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Date: May 9, 2014

**TO: MEMBERS, BOARD OF DIRECTORS**

|                                     |   |
|-------------------------------------|---|
| <b>I. AGENDA ITEM # AND TITLE :</b> | Open Agenda Item 5 - Financial Update: 1 <sup>st</sup> Quarter 2014   |
| <b>II. NAME AND PROGRAM:</b>        | Peter Guastamachio, Acting Chief Financial Officer  |
| <b>III. ACTIVITY:</b>               | <input checked="" type="checkbox"/> Informational<br><input type="checkbox"/> Request for Direction<br><input type="checkbox"/> Action Proposed<br><input type="checkbox"/> Exploratory |
| <b>IV. JUSTIFICATION:</b>           | <input checked="" type="checkbox"/> Standard/Required Item<br><input type="checkbox"/> Board Request – New Item<br><input type="checkbox"/> New Topic from Staff                        |

**V. EXECUTIVE SUMMARY:**

- Estimated annual premiums were 3% more than budget and 32% more than the same period in the prior year.
- Our combined ratio of 140.3% was 8 points higher than budget and 9 points higher than the same period in prior year.
- Net income of \$48 million was \$14 million less than budget.
- Policyholders' surplus grew by \$28.5 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**  
**Three Months Ended March 31, 2014**

The following summarizes our statutory financial results for the three months ended March 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. The California workforce continues to grow at a slow pace with 18.6 million people in the labor force and an unemployment rate of 8.1% in April, 1.8% above the national average of 6.3%. The positive news is that non-farm payrolls in California are still growing at a pace of over 2% per year with construction payrolls leading the charge at 6% per year. There is also strong growth in the Professional and Business Services sector (4% per year) and in the Information, Leisure and Educational sectors in California.
  - We continued our disciplined approach to underwriting. We wrote approximately 38,000 policies, which were 6% more than budget and 7% more than the three months ended March 31, 2013 (the same period in the prior year). Estimated annual premiums were 3% more than budget and 32% more than same period in the prior year. The average premium per policy written was approximately \$10,500 or 3% less than budget and 23% more than the same period in the prior year. Net premiums earned on policies in force of \$342 million were 19% more than budget and 60% more than the same period in prior year. The strong growth in premiums in 2014 is due to a continued hardening market.
  - Our loss and loss adjustment expenses (LAE) ratio of 116.6% was 15 points higher than budget and 19 points higher than the same period in the prior year. This reflects a strengthening of LAE reserves by \$50 million.
  - Our underwriting expense ratio of 23.7% was 7 points lower than budget and 10 points lower than the same period in the prior year. The improvement in this expense ratio was attributable to a combination of factors: maintaining disciplined expense controls, improved operating efficiencies in our underwriting systems, and strong growth in premiums.
  - Our combined ratio of 140.3% was 8 points higher than budget and 9 points higher than the same period in the prior year.
  - The related underwriting loss for the quarter was \$139 million.

**STATE COMPENSATION INSURANCE FUND**  
**Report on Statutory Financial Results**  
**Three Months Ended March 31, 2014**

- Investment and other non-underwriting results
  - Net investment income of \$166 million was 3% higher than budget and 4% lower than the same period in the prior year.
  - Realized capital gains of \$21 million were \$21 million more than budget and \$9 million more than the same period in the prior year.
  - Other expenses, mostly represent charge-offs of uncollectible premiums, were \$5 million lower than budget and \$1 million lower than the same period in the prior year.
- Net income and policyholders' surplus
  - Net income of \$48 million was \$14 million less than budget and \$65 million lower than the same period in the prior year.
  - Policyholders' surplus grew by \$28.5 million since December 31, 2013.

**STATE COMPENSATION INSURANCE FUND**  
**Report on Statutory Financial Results**  
**Three Months Ended March 31, 2014**

| Financial Results (\$ millions)          | 2013<br>Actual | 2014<br>Budget | 2014<br>Actual | Variance<br>to<br>Budget | Variance<br>to Prior<br>Year |
|--|----------------|----------------|----------------|--------------------------|------------------------------|
| Net premiums earned                      | 214            | 288            | 342            | 19%                      | 60%                          |
| Losses                                   | 160            | 216            | 257            | 19%                      | 60%                          |
| Loss adjustment expenses (LAE)           | 48             | 78             | 142            | 82%                      | 196%                         |
| Underwriting expenses                    | 74             | 88             | 82             | -6%                      | 11%                          |
| Underwriting results                     | (69)           | (94)           | (139)          | -48%                     | -101%                        |
| Net investment income                    | 172            | 162            | 166            | 3%                       | -4%                          |
| Realized capital gain (loss)             | 12             | -              | 21             | 21                       | 9                            |
| Other income (expense)                   | (2)            | (6)            | (1)            | 5                        | 1                            |
| Income before dividends to policyholders | 113            | 62             | 48             | -23%                     | -58%                         |
| Dividends to policyholders (credits)     | -              | -              | -              | 0                        | 0                            |
| Net income                               | 113            | 62             | 48             | -14                      | -65                          |
| <b>Standard Industry Ratios</b>          |                |                |                |                          |                              |
| Loss ratio                               | 75.0%          | 75.0%          | 75.0%          | 0%                       | 0%                           |
| LAE ratio                                | 22.5%          | 27.1%          | 41.6%          | 15%                      | 19%                          |
| Loss and LAE ratio                       | 97.5%          | 102.1%         | 116.6%         | 15%                      | 19%                          |
| Underwriting expense ratio               | 34.1%          | 30.3%          | 23.7%          | -7%                      | -10%                         |
| Combined ratio                           | 131.6%         | 132.4%         | 140.3%         | 8%                       | 9%                           |

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.