



333 Bush Street
 San Francisco, CA 94104
 (415) 263-5400
 www.statefundca.com

Date: September 12, 2014

TO: MEMBERS, BOARD OF DIRECTORS

| | |
|-------------------------------------|---|
| I. AGENDA ITEM # AND TITLE : | Open Agenda Item 5 - Financial Update: 2nd Quarter 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 were 5% less than budget and 31% more than the same period in the prior year.
- Our combined ratio of 133.6% was 4 points higher than budget and 3 points higher than the same period in prior year.
- Net income of \$135 million was \$5 million more than budget.
- Policyholders' surplus grew by \$113 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
Six Months Ended June 30, 2014

The following summarizes our statutory financial results for the six months ended June 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 our disciplined approach to underwriting. We wrote approximately 74,000 policies, which were 4% more than budget and were 7% more than the six months ended June 30, 2013 (the same period in the prior year). Estimated annual premiums were 5% less than budget and 31% more than same period in the prior year. The average premium per policy written was approximately \$10,000 or 8% less than budget and 23% more than the same period in the prior year.
 - Net premiums earned of \$726 million were 21% more than budget and 61% more than the same period in prior year. The strong growth in premiums in 2014 is due to a continued hardening market and positive acceptance of our tiered pricing
 - Our loss and loss adjustment expenses (LAE) ratio of 111.4% was 9 points higher than budget and 14 points higher than the same period in the prior year. This reflects a strengthening of LAE reserves by \$50 million in the 1st Quarter for Medical Cost Containment and an increase of \$18 million in prior year loss adjustment expenses due to an increase in the liability for company's self-insurance program.
 - Our underwriting expense ratio of 22.2% was 6 points lower than budget and 11 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 133.6% was 4 points higher than budget and 3 points higher than the same period in the prior year. The increase in the combined ratio is primarily attributed to the increases in LAE mentioned earlier. The related underwriting loss for the quarter was \$242 million.
- Investment and other non-underwriting results
 - Net investment income of \$331 million was 2% higher than budget and 4% lower than the same period in the prior year.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Six Months Ended June 30, 2014

- Realized capital gains of \$47 million were \$47 million more than budget and \$35 million more than the same period in the prior year.
- Other expenses, mostly represent charge-offs of uncollectible premiums, were \$12 million lower than budget and \$3 million lower than the same period in the prior year.
- Net income and policyholders' surplus
 - Net income of \$135 million was \$5 million more than budget and \$89 million lower than the same period in the prior year.
 - Policyholders' surplus grew by \$113 million since December 31, 2013.

STATE COMPENSATION INSURANCE FUND
Report on Statutory Financial Results
Six Months Ended June 30, 2014

| Financial Results (\$ millions) | 2013 Actual | 2014 Budget | 2014 Actual | Variance to Budget | Variance to Prior Year |
|--|----------------|----------------|----------------|--------------------------|------------------------------|
| Net premiums earned | 452 | 601 | 726 | 21% | 61% |
| Losses | 339 | 451 | 545 | 21% | 61% |
| Loss adjustment expenses (LAE) | 102 | 163 | 264 | 62% | 160% |
| Underwriting expenses | 151 | 168 | 160 | -5% | 6% |
| Underwriting results | (140) | (181) | (242) | -34% | -73% |
| Net investment income | 345 | 324 | 331 | 2% | -4% |
| Realized capital gain (loss) | 12 | - | 47 | 47 | 35 |
| Other income (expense) | (4) | (13) | (1) | 12 | 3 |
| Income before dividends to policyholders | 214 | 130 | 135 | 4% | -37% |
| Dividends to policyholders (credits) | (10) | - | - | 0 | 10 |
| Net income | 224 | 130 | 135 | 5 | -89 |
| Standard Industry Ratios | | | | | |
| Loss ratio | 75.0% | 75.0% | 75.0% | 0% | 0% |
| LAE ratio | 22.5% | 27.1% | 36.4% | 9% | 14% |
| Loss and LAE ratio | 97.5% | 102.1% | 111.4% | 9% | 14% |
| Underwriting expense ratio | 33.2% | 27.9% | 22.2% | -6% | -11% |
| Combined ratio | 130.7% | 130.0% | 133.6% | 4% | 3% |

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.