.1%	118.3%	16%	16%
Underwriting expense ratio	25.5%	26.3%	24.8%	-2%	-1%
Combined ratio	127.5%	128.4%	143.1%	15%	16%

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.