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Date: August 18, 2017

TO: MEMBERS, BOARD OF DIRECTORS

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 5 – Financial Update: 2 nd Quarter 2017
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:

- Net premiums earned of \$692 million were 10.8% less than the prior year.
- Combined ratio of 132.1 % was higher than the same period last year which resulted in underwriting loss of \$223 million.
- Net income of \$167 million was \$59 million more than the same period in the prior year.
- Policyholders' surplus grew by \$99 million since December 31, 2016.

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
Six Months Ended June 30, 2017

The following summarizes our statutory financial results for the six months ended June 30, 2017. Our results reflect a decline in premiums earned and continued growth 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, unemployment, market pricing as well as the effects of the insurance profitability cycle.
 - Net premiums earned of \$692 million were 10.8% lower than the prior year which can be attributed to stiffer competition and filed rate decrease of 9.5% effective September 2016.
 - Our loss and loss adjustment expenses (LAE) ratio of 100.6% were 6 points lower than prior year.
 - Underwriting expense ratio of 31.5% was 8 points higher than the same period last year.
 - Combined ratio of 132.1% was 3 points higher than the same period last year. With the enhanced capabilities of tracking expenses at more granular level, State Fund improved its insurance functional allocation methodology effective beginning of the year which resulted to shifting expenses from LAE to Underwriting. The total expenses of \$403 million were \$33 million lower than the same period in prior year. However, our premiums are declining faster than expenses resulting in a higher combined ratio.
- Investment and other non-underwriting results
 - Net investment income of \$318 million was \$2 million lower than the same period in prior year.
 - Realized capital gains of \$94 million were \$63 million higher than the same period in prior year. This is 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 \$167 million was \$59 million higher than the same period in the prior year mainly due to realized capital gains from liquidation of equity holdings.
 - Policyholders' surplus grew by \$99 million since December 31, 2016.

STATE COMPENSATION INSURANCE FUND
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Financial Results (\$ millions)	2016 Actual	2016 Actual Proforma*	2017 Actual	Actual vs. Prior Year \$ Diff	Actual vs. Prior Year % Diff
Net premiums earned (NPE)	777	777	692	(84)	-10.8%
Losses	575	575	512	(62)	-10.8%
Loss adjustment expenses	251	204	184	(67)	-26.6%
UW expenses	185	228	219	34	18.1%
Underwriting results	(234)	(230)	(223)	11	4.8%
Net investment income	320	316	318	(2)	-0.8%
Realized capital gain (loss)	31	31	94	63	201.7%
Other income (expense)	(9)	(9)	(21)	(12)	-131.4%
Income before dividends to policyholders	108	108	167	59	54.9%
Dividends to policyholders (credits)	-	(0)	0	0	n/a
Net income (loss)	108	108	167	59	54.9%
Standard Industry Ratios					
Loss ratio	74.0%	74.0%	74.0%		0.0%
LAE ratio	32.3%	26.2%	26.6%		-5.7%
Loss and LAE ratio	106.3%	100.2%	100.6%		-5.7%
UW expense ratio	23.1%	28.5%	31.5%		8.4%
Combined ratio	129.4%	128.7%	132.1%		2.7%

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