

REPORT OF EXAMINATION
OF THE
STATE COMPENSATION INSURANCE FUND
AS OF
DECEMBER 31, 2020

Filed on February 2, 2022

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Oakland, California
January 26, 2022

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

STATE COMPENSATION INSURANCE FUND

(hereinafter also referred to as State Fund), which has its home office located at 2860 Gateway Oaks Drive, Sacramento, California 95833.

SCOPE OF EXAMINATION

We have performed out single-state examination of State Fund. The previous examination of State Fund was made as of December 31, 2020. This examination covers the period from January 1, 2017 through December 31, 2020.

This examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate State Fund's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. The examination also included identifying and evaluating significant risks that could cause State Fund's surplus to be materially misstated both currently and prospectively.

All accounts and activities of State Fund were considered in accordance with the risk-focused examination process. This includes assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If an adjustment was identified during the course of the

examination, the impact of such adjustment would be documented separately following State Fund's financial statements.

This examination report includes findings of fact and general information about the State Fund and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to State Fund.

STATE FUND HISTORY

State Fund is a public enterprise fund whose organization and powers are defined by California Insurance Code (CIC) Sections 11770 through 11805. Concurrently with the enactment of the first compulsory workers' compensation laws in California, State Fund was established by the California Legislature in 1914 to provide an available market for workers' compensation insurance to employers located in California.

Effective October 7, 2021, Assembly Bill (AB) 1511, an insurance omnibus bill which included Senate Bill (SB) 713 related to State Fund was approved by the Governor and amended CIC Section 11797. AB 1511 authorizes State Fund, until January 1, 2027, discretionary authority to invest in properties, securities, and money market mutual funds not to exceed the lesser of 2.5 percent of its admitted assets or 10 percent of moneys that are in excess of the admitted assets over the liabilities and required reserves allowed pursuant to CIC Sections 1210 and 1192.9. The provisions in SB 713 also allows State Fund limited discretionary authority to invest in environmental, social, or governance investments.

MANAGEMENT AND CONTROL

Pursuant to California Insurance Code Section 11770, the Board of Directors of State Fund is composed of eleven members. Nine of the board members (including the chairperson) are appointed by the Governor, of which one member is required to be from organized labor. Another member who also represents organized labor is appointed by

the Speaker of the Assembly and the eleventh member is appointed by the Senate Committee on Rules. The Director of Industrial Relations is a non-voting ex-officio member of the Board, and is not counted for quorum or any other purposes. Each Board member other than the Director of Industrial Relations serves a period of five years until the appointment and qualification of their successors. There is currently one voting member vacancy that has yet to be appointed by the Governor.

The following are the directors and principal officers of State Fund serving at December 31, 2020:

Board of Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Daniel M. Curtin Carmichael, California	Director California Conference of Carpenters
Richard J. Guggenhime San Francisco, California	Senior Counsel Perkins Coie, LLP
Katrina S. Hagen Sacramento, California	Director California Department of Industrial Relations
David M. Lanier Davis, California	Secretary California Labor and Workforce Development Agency
Senator Michael J. Machado Linden, California	Retired
Jack L. Neureuter Geyserville, California	Retired
Alexis A. Podesta Carmichael, California	Consultant Podesta Company
Arthur H. Pulaski Berkeley, California	Executive Secretary and Treasurer California Labor Federation
Thomas E. Rankin Berkeley, California	President Emeritus California Labor Federation

Name and Location

Principal Business Affiliation

Angela D. Tate
Sacramento California

Principal
Burton and the Brains

William M. Zachry
San Carlos, California

Senior Fellow
Sedgwick Institute

Principal Officers

Name

Title

Vernon L. Steiner

President and Chief Executive Officer

Peter A. Guastamachio

Chief Financial Officer

Kenneth R. Van Laar

Chief Risk Officer

Stephen Hunckler

Chief Claims Operations Officer

Richard J. Law

Chief Operating Officer

Marjorie Hutchings

Chief Information Officer

Margie Lariviere

Chief of Internal Affairs and General
Counsel

Stephanie K. Chan

Chief Investment Officer

Andreas Acker

Executive Vice President and Chief
Administrative Officer

Management Agreements

State Fund has a Master Agreement (Agreement) with the California Department of Human Resources to provide claims administration, legal representation, and Medicare quarterly reporting services to all California state government agencies. Under the terms of the Agreement, the California state government agencies shall pay services fees and reimbursement of expenditures to State Fund in accordance with California Insurance Code Sections 11774 through 11776, and 11871.

TERRITORY AND PLAN OF OPERATION

State Fund is authorized only to transact workers' compensation insurance business in the State of California. State Fund is organized as a public enterprise fund and operates as a competitive, full service workers' compensation insurer that is continuously available to all employers located in California. Its operations are funded from collections of policy

premiums and returns from investments, and most of its employees are civil service employees. State Fund's liabilities are not guaranteed by the State of California; however, the benefits to injured workers insured by State Fund are backed by the California Insurance Guaranty Association.

REINSURANCE

Assumed

State Fund assumes a small amount of workers' compensation insurance business written by Zurich America Insurance Company covering the non-California employees of State Fund's California policyholders pursuant to California Insurance Code Section 11780.5. During 2020, reinsurance assumed was only \$1.6 million.

Ceded

The following is a summary of principal reinsurance agreements in-force as of December 31, 2020:

<u>Type of Contract</u>	<u>Line(s) of Business</u>	<u>Reinsurer(s) and Participation</u>	<u>State Fund's Retention</u>	<u>Reinsurer's Limit</u>
All Perils (excluding terrorism)				
Multi-Year Catastrophe Bond Earthquake Coverage	Workers' Compensation and Employers' Liability Business	<u>Unauthorized</u> Golden State Re II Ltd. (70.0%)	\$50 million ultimate net loss each trigger event	\$300 million excess of \$50 million ultimate net loss each trigger event; \$300 million in aggregate
Two Year Workers' Compensation Excess of Loss	Workers' Compensation and Employers' Liability Business	<u>Authorized</u> Munich Reinsurance America, Inc. (11.67%) <u>Unauthorized</u> Munchener Ruckversicherungs AG (8.33%)	\$50 million ultimate net loss each loss occurrence	\$300 million excess of \$50 million ultimate net loss each loss occurrence; \$600 million for all loss occurrences during each contract year

<u>Type of Contract</u>	<u>Line(s) of Business</u>	<u>Reinsurer(s) and Participation</u>	<u>State Fund's Retention</u>	<u>Reinsurer's Limit</u>
Workers' Compensation First Excess of Loss	Workers' Compensation and Employers' Liability Business	<u>Authorized</u> Arch Reinsurance Company (16.0%) Lloyd's Syndicate (32.27%) Various reinsurers (18.46%) <u>Unauthorized</u> Everest Reinsurance (Bermuda) Ltd. (10.00%) Various reinsurers (23.27%)	\$350 million ultimate net loss each loss occurrence	\$250 million excess of \$350 million ultimate net loss each loss occurrence; \$500 million aggregate limit any one contract year
Workers' Compensation Second Excess of Loss	Workers' Compensation and Employers' Liability Business	<u>Authorized</u> Lloyd's Syndicate (100%)	\$600 million ultimate net loss each loss occurrence	\$50 million excess of \$600 million ultimate net loss each loss occurrence; \$100 million aggregate limit any one contract year
Terrorism				
Terrorism First Excess of Loss	Workers' Compensation and Employers' Liability Business	<u>Authorized</u> Arch Reinsurance Company (16.0%) Lloyd's Syndicate (32.27%) Various reinsurers (18.46%) <u>Unauthorized</u> Everest Reinsurance (Bermuda) Ltd. (10.00%) Various reinsurers (24.09%)	\$50 million ultimate net loss each loss occurrence	\$250 million excess of \$50 million ultimate net loss each loss occurrence; \$500 million aggregate limit any one contract year
Terrorism Second Excess of Loss	Workers' Compensation and Employers' Liability Business	<u>Authorized</u> Lloyd's Syndicate	\$300 million ultimate net loss each loss occurrence	\$50 million excess of \$300 million ultimate net loss each loss occurrence; \$100 million aggregate limit any one contract year

**State Fund is covered under the Federal Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) up to \$545 million in excess of \$241 million ultimate net loss. TRIPRA covers 80% and State Fund retains 20% of the ultimate net loss.*

Loss Portfolio Transfer

In August 2002, State Fund entered into a Loss Portfolio Transfer (LPT) with XL Re Ltd. (XL Re) and ACE Bermuda Insurance Ltd (ACE). Effective January 1, 2007, XL Re assumed all the rights and obligations of ACE under the LPT through an Assumption Reinsurance and Novation Agreement. In 2016, XL Re completed a merger. The merged

company holds the name XL Bermuda Ltd. (XL Bermuda) and effective with the completion of the merger, XL Bermuda assumed all right and obligations of XL Re. The LPT covers workers' compensation losses paid after January 1, 2002 on accident years 1980 to 1998. Loss adjustment expenses, employers' liability and United States Longshoremen's and Harbor Workers' Compensation Act losses are excluded. Under the LPT agreement, State Fund retains an amount of aggregate subject losses and the reinsurers are liable for 90% share of losses in the covered layers. The maximum amount recoverable under the reinsured layers of the agreement is 90% of \$1.45 billion. The following table is a summary of the reinsured layers of coverage:

Coverage Layers	State Fund's Retention	Reinsurer's Limits
First Layer	\$950 million of aggregate subject losses	90% of \$1.15 billion excess of \$950 million aggregate subject losses
Second Layer	\$200 million of aggregate subject losses	90% of \$300 million excess of \$2.1 billion aggregate subject losses

As of December 31, 2020, cumulative subject paid losses were \$2.46 billion, which exceeded the upper limit of the first layer of \$2.1 billion placed at 90% and pierced the second layer of coverage. After State Fund's retention of \$950.0 million and \$200.0 million on the first layer and second layer, respectively, the combined total recoverable losses was \$1.18 billion of which \$1.01 billion was collected from the reinsurers.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by State Fund with the California Department of Insurance for the period ending December 31, 2020. The accompanying comments to the amounts in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the statutory financial statements reported by State Fund.

Statement of Financial Condition as of December 31, 2020

Underwriting and Investment Exhibit for the Year Ended December 31, 2020

Reconciliation of Surplus as Regards Policyholders from December 31, 2016
through December 31, 2020

Statement of Financial Condition
as of December 31, 2020

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$18,976,705,319	\$	\$18,976,705,319	
Common stocks	940,910,511		940,910,511	
Real estate:				
Properties occupied by the company	262,412,739		242,412,739	
Properties held for production	26,121,375		26,121,375	
Properties held for sale	710,488	710,488	0	
Cash, cash equivalents and short-term investments	55,052,522		55,052,522	
Receivables for securities	15,154		15,154	
Investment income due & accrued	122,674,743		122,674,743	
Uncollected premiums, agents' balances in course of collection	109,990,615	56,625,263	53,365,352	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	61,549,780	6,154,989	55,394,791	
Amount recoverable from reinsurers	2,067,398		2,067,398	
Funds held by or deposited with reinsured companies	2,540,000		2,540,000	
Electronic data processing equipment and software	20,966,585	4,498,957	16,467,628	
Furniture and equipment	20,353,686	20,353,686	0	
Aggregate write-ins for other than invested assets	134,804,967	18,820,980	115,983,987	
Total assets	<u>\$20,736,875,881</u>	<u>\$ 107,164,363</u>	<u>\$20,629,711,519</u>	

Liabilities, Surplus, and Other Funds

Notes

Losses			\$ 9,570,359,803	(1)
Loss adjustment expenses			2,146,801,240	(1)
Commissions payable, contingent commissions and other similar charges			33,056,125	
Other expenses (including taxes, licenses, and fees)			94,234,232	
Taxes, licenses and fees (excluding federal and foreign income tax)			9,658,420	
Borrowed money			429,606,505	
Unearned premiums			61,316,396	
Advance premiums			422,188	
Policyholders dividends declared and unpaid			119,500,000	
Ceded reinsurance premiums payable			(49,968)	
Amounts withheld or retained by company for account of others			75,109,577	
Remittances and items not allocated			2,983,772	
Provision for securities			6,451,553	
Payable for securities			17,300,000	
Aggregate write-ins for liabilities			<u>1,696,586,268</u>	(3)
Total liabilities			14,263,336,111	
Aggregate write-ins for special surplus funds		\$ 566,157,203		
Unassigned funds (surplus)		<u>5,800,218,205</u>		
Surplus as regards policyholders			<u>\$ 6,366,375,408</u>	
Total liabilities, surplus, and other funds			<u>\$20,629,711,519</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2020

Underwriting Income

Premiums earned		\$ 1,015,787,011
Deductions:		
Losses incurred	\$ 711,029,523	
Loss adjustment expenses incurred	223,834,000	
Other underwriting expenses incurred	508,596,996	
Aggregate write-ins for underwriting deductions	<u>14,700,000</u>	
Total underwriting deductions		<u>1,458,160,519</u>
Net underwriting loss		(442,373,508)

Investment Income

Net investment income earned	\$ 574,246,632	
Net realized capital gains	<u>88,522,216</u>	
Net investment gain		662,768,848
<u>Other income</u>		
Net loss from agent's or premium balances charged off (amount recovered \$9,340,636; amount charged off \$57,501,065)	(48,160,429)	
Aggregate write-ins for miscellaneous income	<u>121,081</u>	
Total other loss		<u>(48,039,348)</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		172,355,992
Dividends to policyholders		<u>100,540,799</u>
Net income		<u>\$ 71,815,193</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2019		\$ 6,511,834,327
Net income	\$ 71,815,193	
Change in net unrealized capital losses	(17,243,087)	
Change in nonadmitted assets	(18,861,352)	
Change in provision for reinsurance	(65,712)	
Aggregate write-ins for losses in surplus	<u>(181,103,961)</u>	
Change in surplus as regards policyholders for the year		<u>(145,458,919)</u>
Surplus as regards policyholders, December 31, 2020		<u>\$ 6,366,375,408</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance evaluated the Unpaid Liability Adequacy Test and Experience Report as of December 31, 2020 prepared by State Fund's independent actuary and concurred that State Fund's losses and loss adjustment expense reserves as of December 31, 2020 were reasonable and have been accepted for purposes of this examination.

(2) Borrowed Money

Effective February 15, 2012, State Fund entered into an Advances and Security Agreement with the Federal Home Loan Bank (FHLB) of San Francisco. As a member of FHLB, State Fund was approved for \$2.1 billion total financing availability, or the maximum credit limit for advances. Through its membership, State Fund has pledged to the FHLB \$1.18 billion in securities in exchange for cash advances with a current borrowing capacity of \$731.0 million. State Fund utilized these funds for operations and investment in medium-term bonds. The total par value on loan borrowed was \$342.9 million as of year-end 2020.

(3) Pension and Other Postretirement Benefit Plans

State Fund employees are employees of the State of California and participate in the State Pension and Other Postretirement Benefit (OPEB) plans. State Fund is not directly liable for obligations under the plans. As a result, State Fund recognizes Pension and OPEB expense attributable to its proportionate share of the State's Pension and OPEB cost for the period. In 2019, State Fund reclassified \$968.1 million to Pension and OPEB liability based on the State Controller's allocation report as of June 30, 2018, by reducing its special surplus of \$229.6 million for OPEB and \$738.5 million for Pension. In 2020, State Fund reclassified \$180.8 million to Pension and OPEB liability based on the State Controller's allocation report as of June 30, 2020, by reducing its special surplus of \$71.4

million for OPEB and \$109.4 million for Pension. The liabilities for OPEB and Pension as of December 31, 2020 are \$1.15 billion and \$691.9 million, respectively.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by State Fund's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/_____

Allen Lau, CFE
Examiner-In-Charge
Senior Insurance Examiner, Specialist
Department of Insurance
State of California

_____/S/_____

Li Lim, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California