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Date: November 3, 2017

TO: MEMBERS, BOARD OF DIRECTORS

I. AGENDA ITEM # AND TITLE :	Open Agenda Item 5 – Financial Update: 3Q 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 \$1 billion were 12.9% less than the prior year.
- Combined ratio of 133.3% was higher than the same period last year which resulted in underwriting loss of \$340 million.
- Net income of \$210 million was \$55 million more than the same period in the prior year. Included in net income are realized capital gains of \$115 million.
- Policyholders’ surplus grew by \$138 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
Nine Months Ended September 30, 2017

The following summarizes our statutory financial results for the nine months ended September 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, market pricing as well as the effects of the insurance profitability cycle.
 - Net premiums earned of \$1 billion were 12.9% lower than the prior year which can be attributed to stiffer 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.
 - Our loss and loss adjustment expenses (LAE) ratio of 100.6% were 6 points lower than prior year.
 - Underwriting expense ratio of 32.7% was 10 points higher than the same period last year.
 - The total expenses of \$607 million were \$49 million lower than the same period in prior year. However, our premiums are declining faster than expenses resulting in a higher combined ratio. Combined ratio of 133.3% was 4 points higher than the same period last year.
- Investment and other non-underwriting results
 - Net investment income of \$469 million was \$5 million lower than the same period in prior year.
 - Realized capital gains of \$115 million were \$65 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 \$15 million higher than the same period in the prior year.
- Net income and policyholders' surplus
 - Net income of \$210 million was \$55 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 \$138 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)	1,181	1,181	1,028	(153)	-12.9%
Losses	874	874	761	(113)	-12.9%
Loss adjustment expenses	381	310	273	(108)	-28.3%
UW expenses	275	341	334	59	21.3%
Underwriting results	(350)	(344)	(340)	10	2.8%
Net investment income	474	468	469	(5)	-1.0%
Realized capital gain (loss)	49	49	115	65	132.5%
Other income (expense)	(19)	(19)	(34)	(15)	-77.0%
Income before dividends to policyholders	154	154	210	56	36.0%
Dividends to policyholders (credits)	-	-	0	0	n/a
Net income (loss)	154	154	210	55	35.9%
Standard Industry Ratios					
Loss ratio (CY)	74.0%	74.0%	74.0%		0.0%
LAE ratio (CY)	32.3%	26.2%	26.6%		-5.7%
Loss and LAE ratio (CY)	106.3%	100.2%	100.6%		-5.7%
UW expense ratio (CY)	22.9%	28.3%	32.7%		9.8%
Combined ratio (CY)	129.2%	128.5%	133.3%		4.1%

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