# Financial Statements and Supplementary Information – Statutory Basis

State Compensation Insurance Fund
Years Ended December 31, 2023 and 2022
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

State Compensation Insurance Fund

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Years Ended December 31, 2023 and 2022

## Contents

Building a better
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# Report of Independent Auditors

The Audit Committee of the Board of Directors
State Compensation Insurance Fund

We have audited the accompanying statutory-basis financial statements of State Compensation Insurance Fund, which comprise the statements of admitted assets, liabilities, and policyholders' surplus as of December 31, 2023 and 2022, and the related statements of income, changes in policyholders' surplus and cash flow for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in conformity with accounting practices prescribed or permitted by the California Department of Insurance. Management is also responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2 to the statutory-basis financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the California Department of Insurance, which is a basis of accounting other than U.S. generally accepted accounting principles. The effects on the financial statements of the variances between these statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

## Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company at December 31, 2023 and 2022, or the results of its operations or its cash flows for the years then ended.

## Opinion on Statutory Basis of Accounting

In our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Ernst + Young LLP

May 29, 2024

# State Compensation Insurance Fund

## Statements of Admitted Assets, Liabilities, and Policyholders' Surplus – Statutory Basis

*(In Thousands)*

| | December 31 2023 | December 31 2022 |
|---|---|---|
| **Admitted assets** | | |
| Bonds, at amortized cost | **$ 19,265,329** | $ 18,713,822 |
| Preferred stocks | **38,223** | – |
| Common stocks | **667,258** | 808,822 |
| Real estate | **281,241** | 289,059 |
| Cash, cash equivalents, and short-term investments | **12,784** | 240,976 |
| Other invested assets | **81,306** | 4,496 |
| Receivables for securities | **11** | 290 |
| Total cash and investments | **20,346,152** | 20,057,465 |
| | | |
| Premiums in the course of collection | **71,823** | 59,693 |
| Earned but unbilled premiums | **63,062** | 63,449 |
| Reinsurance recoverables | **3,880** | 3,279 |
| Accrued interest and dividends | **134,660** | 123,264 |
| Due from adjusting contracts | **71,916** | 76,418 |
| Other assets | **73,608** | 72,616 |
| Total admitted assets | **$ 20,765,101** | $ 20,456,184 |
| | | |
| **Liabilities and policyholders' surplus** | | |
| Estimated liabilities for: | | |
| Losses | **$ 8,889,406** | $ 9,326,873 |
| Loss adjustment expenses | **1,915,924** | 2,158,945 |
| Retroactive reinsurance ceded | **(179,592)** | (215,164) |
| Unearned premiums | **46,733** | 45,608 |
| Dividends reserve | **152,117** | 102,725 |
| Pension and other postemployment benefit liability | **1,522,673** | 1,472,831 |
| Borrowed money and interest thereon | **835,092** | 369,673 |
| Deposit liability | **78** | 90 |
| Self-insurance reserve | **98,042** | 101,375 |
| Other liabilities | **303,159** | 453,229 |
| Total liabilities | **13,583,632** | 13,816,185 |
| | | |
| Special surplus funds for: | | |
| Retroactive reinsurance | **179,592** | 215,164 |
| Unfunded pension and other postemployment benefits | **287,452** | 364,375 |
| Unassigned surplus | **6,714,425** | 6,060,460 |
| Policyholders' surplus | **7,181,469** | 6,639,999 |
| Total liabilities and policyholders' surplus | **$ 20,765,101** | $ 20,456,184 |

*See accompanying notes to statutory-basis financial statements.*

State Compensation Insurance Fund

## Statements of Income – Statutory Basis

*(In Thousands)*

| | Year Ended December 31 | |
|---|---|---|
| | **2023** | 2022 |
| Net premiums earned | **$ 1,140,256** | $ 1,174,780 |
| Losses incurred | **430,123** | 841,719 |
| Loss adjustment expenses incurred | **72,204** | 296,186 |
| Underwriting and administrative expenses | **452,816** | 442,573 |
| Premium deficiency | **–** | (5,100) |
| Total underwriting deductions | **955,143** | 1,575,378 |
| Net underwriting gain (loss) | **185,113** | (400,598) |
| Net investment income | **556,179** | 506,121 |
| Net capital gains | **14,147** | 61,995 |
| Other (expense) income | **(132,319)** | 13,962 |
| Net income before dividends to policyholders | **623,120** | 181,480 |
| Dividends to policyholders | **94,960** | 101,216 |
| Net income | **$ 528,160** | $ 80,264 |

*See accompanying notes to statutory-basis financial statements.*

State Compensation Insurance Fund

# Statements of Changes in Policyholders' Surplus – Statutory Basis

*(In Thousands)*

| | |
|---|---|
| Balance, January 1, 2022 | $ 6,507,337 |
| Net income | 80,264 |
| Change in nonadmitted assets | (67,169) |
| Decrease in net unrealized gain | (150,780) |
| Unfunded actuarial accrued liability allocation | 269,694 |
| Change in provision for reinsurance | 653 |
| Balance, December 31, 2022 | 6,639,999 |
| Net income | **528,160** |
| Change in nonadmitted assets | **103,570** |
| Increase in net unrealized gain | **24,881** |
| Unfunded actuarial accrued liability allocation | **(115,703)** |
| Change in provision for reinsurance | **562** |
| Balance, December 31, 2023 | **$ 7,181,469** |

*See accompanying notes to statutory-basis financial statements.*

State Compensation Insurance Fund

# Statements of Cash Flow – Statutory Basis

*(In Thousands)*

| | Year Ended December 31 | |
|---|---|---|
| | **2023** | **2022** |
| **Operating activities** | | |
| Premiums collected net of reinsurance | **$ 1,095,691** | $ 1,125,468 |
| Net investment income | **570,545** | 549,838 |
| Other income received | **7,414** | 14,583 |
| Benefits and loss-related payments | **(868,191)** | (941,770) |
| Other underwriting expenses | **(841,076)** | (802,967) |
| Net cash used in operations | **(35,617)** | (54,848) |
| | | |
| **Investment activities** | | |
| Proceeds from investments sold, matured, or repaid: | | |
| Bonds | **1,853,071** | 2,400,576 |
| Stocks | **295,398** | 559,534 |
| Real estate | **471** | – |
| Other invested asset | **6,385** | 444 |
| Net gains on cash, cash equivalents and short-term investments | **13** | – |
| Change in receivable for securities | **280** | 54,489 |
| Total investment proceeds | **2,155,618** | 3,015,043 |
| | | |
| Cost of investments acquired: | | |
| Bonds | **(2,426,703)** | (2,641,105) |
| Stocks | **(162,074)** | (306,731) |
| Real estate | **(625)** | (2,928) |
| Other invested asset | **(69,252)** | (5,157) |
| Change in payable for securities | **(119,588)** | 119,588 |
| Total investments acquired | **(2,778,242)** | (2,836,333) |
| Net cash (used in) provided by investing activities | **(622,624)** | 178,710 |
| | | |
| **Financing and miscellaneous activities** | | |
| Funds received | **465,419** | 59,116 |
| Other cash used | **(35,370)** | (83,454) |
| Net cash provided by (used in) financing and miscellaneous activities | **430,049** | (24,338) |
| | | |
| Net change in cash, cash equivalents, and short-term investments | **(228,192)** | 99,524 |
| Cash, cash equivalents, and short-term investments, beginning of year | **240,976** | 141,452 |
| Cash, cash equivalents, and short-term investments, end of year | **$ 12,784** | $ 240,976 |

*See accompanying notes to statutory-basis financial statements.*

## 1. History and Business

State Compensation Insurance Fund (State Fund or the Company) is a public enterprise fund established by the State of California (the State) through legislation enacted in 1913 to provide an available market for workers' compensation insurance to employers located in California.

State Fund was organized pursuant to and operates in accordance with Section 11770 of the California Insurance Code (the Code). In accordance with the Code, the Governor appoints nine members, including one from organized labor, and names the chairperson. The Speaker of the Assembly appoints one member who represents organized labor, and the Senate Committee on Rules appoints one member. The board also includes the Department of Industrial Relations Director as a non-voting "ex-officio" member.

State Fund's purpose is to provide fairly priced workers' compensation insurance, make workplaces safe, and restore injured workers. State Fund is self-supported with revenue from premiums written and investment income. It does not receive any financial support from the State and the State is not liable for any obligations of State Fund.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The statutory-basis financial statements of State Fund have been prepared in conformity with accounting practices prescribed or permitted by the California Department of Insurance (CDI), and in accordance with the National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual*, to the extent those practices and procedures do not conflict with the California Insurance Code. As a state official approves State Fund's governing board members, U.S. generally accepted accounting principles (GAAP) for State Fund are those promulgated by the Governmental Accounting Standards Board (GASB), which are the accounting standards applicable to state and local governmental entities.

Statutory accounting practices differ in certain respects from GAAP, as prescribed by the GASB. The significant differences from GASB are as follows:

- Cash balances are reported net of bank overdrafts and outstanding checks and, in instances of net negative cash balance, amounts are reported as a negative asset rather than a liability.

**2. Summary of Significant Accounting Policies (continued)**

- Investments in bonds and short-term investments are carried principally at amortized cost, whereas under GASB, such investments would be carried at fair value with changes in fair value reflected in net income.

- Unrealized gains and losses on investments in common stocks are credited or charged directly to policyholders' surplus, whereas under GASB, such changes in fair value would be reflected in net income.

- Certain assets designated as "non-admitted assets" are excluded from total assets. These assets, the change in which is credited or charged directly to policyholders' surplus, consist primarily of the following: premiums in the course of collection that remain outstanding over 90 days, plus all related amounts due that have been recorded on those policies; nonoperating system internally developed software costs; 10% of earned but unbilled premiums (EBUB) in excess of collateral specifically held and identifiable on a per policy basis; 10% of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party or collateral; office furniture and equipment; leasehold improvements; deposits held by others; prepaid expenses and investment income due and accrued over 90 days. Under GASB, these assets would be included in total assets to the extent realizable.

- Gains on retroactive reinsurance are recognized in income and established as special surplus. GASB requires the gains to be deferred and recognized over the estimated settlement period of the reinsured losses using a recovery method.

- Policyholders' dividends are accrued when declared, whereas under GASB they are accrued based on amounts to be paid.

- Fees received for processing the claims of other self-insured State of California departments are netted against loss adjustment expenses, other underwriting expenses, and investment expenses, whereas under GASB, these would be recorded as other income.

- An allocation of rental value to space owned and occupied by State Fund is included in income and expense, whereas it would be excluded under GASB.

**2. Summary of Significant Accounting Policies (continued)**

- GASB requires a classified presentation for the statement of net position, which distinguishes between current and long-term assets and liabilities, which is not required under statutory accounting.

- The statement of cash flow differs in certain respects from the presentation required by GASB, including the presentation of the changes in cash, cash equivalents, and short-term investments, instead of cash and cash equivalents. Short-term investments include securities with maturities, at the time of acquisition, of one year or less. In addition, there is no reconciliation between net income and cash from operations as there would be under GASB.

- A provision for reinsurance is recorded as a liability with a corresponding adjustment to policyholders' surplus for the reinsurance receivable from unauthorized reinsurance carriers with inadequate collateral, and reinsurance recoverables over 90 days, plus all related amounts due that have been recorded on those reinsurance recoverables. Under GASB, such a provision for reinsurance is not recognized.

- Statutory accounting allows a company to segregate surplus to provide for contingencies; while generally, GASB would not allow surplus to be restricted unless required by law.

- Accounting for contingencies requires recording a liability at the midpoint of a range of estimated possible outcomes, when no better estimate in the range exists; while GASB would require the minimum amount in the range to be accrued.

- Under GASB, all leases except for leveraged leases for lessors are accounted for as operating leases. Under GAAP, leases are treated as operating or capital leases by lessees and as operating, sales-type, direct financing or leveraged leases by lessors.

The effects on the financial statements of the variances noted above, although not reasonably determined, are presumed to be material.

## 2. Summary of Significant Accounting Policies (continued)

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with statutory accounting principles prescribed or permitted by the CDI requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

Among the most significant estimates inherent in these statutory-basis financial statements are the liabilities for losses and loss adjustment expenses, the liabilities for State Fund's self- insurance loss and loss adjustment expenses, and State Fund's portion of the pension and other postemployment benefit (OPEB) costs estimated by State Fund based on the independent actuarial valuation prepared for the State, the independent actuarial valuation by third party for retirement actuarial consulting services, and the assessment of State Fund's liabilities from the State Controller's Office (SCO).

### Cash, Cash Equivalents, and Short-Term Investments

Cash consists of cash, savings accounts, and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date. Cash equivalents are money market mutual fund and short-term, highly liquid investments with original maturities of three months or less that are both (a) readily convertible to known amounts of cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Money market funds shall be valued at fair value or net asset value (NAV). Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at cost, which approximates fair value.

### Investments

Investments in bonds are valued in accordance with the requirements of the Securities Valuation Office of the NAIC. Bonds are generally stated at amortized cost, except bonds that are defined by the NAIC as Class 3 through 6, which are stated at the lower of amortized cost or fair value. Amortization is calculated using the scientific constant yield to worst method. Mortgage-backed securities (MBS) are amortized using anticipated prepayments and are accounted for using the prospective method. The carrying value for MBS has been determined in accordance with the

**2. Summary of Significant Accounting Policies (continued)**

guidelines of the NAIC. State Fund uses widely accepted cash flow models from third-party data providers, which use Median Speeds model. Median Speeds serves as a benchmark for MBS prepayment assumptions. This model looks to the specifics of the security dealers' own models. The data provider will scan all of security dealers' prepayment assumptions and choose the speed in the middle.

Investments in common stocks are stated at fair value. Federal Home Loan Bank (FHLB) shares are valued at par, which is presumed to be fair value as they are only redeemable at par and are not publicly traded. Investments in preferred stocks are perpetual preferred stocks which are stated at fair value.

Other invested assets consist of minority ownerships in limited partnerships, which are reported based upon the Company's underlying equity of the investee with changes in value being recorded as a component of unrealized gains or losses in unassigned surplus. Equity amounts are derived from net asset value (NAV) of the investee's U.S. GAAP audited financial statements. As of December 31, 2023 and December 31, 2022, State Fund's unfunded capital commitments were $11,367 and $20,287, respectively.

Fair value for bonds is primarily determined using a pricing hierarchy starting with a widely accepted pricing vendor, followed by State Fund's custodial bank, portfolio managers' independent pricing services, and other pricing services. Fair value for common stock is primarily determined using a pricing hierarchy from a widely accepted pricing vendor.

State Fund reviews its investment portfolio to determine whether or not declines in fair value of individual securities held are other than temporary. Declines in the value of investments that are determined to be other than temporary result in a reduction in carrying amount to fair value, or, for MBSs, to the present value of expected cash flows if management has the ability and intent to hold the MBS to recovery and does not have the intent to sell the investment. If the Company intends to sell the MBS investment or loses the ability to hold it to recovery, the impairment charge is the full difference between the amortized cost and fair value. The impairment charge is included as a realized loss and a new cost basis for the security is established. To determine whether an impairment is "other than temporary," State Fund considers many factors including credit quality, market analysis, current events, probability of recovery, the length of time and extent to which fair

**2. Summary of Significant Accounting Policies (continued)**

value has been less than cost, the financial condition and near-term prospects of the issuers, whether the debtor is current on its contractually obligated interest and principal payments, and management's intent and ability to hold the asset. If the decline is interest related, the Company considers whether it has an intent to sell, or lacks the ability to hold, the security to recovery.

Investment expenses consist primarily of expenses incurred in the investing of funds and pursuit of investment income. Such expenses include custodial expenses, portfolio management, and advisory fees for the short and long-term bonds, equity counsel fees, and fees related to other invested asset; alteration to property, repairs and maintenance, utilities, real estate taxes, and other real property expenses for real estate investments.

Realized capital gains or losses on bonds and common stocks are recognized using specific identification method when securities are sold, redeemed, or otherwise disposed and reported as capital gains or losses in the statement of income. Unrealized gains and losses for assets carried at fair value are reflected in policyholders' surplus.

For bonds, interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period, reductions for premium amortization and interest paid on acquisitions of bonds, and the addition of discount accretion. Investment income is reduced for amounts which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees are reported as investment income when received.

Dividends on common stock and preferred stocks are recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income is recorded on stocks declared to be ex-dividends on or prior to the statement date).

**Real Estate, Furniture, Equipment, and Leasehold Improvements**

Real estate consists of office buildings occupied by State Fund and properties held for the production of income and are stated at cost less accumulated depreciation. Real estate held for sale is carried at the lower of depreciated cost or fair value less estimated cost to sell. On a nonrecurring

**2. Summary of Significant Accounting Policies (continued)**

basis, real estate held for sale is measured at fair value due to impairment recognition. When impaired, State Fund reports the fair value if it's less than the cost. The fair value is obtained from third-party and/or internal appraisals less estimated costs to sell. Impairment loss is measured as the amount by which the individual carrying amounts exceed the fair value of properties occupied or properties held for production. Depreciation on buildings is computed on a straight-line basis over the estimated useful life of the buildings. Buildings acquired prior to 2014 have an estimated useful life of 50 years. Whereas, buildings acquired starting in 2014 have an estimated useful life of 39 years.

Data processing equipment, telephone equipment, and capitalized internally developed software (IDS) are carried at cost less accumulated depreciation computed on a straight-line basis over the estimated useful lives of the assets (3 years). Depreciation on office furniture and equipment is computed on a straight-line basis over the estimated useful lives of the assets (5 years). The aggregate amount of admitted data processing equipment (net of accumulated depreciation) is limited to 3% of State Fund's policyholders' surplus, adjusted for the carrying value of data processing equipment.

The cost of assets retired or otherwise disposed of, and the related accumulated depreciation thereon, are removed from the accounts with any gain or loss realized upon sale or disposal, credited, or charged to operations.

State Fund has a written capitalization policy for purchases of items such as electronic data processing equipment hardware, vehicles, furniture, fixtures, equipment, IDS, leasehold improvements, and land improvements.

**Losses and Loss Adjustment Expenses**

Management records its best estimate of the liabilities for losses and loss adjustment expenses (LAE). These liabilities include the estimated future cost of reported claims, the cost of claims incurred but not reported, and expenses related to investigating and settling claims. State Fund does not discount these liabilities. These liabilities are based on actuarial estimates that are subject to considerable uncertainty. Should State Fund's losses develop in the future differently from their historical loss development or those projected by the actuarial methods, actual losses would vary, perhaps significantly, from such actuarial estimates. Any adjustments to these estimates are reflected in operations when known (refer to Note 8).

**2. Summary of Significant Accounting Policies (continued)**

Management's estimates are based on its knowledge and experience about past and current events and circumstances, and its assumptions about conditions it expects to exist in the future. Factors relevant to the estimation of loss and loss adjustment expense liabilities include the estimation of the ultimate frequency and severity of losses, the level of future medical cost inflation over long periods of time, the future legal and regulatory environment, and the amount of future expenses required to investigate and settle claims. Management's estimates are reviewed quarterly by a nationally recognized consulting actuarial firm (the Appointed Actuary). The Appointed Actuary is retained in accordance with CDI regulatory provisions as the designee to issue a statement of actuarial opinion that has been reviewed with the Board of Directors (BOD) as required by CDI regulatory provisions.

State Fund establishes case reserves for all claims. Incurred but not reported (IBNR) reserves are established on the book as a whole and include a provision for development of reserves on reported losses. State Fund's aggregate reserves are established based on in-house analyses, and input from external actuaries using a variety of reserve techniques, including paid loss development, incurred loss development, frequency-severity, and historical loss ratios adjusted to current rate levels.

**Revenue Recognition and Unearned Premiums**

State Fund applies the "Western Accounting Method" in which direct written premium is recognized when billed to the policyholder. Insurance premiums are recognized as earned ratably over the term of the policies, that is, in proportion to the amount of insurance protection provided. The portion of the premiums that will be earned in the future is deferred and reported as unearned premiums.

State Fund offers two types of billing options to policyholders: (1) payroll reporting and (2) installment billing, based on estimated annual premium. Payroll reporting policies are billed at the back end of the billing cycles so the deposits are treated as deposit premium, whereas installment policies are billed at the front end of the billing cycles so the deposits are treated as deposit liability. Subsequent non-deposit premium bills for both billing options are recorded as premiums written and earned pro rata over the policy term. Unearned premiums are established to cover the unexpired portion of premiums written. State Fund records an estimate for earned but unbilled premium (EBUB) as a direct adjustment to earned premiums. State Fund reflects 10% of

**2. Summary of Significant Accounting Policies (continued)**

EBUB in excess of collateral specifically held and identifiable on a per policy basis as a non-admitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they are written off against operations in the period that the determination is made.

A premium deficiency liability is recognized if the sum of anticipated losses and loss adjustment expenses, maintenance costs, and any acquisition costs not previously expensed, less anticipated investment income, exceed the unearned premiums. State Fund considers anticipated investment income when determining the existence of a premium deficiency. State Fund did not recognize a premium deficiency reserve as of December 31, 2023 and December 31, 2022, respectively.

**Reinsurance**

In the normal course of business, State Fund evaluates its net exposure to catastrophic and other events, and may use internal capital and/or reinsurance to manage that risk.

State Fund evaluates and monitors the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. State Fund does not believe it is exposed to any material credit risk.

State Fund analyzes its reinsurance agreements to ensure that they meet risk transfer requirements. The reinsurer must assume significant insurance risk under the reinsured portions of the underlying insurance contracts, and there must be a reasonably possible chance that the reinsurer may realize a significant loss from the transaction. Based on management's evaluation, all reinsurance agreements transfer significant insurance risk and, accordingly, are accounted for as reinsurance. In 2023, State Fund does not have any new reinsurance agreements.

Reinsurance recoverables on paid losses and LAE are reported as assets. Estimated reinsurance recoverables on unpaid losses and LAE are recognized in a manner consistent with the liabilities related to the underlying reinsured contracts. The Loss Portfolio Transfer (LPT) agreement is accounted for as retroactive reinsurance in accordance with SSAP No. 62R, *Property and Casualty Reinsurance.*

**2. Summary of Significant Accounting Policies (continued)**

**Guaranty Fund and Other Assessments**

In California, all insurers writing workers' compensation, including State Fund, are subject to assessment by the California Insurance Guarantee Association (CIGA) and the Department of Industrial Relations (DIR) to protect claimants against insurer insolvencies and administer various aspects of the workers' compensation system. The DIR assessment aggregates to approximately 5.85% and 5.9% of direct written premium for 2023 and 2022, respectively. Annual assessments are paid in advance, based on prior year premiums with the final assessment based on reported calendar year written premium. Additional amounts owed are included in other liabilities.

Amounts prepaid in excess of the final assessment amount are available for credit against future assessments and included in guaranty fund receivables.

In California, all insurers are required by law to bill their policyholders a premium surcharge to cover such fund assessments. State Fund generally requires the policyholder to pay an estimated surcharge at policy inception. CIGA surcharges related to unexpired policies and DIR surcharges collected in excess of assessments are included in other liabilities. Additional surcharges owed by policyholders are included in guaranty fund receivables and the DIR assessments are included in other assets. State Fund remains liable to assessing agencies should policyholders fail to remit premium surcharges.

Effective for the year beginning 2019, the CIGA's Board of Governors elected not to declare an assessment for the "worker's compensation", "automobile/homeowners" or "all other" lines of business. Therefore, State Fund will not surcharge policies generating direct written premium in the workers' compensation beginning January 1, 2019. State Fund will continue to be obligated to fund CIGA at rates that are determined and announced annually as soon as CIGA resumes the assessment for workers' compensation. There were no CIGA assessment for 2023 and 2022.

Under the U.S. Longshoremen's and Harbor Workers' (L&H) Compensation Act (the Act), all carriers and self-insurers writing U.S. L&H policies, including State Fund, are required to make payments into a Special Fund based on a prorated assessment determined by the Secretary of the U.S. Department of Labor. The Special Fund was created to protect injured employees or their survivors by providing for subsequent injuries as defined by the Act. State Fund recorded a liability of $5,000 and $5,500, which are included in other liabilities as of December 31, 2023 and 2022, respectively, for future assessments under the Act. State Fund is no longer offering U.S. L&H coverage and has sunset the underwriting of these policies effective January 1, 2024.

## 2. Summary of Significant Accounting Policies (continued)

### Pension and Other Postemployment Benefit Plans

State Fund employees are employees of the State. Consequently, State Fund employees participate in the State pension and 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.

The State employee pension plan is administered by the Public Employees' Retirement System of the State of California (CalPERS). State Fund pays CalPERS the estimated employers' share of its current employees' retirement cost based on assessments computed by CalPERS and SCO.

The State's OPEB plan provides medical, prescription drugs, and dental benefits (healthcare benefits) to retired statewide employees. The authority for establishing and amending the OPEB plan lies with CalPERS, while the authority for establishing and amending the funding policy lies with the State Legislature. The State's OPEB plan is a substantive agent-multiple employer defined benefit plan.

For fiscal years beginning on July 1, 2016 and prior, the State's annual OPEB cost was calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined by the State in accordance with the parameters of GASB No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45).

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the service cost, or normal cost each year and amortize any unfunded actuarial accrued liabilities (or funding excess) (UAAL) over a period not to exceed 30 years.

For fiscal year beginning on July 1, 2017, the State's annual OPEB expense is calculated based on the service cost, less member contributions, less the expected return on assets, plus an amortization of changes in the Net OPEB liability due to demographic experience, investment performance, assumption changes and plan changes in accordance with the parameters of GASB No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pension* (GASB 75 or Statement). GASB 75 was effective for public employers' fiscal years beginning after June 15, 2017. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project

**2. Summary of Significant Accounting Policies (continued)**

benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria. The State adopted GASB 75 on July 1, 2017.

To comply with GASB No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68) and GASB 75, CalPERS and a third party actuarial firm prepared an actuarial valuation report for the State's net pension and OPEB liabilities for the State's fiscal year ended June 30, 2023, (using a valuation date of June 30, 2022). Prior to fiscal year 2018–2019, the State determined the annual allocation for State Fund based upon the relationship of pensionable compensation for State Fund compared to the total State for Pension liabilities and active employee health benefit costs for State Fund compared to the total State active employee health benefit costs for OPEB liability. Starting fiscal year 2018–2019, the State determines the annual OPEB allocation ratio for State Fund based on employer OPEB contributions consisting of prefunding contributions and pro-rata payments after application of implicit rate subsidy factor. Pension allocation basis remains unchanged. State Fund records its additional share (per GASB 45 for 2017 and prior, and per GASB 75 for 2018) of the annual OPEB cost and carries the accumulated balance (i.e., the allocated amount less the amount State Fund has funded to the State) as a liability. State Fund continues to pay on a "pay-as-you-go" funding policy until OPEB prefunding took effect on July 1, 2018, for additional contributions made by both employers and employees.

State Fund continued to engage a third party for retirement actuarial consulting services to project the impact on Statutory accounting of GASB 68 and GASB 75. All actuarial methodologies, assumptions, and results as of June 30, 2022, discussed herein were provided to State Fund by the State and were followed by State Fund's external pension actuary for projection as of December 31, 2023, year-end reporting purposes.

Projected benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between employer and plan members to that point. The actuarial calculations reflect a long-term perspective. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revisions as results are compared to past expectations and new estimates are made about the future. The State's UAAL for the pension and OPEB plans are based on a

**2. Summary of Significant Accounting Policies (continued)**

variety of actuarial assumptions as disclosed in the State's Annual Comprehensive Financial Report (ACFR). Separate actuarial valuations related to State Fund are not available. As a result, the portion of the State's unfunded pension and OPEB liabilities attributable to State Fund is estimated by State Fund, and will change over time.

State Fund recognizes in the statement of income only the annual service cost allocation from the State, as this is the Company's current year expense for the plan for the period, in accordance with Statutory accounting for plans in which an insurer participates but is not directly liable. In December 2012, State Fund established a special surplus account to provide for the portion of the contingency for OPEB and pension costs that have not already been accrued as a liability, as permitted by SSAP No. 72, *Surplus and Quasi-Reorganizations*. The annual UAAL allocation from the State is recorded as a direct reduction to the special surplus account prior to 2019. In December 2019, State Fund reclassified its portion of OPEB and pension total liabilities based on its proportionate share provided by SCO as per compliance with GASB 68 and 75, following SSAP No. 5R, *Liabilities, Contingencies and Impairment of Assets*. These resulted in State Fund reducing its special surplus for OPEB and pension and increasing its corresponding liabilities (refer to Note 11).

Effective in 2020, the pension contributions pertaining to the Amortization of Unfunded Liability are applied as a reduction to pension liability and the remaining amounts representing the normal costs are recorded as pension expenses (refer to Note 11).

**Related Parties**

State Fund has an agreement with CalHR to adjust the workers' compensation claims and process the payments related to those claims on behalf of state agencies. This is referred to as State Contracts. State Fund pays compensation benefits to the injured workers and medical benefits to the health providers. State Fund is reimbursed by the state agencies for compensation and medical benefits paid, and the cost of adjusting. State Fund also bills monthly service fees for processing these claims on a full cost recovery basis. State Fund records a receivable for the reimbursements and monthly service fees under "Due from adjusting contracts". All agencies make deposits in a trust account that is held by State Fund for future bills. The deposits are included under other liabilities in the statements of admitted assets, liabilities, and policyholders' surplus.

## 2. Summary of Significant Accounting Policies (continued)

### Income Taxes

State Fund is exempt from income taxation under the Internal Revenue Code 501(a). State Fund pays premium taxes to the CDI.

## 3. Risk-Based Capital

California law imposes risk-based capital (RBC) requirements on admitted California insurance companies, including State Fund. These RBC requirements set forth a calculation to determine the required levels of policyholders' surplus, and provide certain consequences for failure to meet these requirements. State Fund operates in conformity with the California law imposed for RBC. As of December 31, 2023 and 2022, policyholders' surplus exceeded the minimum RBC requirements.

## 4. Investment Securities

State Fund's investments are primarily comprised of bonds and common stocks.

*(Dollars in Thousands)*

## 4. Investment Securities (continued)

### Bonds

The carrying value, gross unrealized gains and losses, and fair value of investments in bonds are as follows:

| | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2023** | | | | |
| All other governments | **$ 4,994** | **$ –** | **$ (230)** | **$ 4,764** |
| Industrial and miscellaneous | **9,535,349** | **37,066** | **(836,000)** | **8,736,415** |
| Hybrid securities | **58,773** | **1,833** | **(20)** | **60,586** |
| Political subdivisions | **526,074** | **4,797** | **(74,686)** | **456,185** |
| Special revenue/assessment | **2,362,993** | **16,536** | **(245,989)** | **2,133,540** |
| States, territories, and possessions | **174,918** | **1,576** | **(14,456)** | **162,038** |
| U.S. Government | **59,261** | **–** | **(727)** | **58,534** |
| Mortgage-backed securities: | | | | |
| Special revenue/assessment | **6,112,037** | **21,961** | **(574,120)** | **5,559,878** |
| U.S. Government | **430,930** | **2,980** | **(15,662)** | **418,248** |
| Total | **$ 19,265,329** | **$ 86,749** | **$ (1,761,890)** | **$ 17,590,188** |
| | | | | |
| **December 31, 2022** | | | | |
| All other governments | $ 4,991 | $ – | $ (326) | $ 4,665 |
| Industrial and miscellaneous | 9,264,898 | 3,894 | (1,072,959) | 8,195,833 |
| Political subdivisions | 583,935 | 4,059 | (92,678) | 495,316 |
| Special revenue/assessment | 2,382,634 | 10,548 | (319,614) | 2,073,568 |
| States, territories, and possessions | 202,295 | 843 | (18,966) | 184,172 |
| U.S. Government | 59,268 | – | (2,157) | 57,111 |
| Mortgage-backed securities: | | | | |
| Special revenue/assessment | 5,952,785 | 4,313 | (665,379) | 5,291,719 |
| U.S. Government | 263,016 | 807 | (16,885) | 246,938 |
| Total | $ 18,713,822 | $ 24,464 | $ (2,188,964) | $ 16,549,322 |

*(Dollars in Thousands)*

## 4. Investment Securities (continued)

The tables below reflect the summary of temporarily impaired financial instruments:

| | 12 Months or Under | | Over 12 Months | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **December 31, 2023** | | | | | | |
| All other governments | **$ –** | **$ –** | **$ 4,764** | **$ (230)** | **$ 4,764** | **$ (230)** |
| Industrial and miscellaneous | **455,708** | **(8,143)** | **6,786,545** | **(827,857)** | **7,242,253** | **(836,000)** |
| Hybrid securities | **2,454** | **(20)** | **–** | **–** | **2,454** | **(20)** |
| Political subdivisions | **11,206** | **(77)** | **322,959** | **(74,609)** | **334,165** | **(74,686)** |
| Special revenue/assessment | **206,203** | **(4,523)** | **1,442,499** | **(241,466)** | **1,648,702** | **(245,989)** |
| States, territories, and possessions | **23,831** | **(516)** | **92,371** | **(13,940)** | **116,202** | **(14,456)** |
| U.S. Government | **–** | **–** | **58,534** | **(727)** | **58,534** | **(727)** |
| Mortgage-backed securities: | | | | | | |
| Special revenue/assessment | **418,997** | **(3,892)** | **4,299,600** | **(570,228)** | **4,718,597** | **(574,120)** |
| U.S. Government | **110,202** | **(2,135)** | **172,166** | **(13,527)** | **282,368** | **(15,662)** |
| Total | **$ 1,228,601** | **$ (19,306)** | **$13,179,438** | **$(1,742,584)** | **$14,408,039** | **$ (1,761,890)** |
| **December 31, 2022** | | | | | | |
| All other governments | $ 4,665 | $ (326) | $ – | $ – | $ 4,665 | $ (326) |
| Industrial and miscellaneous | 6,581,800 | (648,005) | 1,446,090 | (424,954) | 8,027,890 | (1,072,959) |
| Political subdivisions | 274,412 | (58,379) | 92,750 | (34,299) | 367,162 | (92,678) |
| Special revenue/assessment | 1,410,204 | (218,153) | 303,942 | (101,461) | 1,714,146 | (319,614) |
| States, territories, and possessions | 57,112 | (8,857) | 28,391 | (10,109) | 85,503 | (18,966) |
| U.S. Government | 92,254 | (2,157) | – | – | 92,254 | (2,157) |
| Mortgage-backed securities: | | | | | | |
| Special revenue/assessment | 3,237,793 | (270,565) | 1,827,789 | (394,814) | 5,065,582 | (665,379) |
| U.S. Government | 217,310 | (16,885) | – | – | 217,310 | (16,885) |
| Total | $11,875,550 | $(1,223,327) | $ 3,698,962 | $ (965,637) | $15,574,512 | $(2,188,964) |

As of December 31, 2023 and 2022, 2,773 and 2,917 securities were in an unrealized loss position, which resulted in an unrealized loss of $1,761,890 and $2,188,964, respectively. As of December 31, 2023, the decrease in the unrealized loss from 2022 to 2023 is mostly due to flat to slightly lower Treasury rates and tighter credit spreads which reduced the portfolio's unrealized loss position. Unlike 2022 where Treasury rates rose and credit spreads widened contributing to increase unrealized losses. State Fund's bond portfolio is primarily comprised of investment grade

*(Dollars in Thousands)*

**4. Investment Securities (continued)**

securities. As of December 31, 2023 and 2022, 99% and 100% of all bonds held by State Fund were rated Class 1 and Class 2 by the NAIC, respectively. State Fund concluded that the gross unrealized losses as of December 31, 2023 and 2022 were temporary in nature.

State Fund did not recognize other-than-temporary impairments on bonds for both years ended December 31, 2023 and 2022.

The carrying value and fair value of bonds as of December 31, 2023, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. MBS provide for periodic payments through their lives so they are listed separately.

| | **2023** | |
|---|---|---|
| | **Carrying Value** | **Fair Value** |
| Due in one year or less | $ 450,537 | $ 445,483 |
| Due after one year through five years | 3,899,546 | 3,790,526 |
| Due after five years through ten years | 4,613,025 | 4,208,700 |
| Due after ten years | 3,759,254 | 3,167,353 |
| Mortgage-backed securities | 6,542,967 | 5,978,126 |
| Total | $ 19,265,329 | $ 17,590,188 |

Proceeds from sales of bonds during 2023 were $1,853,087 with gross realized gains of $551 and gross realized losses of $5,684. Proceeds from sales of bonds during 2022 were $2,401,417 with gross realized gains of $2,343 and gross realized losses of $261.

State Fund had $59,261 and $59,269 on deposit with the Federal Reserve Bank of St. Louis as of December 31, 2023 and 2022, respectively, to satisfy the U.S. Department of Labor regulations relating to State Fund's issuance of U.S. L&H policies.

*(Dollars in Thousands)*

## 4. Investment Securities (continued)

### Preferred Stocks

The tables below reflect costs, gross unrealized gains and losses, and fair value of investments in preferred stocks:

| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2023** | | | | |
| Industrial and miscellaneous | **$ 37,554** | **$ 786** | **$ (117)** | **$ 38,223** |
| Total preferred stocks | **$ 37,554** | **$ 786** | **$ (117)** | **$ 38,223** |

The tables below reflect the summary of temporarily impaired preferred stocks:

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **December 31, 2023** | | | | | | |
| Industrial and miscellaneous | **$ 10,582** | **$ (117)** | **$ –** | **$ –** | **$ 10,582** | **$ (117)** |
| Total preferred stocks | **$ 10,582** | **$ (117)** | **$ –** | **$ –** | **$ 10,582** | **$ (117)** |

There were no sales and disposals of preferred stocks during 2023.

*(Dollars in Thousands)*

## 4. Investment Securities (continued)

### Common Stocks

The tables below reflect costs, gross unrealized gains and losses, and fair value of investments in common stocks:

| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2023** | | | | |
| Industrial and miscellaneous | **$ 534,355** | **$ 140,963** | **$ (8,060)** | **$ 667,258** |
| Total common stocks | **$ 534,355** | **$ 140,963** | **$ (8,060)** | **$ 667,258** |
| **December 31, 2022** | | | | |
| Industrial and miscellaneous | $ 687,306 | $ 156,903 | $ (35,387) | $ 808,822 |
| Total common stocks | $ 687,306 | $ 156,903 | $ (35,387) | $ 808,822 |

The tables below reflect the summary of temporarily impaired common stocks:

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **December 31, 2023** | | | | | | |
| Industrial and miscellaneous | **$ 59,346** | **$ (5,631)** | **$ 23,255** | **$ (2,429)** | **$ 82,601** | **$ (8,060)** |
| Total common stocks | **$ 59,346** | **$ (5,631)** | **$ 23,255** | **$ (2,429)** | **$ 82,601** | **$ (8,060)** |
| **December 31, 2022** | | | | | | |
| Industrial and miscellaneous | $ 185,150 | $ (34,175) | $ 10,072 | $ (1,212) | $ 195,222 | $ (35,387) |
| Total common stocks | $ 185,150 | $ (34,175) | $ 10,072 | $ (1,212) | $ 195,222 | $ (35,387) |

Proceeds from sales or disposals of common stocks during 2023 were $295,398 with gross realized gains of $38,677 and gross realized losses of $15,061. Proceeds from sales or disposals of common stocks during 2022 were $559,534 with gross realized gains of $105,034 and gross realized losses of $41,763.

*(Dollars in Thousands)*

## 4. Investment Securities (continued)

State Fund recognized $5,691 other-than-temporary impairment on common stocks for the year ended 2023. State Fund recognized $3,358 other-than-temporary impairment on common stocks for the year ended 2022.

State Fund is a member of FHLB of San Francisco and owns a Class B membership stock. As of December 31, 2023 and 2022, FHLB par value are $21,777 and $15,000, respectively.

### Structured Securities and Other

State Fund does not engage in subprime residential mortgage lending nor does it invest directly in subprime fixed-income securities. As of December 31, 2023 and 2022, State Fund has no direct subprime mortgage-related risk exposure. State Fund invests in MBS that are primarily backed by government agencies or government-sponsored entities, specifically Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC). These types of securities are collateralized by loans, but are ultimately backed by the issuing agencies. GNMA securities are guaranteed by the U.S. Treasury. State Fund, as well as other state and local agencies, are authorized to invest funds in the State's Pooled Money Investment Account (PMIA). State Fund's holdings in the PMIA at December 31, 2023 and 2022, were $6,539 and $5,715, respectively.

There were no structured securities as of December 31, 2023 and 2022. Net investment income earned by investment category is as follows:

| | **Year Ended December 31** | |
|---|---|---|
| | **2023** | **2022** |
| Bonds | **$ 605,610** | $ 533,735 |
| Preferred stocks | **411** | – |
| Common stocks | **15,605** | 22,606 |
| Real estate | **31,832** | 30,675 |
| Other | **7,760** | 1,447 |
| Total investment income | **661,218** | 588,463 |
| Less: investment expenses | **(105,039)** | (82,342) |
| Net investment income | **$ 556,179** | $ 506,121 |

*(Dollars in Thousands)*

## 5. Fair Value Measurement

State Fund categorizes its financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique, per SSAP No. 100R. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest-priority-level input that is significant to the fair value measurement of the instrument in its entirety.

- Level 1 – Quoted prices in active markets for identical assets or liabilities
- Level 2 – Inputs, other than quoted prices, that are observable by a marketplace participant, either directly or indirectly
- Level 3 – Unobservable inputs that are significant to the fair value measurement

The tables below summarize State Fund's fair value of financial instruments by Level 1, 2 and 3:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **December 31, 2023** | | | | |
| Financial assets: | | | | |
| Bonds | $ – | $ 17,590,188 | $ – | $ 17,590,188 |
| Preferred stocks | – | 38,223 | – | 38,223 |
| Common stocks | 645,481 | 21,777 | – | 667,258 |
| Cash, cash equivalents, and short-term investments | 12,784 | – | – | 12,784 |
| Receivables for securities | 11 | – | – | 11 |
| Total | $ 658,276 | $ 17,650,188 | $ – | $ 18,308,464 |
| | | | | |
| Financial liabilities: | | | | |
| Borrowed money and interest thereon | $ – | $ 812,567 | $ – | $ 812,567 |
| Total | $ – | $ 812,567 | $ – | $ 812,567 |

*(Dollars in Thousands)*

## 5. Fair Value Measurement (continued)

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **December 31, 2022** | | | | |
| Financial assets: | | | | |
| Bonds | $ – | $ 16,549,322 | $ – | $ 16,549,322 |
| Common stocks | 707,326 | 15,000 | 86,496 | 808,822 |
| Cash, cash equivalents, and short-term investments | 238,728 | 2,234 | – | 240,962 |
| Receivables for securities | 290 | – | – | 290 |
| Total | $ 946,344 | $ 16,566,556 | $ 86,496 | $ 17,599,396 |
| | | | | |
| Financial liabilities: | | | | |
| Borrowed money and interest thereon | $ – | $ 322,647 | $ – | $ 322,647 |
| Total | $ – | $ 322,647 | $ – | $ 322,647 |

During February 2023, State Fund's common stock holding, RREEF America REIT II, Inc., were converted into units of limited partnership interest in RREEF America II LP due to a merger and State Fund was admitted as a Limited Partner. As a result, the corresponding interest transferred out from Level 3, with a total value of $86,496.

## 6. Borrowed Money

### Supplemental Employer Pension Contributions (Senate Bill No. 84)

Senate Bill No. (SB) 84 requires the State Controller to transfer up to $6,000,000 from the Surplus Money Investment Fund and other funds in the PMIA that accrue interest to the General Fund as a cash loan, the proceeds of which would supplement the state's employer contributions for the 2017–2018 fiscal year. As of December 31, 2023, State Fund's SB 84 loan balance and accrued interest payable were $21,109 and $599, respectively. As of December 31, 2022, State Fund's SB 84 loan balance and accrued interest payable were $36,302 and $818, respectively. In 2023, State Fund incurred and paid interests of $1,197 and $1,416, respectively. In 2022, State Fund incurred and paid interests of $1,164 and $463, respectively. The interest rate is the yield of the two-year constant maturity United States Treasury rate. The bill requires the principal and interest be fully repaid by June 30, 2030.

*(Dollars in Thousands)*

## 6. Borrowed Money (continued)

Aggregated principal amounts due over the term of the loan:

| | | |
|---|---|---|
| 2024 | $ | 15,686 |
| 2025 | | 5,423 |
| Total amount due | $ | 21,109 |

### Federal Home Loan Bank (FHLB) Agreements

State Fund has pledged bonds to FHLB in exchange for cash advances to utilize for operations and investment in short to medium-term bonds. Under the Securities Backed Credit Program, members of the FHLB may borrow up to 100% of the current market value of its eligible securities pledged. FHLB assigned the appropriate borrowing capacity to each security according to the security type and then determines the total borrowing capacity as a percentage of the market value of the Securities Backed Credit collateral. The current borrowing of $806,544 is subject to prepayment penalties.

The table below summarizes the FHLB pledge and borrowing:

| | 2023 | 2022 |
|---|---|---|
| Actual or estimated borrowing capacity as of reporting date | **$ 1,864,982** | $ 1,270,937 |
| Collateral amount pledged as of reporting date: | | |
| Fair value | **2,209,636** | 1,888,770 |
| Carrying value | **2,532,671** | 2,214,832 |
| Maximum collateral amount pledged during the reporting period: | | |
| Fair value | **2,285,804** | 1,961,016 |
| Carrying value | **2,640,019** | 2,277,455 |
| Maximum amount borrowed during the reporting period | **806,544** | 330,619 |
| Borrowing from FHLB as of reporting date | **$ 806,544** | $ 330,619 |
| Accrued interest on borrowing | **6,840** | 1,934 |
| Total borrowing and accrued interest | **$ 813,384** | $ 332,553 |

*(Dollars in Thousands)*

**6. Borrowed Money (continued)**

The tables below summarize the date issued, maturity date, face value, carrying value, interest rate and effective interest rate, and interest paid related to the FHLB borrowing agreement:

| December 31, 2023 | | | | | |
|---|---|---|---|---|---|
| **Date Issued** | **Maturity Date** | **Face Value/ Carrying Value** | **Interest Rate** | **Effective Interest Rate** | **Interest Paid** |
| 1/23/2019 | 1/23/2024 | $ 24,966 | 2.90% | 2.90% | $ 734 |
| 3/16/2020 | 9/13/2024 | 10,000 | 1.15 | 1.15 | 117 |
| 3/17/2020 | 6/12/2024 | 10,070 | 1.22 | 1.22 | 125 |
| 3/19/2020 | 3/19/2025 | 7,250 | 1.46 | 1.46 | 107 |
| 3/20/2020 | 3/3/2025 | 1,940 | 1.38 | 1.38 | 27 |
| 3/23/2020 | 3/24/2025 | 21,260 | 1.38 | 1.38 | 297 |
| 3/24/2020 | 3/24/2025 | 1,750 | 1.58 | 1.58 | 28 |
| 3/25/2020 | 3/25/2025 | 14,980 | 1.58 | 1.58 | 240 |
| 3/27/2020 | 3/27/2025 | 3,150 | 1.58 | 1.58 | 50 |
| 3/30/2020 | 3/31/2025 | 9,000 | 1.45 | 1.45 | 132 |
| 3/30/2020 | 3/31/2025 | 4,000 | 1.10 | 1.10 | 45 |
| 4/7/2020 | 4/7/2025 | 1,600 | 0.94 | 0.94 | 15 |
| 4/9/2020 | 4/6/2023 | 14,460 | 0.67 | 0.67 | 98 |
| 5/22/2020 | 2/13/2025 | 10,000 | 2.74 | 2.74 | 278 |
| 3/25/2022 | 1/2/2026 | 8,200 | 2.75 | 2.75 | 229 |
| 3/29/2022 | 4/1/2027 | 1,750 | 2.74 | 2.74 | 49 |
| 4/26/2022 | 2/1/2027 | 20,000 | 3.10 | 3.10 | 629 |
| 8/26/2022 | 8/28/2025 | 3,750 | 3.59 | 3.59 | 137 |
| 10/18/2022 | 7/1/2027 | 2,600 | 4.45 | 4.45 | 82 |
| 10/19/2022 | 6/15/2027 | 7,465 | 4.46 | 4.46 | 338 |
| 11/4/2022 | 11/4/2025 | 2,500 | 4.70 | 4.70 | 119 |
| 11/7/2022 | 10/27/2025 | 15,000 | 4.89 | 4.89 | 721 |
| 11/15/2022 | 11/15/2027 | 19,250 | 4.16 | 4.16 | 812 |
| 1/6/2023 | 1/6/2028 | 13,250 | 4.08 | 4.08 | 272 |
| 3/1/2023 | 1/20/2028 | 9,500 | 4.42 | 4.42 | 164 |
| 3/9/2023 | 1/21/2028 | 17,960 | 4.52 | 4.52 | 302 |
| 4/24/2023 | 4/20/2028 | 29,100 | 3.94 | 3.94 | 570 |
| 4/28/2023 | 3/15/2028 | 23,970 | 3.80 | 3.80 | 354 |
| 5/1/2023 | 5/1/2026 | 2,000 | 4.08 | 4.08 | 42 |
| 5/11/2023 | 6/3/2027 | 10,050 | 3.81 | 3.81 | 219 |
| 5/15/2023 | 7/22/2026 | 9,960 | 3.97 | 3.97 | 85 |
| 5/16/2023 | 1/27/2027 | 22,610 | 3.91 | 3.91 | 420 |
| 5/18/2023 | 5/19/2025 | 25,250 | 4.32 | 4.32 | 561 |

*(Dollars in Thousands)*

## 6. Borrowed Money (continued)

| December31,2023 | | | | | |
|---|---|---|---|---|---|
| DateIssued | Maturity Date | FaceValue/ Carrying Value | Interest Rate | Effective Interest Rate | Interest Paid |
| 5/19/2023 | 5/19/2028 | $ 45,445 | 3.90% | 3.90% | $ 906 |
| 5/23/2023 | 6/9/2026 | 22,600 | 4.28 | 4.28 | 599 |
| 5/23/2023 | 12/16/2024 | 23,750 | 4.78 | 4.78 | 1,088 |
| 6/2/2023 | 3/2/2028 | 20,440 | 4.08 | 4.08 | 213 |
| 6/8/2023 | 3/30/2028 | 20,300 | 4.07 | 4.07 | 262 |
| 6/5/2023 | 5/30/2028 | 10,046 | 4.17 | 4.17 | 207 |
| 6/15/2023 | 1/14/2028 | 14,080 | 4.25 | 4.25 | 48 |
| 7/17/2023 | 6/7/2027 | 2,870 | 4.43 | 4.43 | 51 |
| 7/19/2023 | 9/1/2027 | 4,660 | 4.38 | 4.38 | 25 |
| 7/19/2023 | 6/7/2027 | 6,660 | 4.42 | 4.42 | 115 |
| 7/26/2023 | 5/24/2027 | 23,477 | 4.59 | 4.59 | 362 |
| 7/26/2023 | 2/1/2028 | 12,935 | 4.45 | 4.45 | 10 |
| 7/27/2023 | 3/27/2028 | 24,520 | 4.42 | 4.42 | 187 |
| 10/6/2023 | 8/16/2028 | 9,800 | 4.93 | 4.93 | – |
| 10/6/2023 | 4/27/2026 | 24,900 | 5.15 | 5.15 | 75 |
| 10/6/2023 | 8/16/2028 | 5,000 | 4.92 | 4.92 | – |
| 10/10/2023 | 5/21/2027 | 23,200 | 5.15 | 5.15 | 139 |
| 10/16/2023 | 5/15/2028 | 14,180 | 4.88 | 4.88 | 58 |
| 10/16/2023 | 7/3/2028 | 19,780 | 4.88 | 4.88 | – |
| 10/17/2023 | 10/17/2028 | 16,660 | 4.82 | 4.82 | – |
| 10/20/2023 | 10/20/2026 | 11,250 | 5.28 | 5.28 | – |
| 10/20/2023 | 3/24/2028 | 9,400 | 5.19 | 5.19 | – |
| 10/26/2023 | 10/26/2026 | 5,000 | 5.13 | 5.13 | – |
| 12/29/2023 | 1/2/2024 | 57,000 | 5.62 | 5.62 | – |
| | | $ 806,544 | | | $ 12,743 |

*(Dollars in Thousands)*

## 6. Borrowed Money (continued)

| December 31, 2022 | | | | | |
|---|---|---|---|---|---|
| **Date Issued** | **Maturity Date** | **Face Value/ Carrying Value** | **Interest Rate** | **Effective Interest Rate** | **Interest Paid** |
| 1/22/2019 | 2/27/2023 | $ 25,418 | 2.87% | 2.87% | $ 740 |
| 1/23/2019 | 1/23/2024 | 24,966 | 2.90 | 2.90 | 734 |
| 3/16/2020 | 9/13/2024 | 10,000 | 1.15 | 1.15 | 117 |
| 3/17/2020 | 6/12/2024 | 10,070 | 1.22 | 1.22 | 125 |
| 3/19/2020 | 3/19/2025 | 7,250 | 1.46 | 1.46 | 107 |
| 3/20/2020 | 3/3/2025 | 1,940 | 1.38 | 1.38 | 27 |
| 3/23/2020 | 3/24/2025 | 21,260 | 1.38 | 1.38 | 297 |
| 3/24/2020 | 3/24/2025 | 1,750 | 1.58 | 1.58 | 28 |
| 3/25/2020 | 3/25/2025 | 14,980 | 1.58 | 1.58 | 240 |
| 3/27/2020 | 3/27/2025 | 3,150 | 1.58 | 1.58 | 50 |
| 3/30/2020 | 3/31/2025 | 9,000 | 1.45 | 1.45 | 132 |
| 3/30/2020 | 3/31/2025 | 4,000 | 1.10 | 1.10 | 45 |
| 3/30/2020 | 3/30/2023 | 2,250 | 0.69 | 0.69 | 16 |
| 4/1/2020 | 3/30/2023 | 24,300 | 0.69 | 0.69 | 170 |
| 4/7/2020 | 4/7/2025 | 1,600 | 0.94 | 0.94 | 15 |
| 4/9/2020 | 4/6/2023 | 39,960 | 0.74 | 0.74 | 300 |
| 5/22/2020 | 2/13/2025 | 14,460 | 0.67 | 0.67 | 98 |
| 3/25/2022 | 1/2/2026 | 10,000 | 2.74 | 2.74 | 75 |
| 3/25/2022 | 1/4/2027 | 8,200 | 2.75 | 2.75 | 63 |
| 3/29/2022 | 4/1/2027 | 1,750 | 2.74 | 2.74 | 25 |
| 4/26/2022 | 2/1/2027 | 20,000 | 3.10 | 3.10 | 167 |
| 8/26/2022 | 8/28/2025 | 3,750 | 3.59 | 3.59 | – |
| 10/18/2022 | 7/1/2027 | 2,600 | 4.45 | 4.45 | – |
| 10/19/2022 | 6/15/2027 | 7,465 | 4.46 | 4.46 | 53 |
| 11/4/2022 | 11/4/2025 | 2,500 | 4.70 | 4.70 | – |
| 11/7/2022 | 10/27/2025 | 15,000 | 4.89 | 4.89 | – |
| 11/15/2022 | 11/15/2027 | 19,250 | 4.16 | 4.16 | – |
| 12/15/2022 | 12/15/2025 | 23,750 | 4.15 | 4.15 | – |
| | | $ 330,619 | | | $ 3,624 |

Based on the advance agreement, State Fund is subject to normal covenants of compliance with the FHLB credit program, compliance with applicable laws, providing reports as FHLB may require, insurance on the collateral, and notices for specified events such as defaults, mergers, change in charter, etc. There have been no violations of the terms and covenants for the advances.

*(Dollars in Thousands)*

**7. Real Estate, Furniture, Equipment, and Leasehold Improvements**

Real estate is comprised of the following:

| | December 31 2023 | December 31 2022 |
|---|---|---|
| Property occupied by the Company | **$ 364,385** | $ 363,816 |
| Property held for the production of income | **37,922** | 37,866 |
| Property held for sale | **464** | 710 |
| | **402,771** | 402,392 |
| Accumulated depreciation | **(121,530)** | (113,333) |
| Total | **$ 281,241** | $ 289,059 |

Depreciation expense on real estate was $8,197 and $8,170 for the years ended December 31, 2023 and 2022, respectively. Proceeds from sales of property during 2023 were $471 with gross realized gains of $225. As of December 31, 2023 and 2022, State Fund did not impair real estate property held for sale.

Furniture, equipment, and leasehold improvements are included in other assets and comprise the following:

| | December 31 2023 | December 31 2022 |
|---|---|---|
| Data processing equipment and software | **$ 239,536** | $ 238,113 |
| Office furniture, equipment, and leasehold improvements | **79,053** | 78,397 |
| | **318,589** | 316,510 |
| Accumulated depreciation | **(268,446)** | (269,274) |
| | **50,143** | 47,236 |
| Non-admitted assets | **(47,264)** | (41,910) |
| Total | **$ 2,879** | $ 5,326 |

Depreciation and amortization expenses on furniture, equipment, and leasehold improvements were $4,979 and $9,655 or the years ended December 31, 2023 and 2022, respectively.

*(Dollars in Thousands)*

## 8. Estimated Liabilities for Losses and Loss Adjustment Expenses

The table below reflects changes in the estimated liabilities for losses and loss adjustment expenses over the prior 12 months through December 31, 2023 and 2022. Loss and loss adjustment expense reserves are shown net of reinsurance but gross of the impact of an LPT.

| | **2023** | 2022 |
|---|---|---|
| Estimated liabilities for losses and loss adjustment expenses as of January 1, 2023 and 2022, net of ceded reinsurance of $30,434 and $37,885, respectively | **$ 11,485,818** | $ 11,590,407 |
| Add incurred related to: | | |
| Current year | **1,150,518** | 1,271,329 |
| Prior years | **(648,191)** | (133,424) |
| Total incurred | **502,327** | 1,137,905 |
| Less paid related to: | | |
| Current year | **172,616** | 199,511 |
| Prior years | **1,010,199** | 1,042,983 |
| Total paid | **1,182,815** | 1,242,494 |
| Estimated liabilities for losses and loss adjustment expenses as of December 31, 2023 and 2022, net of ceded reinsurance of $22,559 and $30,434, respectively | **$ 10,805,330** | $ 11,485,818 |

The decrease in incurred losses and loss adjustment expenses on insured events in prior years were approximately $648,191 and $133,424 in 2023 and 2022, respectively. In 2023, the significant releases in reserves were attributed to lower claims trend in California workers' compensation market and Claims programs' continued improvement to quality, maintaining, and increasing closure rates. In 2022, the decreases were due to favorable developments on loss and LAE reserves. For both years 2023 and 2022, the decreases were due to favorable developments on loss and LAE reserves.

Subrogation recoveries are considered when setting loss reserves. The estimated subrogation included as a reduction to IBNR was $37,181 and $38,788 as of December 31, 2023 and 2022, respectively.

*(Dollars in Thousands)*

## 8. Estimated Liabilities for Losses and Loss Adjustment Expenses (continued)

State Fund writes workers' compensation insurance, a line that exposes State Fund to long-term liabilities with a potential for significant reserve variability. Management has identified the major risk factors in reserve estimation as medical inflation and changes in utilization of medical procedures, exposure to the retroactive impact of future legislative, regulatory and judicial decisions that impact medical treatment and delivery and Medicare set-aside requirements.

The workers' compensation benefit program provides medical care for the lifetime of the claimant in some cases. This exposes any current estimate of future liability to the uncertainties of future medical cost inflation. State Fund uses various development modeling techniques to assist in the evaluation of its reserves under the direction of its management.

These risk factors, coupled with the variability that is inherent in reserve estimation, could result in material adverse deviation from the carried estimated liabilities for losses and LAE.

As a workers' compensation carrier, State Fund has incidental exposure to asbestos and environmental claims. Given that State Fund's book is principally small to medium size businesses, State Fund has no significant asbestos and environmental exposure aggregations. Claims are made up on a per claim basis.

The table below reflects the amount paid and reserved for losses and loss adjustment expenses for asbestos claims on direct, assumed, and net of reinsurance bases:

| | **2023** | **2022** |
|---|---|---|
| Asbestos, direct: | | |
| Beginning reserves (including case, bulk and IBNR, and LAE) | **$ 48,749** | $ 49,675 |
| Losses and LAE incurred | **(2,000)** | – |
| Calendar year payments for losses and LAE | **(1,347)** | (926) |
| Ending reserves (including case, bulk and IBNR, and LAE) | **$ 45,402** | $ 48,749 |

There were no asbestos claims with ceded reserves as of December 31, 2023 and 2022, respectively.

*(Dollars in Thousands)*

## 8. Estimated Liabilities for Losses and Loss Adjustment Expenses (continued)

State Fund has purchased annuities from life insurers under which the claimants are payees. State Fund requires the insurance companies that underwrite structured settlement annuities to have an A.M. Best credit rating of A+ or better. The present value of purchased annuities as reported to State Fund by the issuers was $667,311 and $680,899 at December 31, 2023 and 2022, respectively. This represents the discounted amount, as the nominal amount is not currently readily available from the issuers. These annuities have been used to reduce unpaid losses. State Fund is contingently liable for 100% of the annuities should the issuers of the annuities fail to perform under the terms of the annuities, which would require State Fund to report these obligations at the nominal value.

Structured settlement annuities due from life insurers equal or exceed 1% of State Fund's policyholders' surplus as of December 31, 2023 are as follows:

| Life Insurer | Annuities Reserve | Location | Licensed in California |
|---|---|---|---|
| Pacific Life Insurance Company | $ 163,039 | 700 Newport Center Dr., Newport Beach, CA 92660 | Yes |
| Metropolitan Life Insurance Company | 138,016 | 200 Park Ave., New York City, NY 10166 | Yes |
| The Hartford Life Insurance Company | 85,734 | One American Row, Hartford, CT 06103 | Yes |

*(Dollars in Thousands)*

## 9. Reinsurance

### Ceded Reinsurance

Certain premiums and losses are ceded to other insurance companies under various historical reinsurance agreements. State Fund has reported ceded reinsurance balances (prior to the LPT) as follows:

| | Year Ended December 31 | |
|---|---|---|
| | **2023** | **2022** |
| Reinsurance ceded: | | |
| Premium written | **$ –** | $ 15,615 |
| Premium earned | **–** | 15,615 |
| Premium payable (receivable) | **–** | 1,297 |
| Loss and loss adjustment expense incurred | **3,641** | 5,560 |
| Loss and loss adjustment expense recoverable | **26,439** | 33,713 |

Ceded loss and loss adjustment expense recoverable includes $19,240 and $23,660 from Reliastar Life Insurance Company as of December 31, 2023 and 2022, respectively.

State Fund remains liable for amounts ceded in the event that reinsurers are unable to honor their obligations.

State Fund cedes insurance risk relating to its workers' compensation business on multiple reinsurance treaties to multiple reinsurance companies. In accordance with statutory accounting practices, the reinsured risks are reflected net of the related loss and loss adjustment expense reserves.

State Fund does not have an unsecured aggregate recoverable for losses, paid and unpaid, loss adjustment expenses, and unearned premium with any individual reinsurers (excluding the LPT), authorized or unauthorized, that exceeds 3% of its policyholders' surplus.

### Catastrophic Reinsurance

State Fund's underwriting risk exposure is concentrated in California. As such, State Fund is exposed to earthquakes, terrorist acts, and other catastrophic events. These have not had significant adverse effects on operations in the past, but could present risks in the future. Each year, State Fund evaluates catastrophic risk as well as mitigation strategies.

**9. Reinsurance (continued)**

State Fund uses the modeling resources of its lead reinsurance intermediary to estimate the cumulative exceedance probability curve for aggregate annual terrorism losses and for per occurrence earthquake losses at both random and peak exposure periods.

For 2023, State Fund did not purchase reinsurance protection.

For terrorism incidents in 2023, including losses generated from nuclear, biological, chemical, or radiological events, State Fund was covered by the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA). TRIPRA provided coverage for 80% of losses in excess of 20% of 2022 Direct Earned Premium, or approximately $237,000, subject to a statutorily determined industry-wide maximum.

For 2022, State Fund had reinsurance coverage against natural catastrophes totaling $520,000: $210,000 from the multi-year catastrophe bond (covering earthquake), $60,000 from a treaty covering 20% of the $300,000 layer in excess of the $50,000 retention (covering all perils), and $250,000 from treaties that cover $300,000 in excess of $350,000 (covering all perils). For terrorism incidents, including losses generated from nuclear, biological, chemical, or radiological events, State Fund was covered by a combination of private reinsurance and TRIPRA. Private per occurrence excess of loss reinsurance covered $250,000 of losses in excess of $50,000 not first covered under TRIPRA. TRIPRA provided coverage for 80% of losses in excess of 20% of 2021 Direct Earned Premium, or approximately $250,000.

**Commutation**

For the year ended December 31, 2023, State Fund commuted certain reinsurance contracts with recoverable on unpaid losses and LAE of $73, which included $72 of losses incurred and $1 of LAE, from Starr Indemnity and Liability Company. State Fund's commutation settlement proceeds, net of reinsurance recoverable on paid losses and LAE was $73. The net effect of the commutation was an increase in losses and LAE of $73.

For the year ended December 31, 2022, State Fund had no commutation of ceded reinsurance.

**9. Reinsurance (continued)**

**Loss Portfolio Transfer (LPT)**

In August 2002, State Fund entered into a Loss Portfolio Transfer agreement (LPT) with XL Re Ltd. and ACE Bermuda Insurance Ltd. (the Reinsurers). The retroactive reinsurance agreement reinsured losses paid after January 1, 2002, on accident years 1980 through 1998. Under the LPT, State Fund retains liability for the first $950,000 of aggregate subject losses. In the first reinsured layer of coverage, the Reinsurers are liable for a 90% share of the next $1,150,000 of subject losses. Upon exhaustion of the first layer, State Fund retains the next $200,000 of subject losses in excess of $2,100,000. Then, in a second reinsured layer, the Reinsurers are liable for a 90% share of the next $300,000 of subject losses. The maximum amount recoverable from the Reinsurers under both reinsured layers of the treaty is 90% of $1,450,000.

Under the LPT, State Fund initially recorded a retroactive ceded loss reserves credit of $1,035,000 for a payment of $728,744, thus recognizing a retroactive gain of $319,756. The gain was recorded as special surplus for retroactive reinsurance. The special surplus arising from the transaction will be considered to be earned surplus and transferred to unassigned funds (surplus) when cash recoveries from the Reinsurers exceed the total consideration paid by State Fund for the LPT. Additionally, State Fund received $1,791 as interest on monies held by the Reinsurers prior to the final consummation of the LPT. This resulted in a net amount paid by State Fund of $726,953.

As of December 31, 2005, State Fund’s carried gross loss reserves for the subject losses exceeded the upper limit of the second layer of the treaty. State Fund increased retroactive ceded reserves by an additional $270,000 (the $300,000 in the second layer less State Fund’s 10% retention). As a result, State Fund recognized an additional retroactive gain of $256,500 ($270,000 net of a $13,500 deposit with Reinsurers for the coverage). Special surplus for retroactive reinsurance increased from $319,800 in 2004 to $576,300 at year-end of 2005. The special surplus for retroactive reinsurance began to decline in 2012 as the total recovered balance began to exceed LPT consideration paid. The special surplus for retroactive reinsurance was reduced by $35,572 in 2023 and $38,627 in 2022 and transferred to unassigned surplus.

Effective January 1, 2007, XL Re Ltd. assumed all the rights and obligations of Ace Bermuda Insurance Ltd. to State Fund under the LPT through an Assumption Reinsurance and Novation Agreement.

**9. Reinsurance (continued)**

In 2016, XL Re Ltd. completed a merger. The merged company holds the name XL Bermuda Ltd. and effective with the completion of the merger, XL Bermuda Ltd. assumed all rights and obligations of XL Re Ltd.

The original LPT contained a provision under the Large Payment Oversight clause, which was intended to address acceleration of payments due to settlement of claims. If the aggregate of Large Payments (defined as individual payments exceeding $10 intended to settle future liability) exceeds tabled values in the treaty (as specified at successive year-ends), this would void coverage on claims with subsequent Large Payments unless the Reinsurers provide prior written consent for the payments, or State Fund agreed that reimbursement would be apportioned over the life expectancy of the injured employee.

The Large Payment Oversight provision was triggered in the third quarter of 2009. In order to simplify administration by all parties of this provision, State Fund and the Reinsurer amended the original LPT contract to allow the deferral of subsequent Large Payments to be done on the aggregated total for each calendar quarter, based on an agreed average life expectancy for the entire body of claims involved in the LPT.

As of December 31, 2023, cumulative subject paid losses were $2,600,589, which exceeded the upper limit of the second layer of $2,600,000 placed at 90%. After the $950,000 and $200,000 Company retention on the first and second layer, respectively, which resulted to a combined total recoverable losses of $1,305,000, of which $1,125,408 was collected from the Reinsurers, $10,230 was billed as a current receivable, and $169,361 was receivable but not yet due from deferred large loss settlements.

As of December 31, 2022, cumulative subject paid losses were $2,561,302, which exceeded the upper limit of the first layer of $2,100,000 placed at 90% and has pierced the second layer of coverage. After the $950,000 and $200,000 Company retention on the first and second layer, respectively, which resulted to a combined total recoverable losses of $1,270,171, of which $1,089,836 was collected from the Reinsurers, $10,036 was billed as a current receivable, and $170,300 was receivable but not yet due from deferred large loss settlements.

*(Dollars in Thousands)*

## 10. Commitments and Contingencies

State Fund leases certain office space, furniture, equipment, and vehicles under noncancelable operating leases. The aggregate minimum annual lease payments under such operating leases as of December 31, 2023, were as follows:

| | | |
|---|---|---|
| 2024 | $ | 9,065 |
| 2025 | | 8,569 |
| 2026 | | 8,340 |
| 2027 | | 5,572 |
| 2028 | | 2,737 |
| Future years | | 4,468 |
| Total | $ | 38,751 |

Leases for office space generally require additional payments comprising State Fund's pro rata share of increases in real estate taxes and building operating expenses. For the years ended December 31, 2023 and 2022, the total rental expense for office space was $37,750 and $38,140, respectively, which is comprised of an allocation of rental value to space owned and occupied by State Fund of $27,231 and $25,810, and expense for leased properties of $10,519 and $12,330, respectively. Other lease expenses were $163 and $177 for the years ended December 31, 2023 and 2022, respectively.

State Fund owns several properties that are partially leased to unrelated parties. Real Estate owned and leased is stated at cost, less accumulated depreciation. The Company is responsible for the payment of property taxes, insurance and maintenance costs related to the leased properties.

Rental income for the year ended December 31, 2023, was $4,601. The portion of the carrying value and accumulated depreciation of real estate owned that are partially leased are $24,590 and $7,691, respectively.

Rental income for the year ended December 31, 2022, was $4,866. The portion of the carrying value and accumulated depreciation of real estate owned that are partially leased are $24,040 and $6,194, respectively.

*(Dollars in Thousands)*

**10. Commitments and Contingencies (continued)**

Future minimum lease payment receivables under noncancelable leasing arrangements as of December 31, 2023, are as follows:

| | | |
|---|---|---|
| 2024 | $ | 4,990 |
| 2025 | | 5,005 |
| 2026 | | 2,392 |
| 2027 | | 2,386 |
| 2028 | | 1,871 |
| Future years | | 4,079 |
| Total | $ | 20,723 |

Lawsuits arise against State Fund in the normal course of business. Contingent liabilities arising from litigation and other matters are not considered material in relation to the financial position of State Fund.

**11. Pension and Other Postemployment Benefit Plans**

State Fund incurred pension expense of $37,587 and $34,782 for the years ended December 31, 2023 and 2022, respectively.

State Fund paid retiree health benefit pro rata assessments of $35,178 and $38,526 for the years ended December 31, 2023 and 2022, respectively. In addition, State Fund also paid $10,723 and $10,960 of additional contributions for employer's OPEB Prefunding in 2023 and 2022, respectively.

In 2023, State Fund reclassified a total of $115,703 into liabilities from special surpluses, by increasing OPEB surplus and decreasing OPEB liability by $236,507, decreasing Pension surplus and increasing Pension liability by $352,210 based on the State Controller's allocation report (Accounting Element) as of June 30, 2023, or current unadjusted account balance when State Controller's report was not available. In addition, Pension surplus decreased by $295,615 with a corresponding increase in OPEB surplus by the same amount. These reclassifications are made in compliance with SSAP 5R. The liabilities for OPEB and Pension as of December 31, 2023 are $823,587 and $699,086 respectively. In December 2023, State Fund decreased its special surplus for UAAL for Pension by $295,615 and increased its special surplus for OPEB by $218,692 as projected by our third party actuary.

**11. Pension and Other Postemployment Benefit Plans (continued)**

In 2022, State Fund reclassified a total of $269,694 into special surpluses from liabilities, by increasing Pension surplus and decreasing OPEB liability by $82,810, increasing Pension surplus and decreasing Pension liability by $186,884 based on the State Controller's allocation report (Accounting Element) as of June 30, 2022. In addition, Pension surplus increased by $94,681 with a corresponding decrease in OPEB surplus by the same amount. These reclassifications are made in compliance with SSAP 5R. The liabilities for OPEB and Pension as of December 31, 2022 are $1,051,609 and $421,223, respectively. In December 2022, State Fund decreased its special surplus for UAAL for Pension by $139,821 as projected by our third party actuary.

In 2023 and 2022, State Fund recorded OPEB expenses of $54,386 and $51,417, respectively.

The special surplus was decreased by $76,923 and increased by $129,873, respectively, for the years ended December 31, 2023 and 2022.

**12. Risks and Uncertainties**

Some of State Fund's more significant risks are discussed below and in other notes to these financial statements. State Fund's business may also be adversely affected by risks and uncertainties not currently known or that are currently considered immaterial.

State Fund invests in various investment securities that are exposed to various risks, such as interest rate, market risk, and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and that change could materially affect the amounts reported in the statutory-basis financial statements. A substantial amount of the State Fund's assets is invested in debt and equity securities. Defaults, downgrades, or other events impairing the value of securities owned may reduce policyholders' surplus. State Fund attempts to mitigate these risks by adhering to investment policies that provide portfolio diversification and by complying with investment limitations governed by state insurance laws and regulations, as applicable. Additionally, management actively manages the investment risks by monitoring credit and rating changes on its portfolio. Underwriting risk is the risk that premiums from insured policies will be insufficient to cover the claims and expenses under the policies. State Fund's underwriting risk exposure is concentrated in California. As such, State Fund is exposed to losses from earthquakes, terrorist

## 12. Risks and Uncertainties (continued)

acts, and other catastrophic events, as well as the negative effects of significant economic and political events concentrated within the State. State Fund attempts to manage underwriting risk through price monitoring, which includes analyzing and monitoring current and historical State Fund data and industry data and trends, and through reinsurance.

State Fund attempts to protect its computer systems and communications systems but may experience interruptions and breaches, including computer viruses, malicious software, cyber-attacks, and hacking, which could impair the ability to conduct business and communicate, internally and with policyholders and customers, or result in the theft of trade secrets or other misappropriation of assets, or otherwise compromise privacy of State Fund's sensitive information, or that of its customers or other business partners.

Refer to Note 8 for discussion of the risks and uncertainties regarding estimates of reserves for losses and loss adjustment expenses incurred but unpaid. Refer to Note 2 for discussion of the risks and uncertainties regarding estimates of contingent obligations for unfunded pension and OPEB.

## 13. Related Parties

State Fund entered into a MSA with CalHR to administer state agencies' worker's compensation claims (refer to Note 2).

In 2023 and 2022, State Fund billed state agencies a total of $203,389 and $200,080 as service fees, respectively, based on the MSA.

State Fund reported $71,916 and $76,418 due from state agencies in 2023 and 2022, respectively. The deposit in the trust fund account from state agencies has a balance of $85,261 and $77,123 as of December 31, 2023 and 2022, respectively.

*(Dollars in Thousands)*

## 14. Special Surplus Funds

The following summarizes changes in the balances of special surplus funds:

| | Retroactive Reinsurance | Unfunded Pension and OPEB |
|---|---|---|
| Balance at December 31, 2021 | $ 253,792 | $ 234,502 |
| Transfer to unassigned surplus – LPT Recoveries | (38,628) | – |
| Transfer from OPEB liability *(Note 11)* | – | 82,810 |
| Transfer from Pension liability *(Note 11)* | – | 186,884 |
| Transfer to unassigned surplus *(Note 11)* | – | (139,821) |
| Balance at December 31, 2022 | 215,164 | 364,375 |
| Transfer to unassigned surplus – LPT Recoveries | **(35,572)** | – |
| Transfer from OPEB liability *(Note 11)* | – | **236,507** |
| Transfer to Pension liability *(Note 11)* | – | **(352,210)** |
| Transfer from unassigned surplus *(Note 11)* | – | **38,780** |
| Balance at December 31, 2023 | **$ 179,592** | **$ 287,452** |

## 15. Policyholders' Dividends

State Fund declared a total of $108,000 in dividends in 2023. The qualifying policyholders receive 10% of estimated annual premium and 7.5% of final billed premium for Large Account Safety Dividend (LASD) for policy year 2023. This was partially offset by $97, $3,766, and $9,178 release of 2019, 2020, and 2021 policyholders' dividends reserves, respectively, in excess of estimated payments. State Fund declared a total of $117,500 in dividends in 2022. The qualifying policyholders receive 5% of estimated annual premium and 5% of final billed premium for LASD for policy year 2022. This was partially offset by a $16,284 release of 2020 policyholders' dividends reserves in excess of estimated payments.

## 16. Subsequent Event

Management of State Fund has evaluated all events occurring after December 31, 2023 through May 29, 2024, the date the financial statements were available to be issued, and has concluded that no other subsequent event required either recognition or disclosure in the financial statements.

# Supplementary Information

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# Report of Independent Auditors on Supplementary Information

The Audit Committee of the Board of Directors
State Compensation Insurance Fund

We have audited, in accordance with auditing standards generally accepted in the United States of America, the statutory-basis financial statements of State Compensation Insurance Fund for the years ended December 31, 2023 and 2022, and have issued an adverse opinion with respect to conformity with U.S. generally accepted accounting principles and an unmodified opinion with respect to conformity with accounting practices prescribed or permitted by the California Department of Insurance thereon dated May 29, 2024. Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying reinsurance disclosures and supplemental investment disclosures are presented to comply with the National Association of Insurance Commissioners' *Annual Statement Instructions* and the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the statutory-basis financial statements as a whole.

This report is intended solely for the information and use of the Company and state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

May 29, 2024

State Compensation Insurance Fund

Investment Risks Interrogatories
*(Dollars in Thousands)*

December 31, 2023

The following is a summary of certain financial data included in other exhibits and schedules of State Fund's 2023 Statutory Annual Financial Statement as filed with state regulatory authorities.

The following information is as of December 31, 2023.

1. State Fund's total admitted assets as filed in the 2023 Annual Statement is: $20,765,101

2. State Fund's ten largest exposures to a single issuer/borrower/investment:

| Issuer | Description of Exposure | | Amount | Percentage of Total Admitted Assets |
|---|---|---|---|---|
| Morgan Stanley | Long-term bonds, common stocks, and preferred stocks | $ | 271,856 | 1.3% |
| Bank of America Corporation | Long-term bonds, common stocks, and preferred stocks | | 242,299 | 1.2 |
| The Goldman Sachs Group, Inc. | Long-term bonds and preferred stocks | | 238,870 | 1.2 |
| Citigroup Inc. | Long-term bonds and preferred stocks | | 238,685 | 1.1 |
| JPMorgan Chase & Co. | Long-term bonds, common stocks, and preferred stocks | | 232,162 | 1.1 |
| UnitedHealth Group Incorporated | Long-term bonds and common stocks | | 212,040 | 1.0 |
| Comcast Corporation | Long-term bonds and common stocks | | 179,761 | 0.9 |
| The PNC Financial Services Group, Inc. | Long-term bonds, common stocks, and preferred stocks | | 170,175 | 0.8 |
| Truist Financial Corporation | Long-term bonds and preferred stocks | | 162,032 | 0.8 |
| Walmart Inc. | Long-term bonds and common stocks | | 150,433 | 0.7 |

State Compensation Insurance Fund

Investment Risks Interrogatories (continued)
*(Dollars in Thousands)*

December 31, 2023

3. The amounts and percentages of State Fund's total admitted assets held in bonds by NAIC designation are as follows:

| Ratings | Bond Amount | Percentage of Total Admitted Assets |
|---|---|---|
| NAIC – 1 | $ 17,172,749 | 82.7% |
| NAIC – 2 | 2,082,469 | 10.0 |
| NAIC – 3 | 10,110 | – |

| Ratings | Preferred Stocks Amount | Percentage of Total Admitted Assets |
|---|---|---|
| NAIC – 1 | $ 4,892 | – |
| NAIC – 2 | 27,861 | 0.1% |
| NAIC – 3 | 5,470 | – |

4.–10. State Fund does not hold any foreign (non-Canadian) investments.

11. Assets held in Canadian investments are less than 2.5% of State Fund's total admitted assets.

12. State Fund does not have assets held in investments with contractual sales restrictions.

*(Dollars in Thousands)*

13.–14. State Fund's ten largest equity interests:

| Issuer | | Amount | Percentage of Total Admitted Assets |
|---|---|---|---|
| Microsoft Corporation | $ | 23,258 | 0.1% |
| Federal Home Loan Banks | | 21,777 | 0.1 |
| UnitedHealth Group Incorporated | | 20,054 | 0.1 |
| Visa Inc. | | 18,574 | 0.1 |
| Danaher Corporation | | 17,900 | 0.1 |
| The TJX Companies, Inc. | | 17,179 | 0.1 |
| American Express Company | | 17,127 | 0.1 |
| McDonald's Corporation | | 17,024 | 0.1 |
| Mastercard Incorporated | | 16,880 | 0.1 |
| Colgate-Palmolive Company | | 16,588 | 0.1 |

15. Assets held in a partnership is less than 2.5% of State Fund's total admitted assets.

16.–17. State Fund does not hold any investments in mortgage loans.

18. Assets held in real estate are less than 2.5% of State Fund's total admitted assets.

19. State Fund does not hold any investment in mezzanine real estate loans.

20. State Fund does not have assets subject to securities lending, repurchase, or reverse repurchase agreements.

21. State Fund does not have warrants that are not attached to other financial instruments, options, caps, and floors.

22. State Fund does not have any collars, swaps, or forwards.

23. State Fund does not have any futures contracts.

State Compensation Insurance Fund

## Summary Investment Schedule

*(Dollars in Thousands)*

December 31, 2023

| | Gross Investment Holdings | | Admitted Assets as Reported in the Annual Statement | |
|---|---|---|---|---|
| | **Amount** | **Percentage** | **Amount** | **Percentage** |
| Long-term bonds: | | | | |
| U.S. Governments | $ 490,191 | 2.4% | $ 490,191 | 2.4% |
| All other governments | 4,994 | – | 4,994 | – |
| U.S. states, territories and possessions, etc., guaranteed | 174,918 | 0.9 | 174,918 | 0.9 |
| U.S. political subdivisions of states, territories and possessions, guaranteed | 526,073 | 2.6 | 526,073 | 2.6 |
| U.S. special revenue and special assessment obligations, etc., non-guaranteed | 8,475,030 | 41.7 | 8,475,030 | 41.7 |
| Industrial and miscellaneous | 9,535,350 | 46.9 | 9,535,350 | 46.9 |
| Hybrid securities | 58,773 | 0.3 | 58,773 | 0.3 |
| Preferred stocks: | | | | |
| Industrial and miscellaneous other (unaffiliated) | 38,223 | 0.2 | 38,223 | 0.2 |
| Common stocks: | | | | |
| Industrial and miscellaneous Publicly traded (unaffiliated) | 667,258 | 3.3 | 667,258 | 3.3 |
| Real estate: | | | | |
| Properties occupied by Company | 246,878 | 1.2 | 246,878 | 1.2 |
| Properties held for production of income | 33,899 | 0.1 | 33,899 | 0.1 |
| Properties held for sale | 464 | – | 464 | – |
| Cash, cash equivalents, and short-term investments: | | | | |
| Cash | 5,794 | – | 5,794 | – |
| Cash equivalents | 6,990 | – | 6,990 | – |
| Short-term investments | – | – | – | – |
| Other invested assets: | 81,306 | 0.4 | 81,306 | 0.4 |
| Receivable for securities | 11 | – | 11 | – |
| Total cash and investments | $ 20,346,152 | 100% | $ 20,346,152 | 100% |

*See accompanying independent auditors' report.*

State Compensation Insurance Fund

Reinsurance Interrogatories
*(Dollars in Thousands)*

December 31, 2023

1. Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? Yes [ ] No [X]

2. If yes, indicate the number of reinsurance contracts containing such provisions.

3. If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? Yes [ ] No [ ]

4. Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured? Yes [X] No [ ]

5. If yes, give full information.

   During the third quarter of 2023, the reinsurer Starr Indemnity was released from liability as a result of a commutation agreement.

6. Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

   (a) A contract term longer than two years and the contract noncancelable by the reporting entity during the contract term;

(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

(c) Aggregate stop loss reinsurance coverage;

(d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

(f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [ ] No [X]

7. Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:

(a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract. Yes [ ] No [X]

8. If yes to 6 or 7, please provide the following information:

   (a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;

   (b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 6 or 7; and

   (c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

9. Except for transactions meeting the requirements of paragraph 37 of SSAP No. 62R, *Property and Casualty Reinsurance*, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

   (a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or

   (b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [ ] No [X]

10. If yes to 9, explain why the contract(s) is treated differently for GAAP and SAP.

State Compensation Insurance Fund

Note to Supplementary Information

December 31, 2023

**Basis of Presentation**

The accompanying supplementary information presents selected statutory-basis financial data as of December 31, 2023, and for the year then ended, for purposes of complying with the National Association of Insurance Commissioner's *Annual Statement Instructions* and *Accounting Practices and Procedures Manual* and agrees to, or is included in, the amounts reported in Company's 2023 Statutory Annual Statement as filed with the CDI.

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