

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

February 16-17, 2012

The Board of Directors of the State Compensation Insurance Fund met on February 16 and 17, 2012, at 333 Bush Street, San Francisco, California.

February 16, 2012

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order on February 16, 2012 at 2:20 p.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Daniel M. Curtin, Donald E. Garcia; Sen. Michael J. Machado (Ret.); Francis E. Quinlan; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; William M. Zachry; and non-voting member Christine Baker.

There was a quorum.

Also present: President and CEO Thomas E. Rowe; Chief Financial Officer Dan Sevilla; General Counsel and Corporate Secretary Carol R. Newman; Deputy Chief Counsel and Assistant Corporate Secretary Judith Sapper; and Board Liaison and Assistant Corporate Secretary Hilda Padua.

AGENDA ITEM 2: ANTITRUST ADMONITION

Mr. Mulryan called attention to and requested the Board members read State Fund's Antitrust Admonition, which is included in each Board member's meeting materials.

AGENDA ITEM 3: CONSENT CALENDAR

Mr. Mulryan asked whether any Board member had any comments on the items on the Consent Calendar of which there were none.

MOTION: Mr. Zachry

Second: Ms. Chalupa

To approve the Consent Calendar as presented.

Mr. Mulryan requested public comment of which there was none. Mr. Mulryan called for the vote.

YES: 10

NO: 0

Motion carried.

AGENDA ITEM 4: PERSONNEL MATTERS

Senior Vice President of Human Resources and Organizational Development Andreas Acker presented an update on personnel matters.

a. Workforce Update

As of December 31, 2011 there were 5497 active employees with 15 new hires, 144 promotions, and 1638 separations. The annualized separation rate through December 31, 2011 was 22.7%. There were 993 employees (15% of the available workforce) who took the separation package at the end of 2011, decreasing the layoff by half. The separations resulted in stress in the system where workloads and staff in other programs needed to be adjusted. Attrition remains very strong and additional separations due to retirements are forecast for 2012.

b. Accrued Leave Balances

There are a total of 199,024 annual leave and vacation hours over the 640 hour cap. There were 760 employees with leave balances exceeding the cap at the end of 2011, of which 462 are rank and file and 298 are Exempt, Career Executive Assignment (CEA), managers and supervisors. Since 2008, State Fund has taken steps to reduce the number of hours over the 640 cap by 62%. For employees with more than 640 hours the target for 2011 was to use all their newly accrued time and for 2012 the goal is to use all newly accrued hours plus 10% of the accrued time exceeding the cap. In addition, Ethics and Labor Relations will monitor and implement leave usage including providing the Executive Committee with a list of employees within each program who had over 640 hours accrued time in 2010-2011 year and the reasons the time was not reduced.

AGENDA ITEM 5: FINANCIAL UPDATE--4RD QUARTER 2011

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results through December 31, 2011. State Fund's financial results are significantly impacted by economic conditions, including unemployment and market pricing. State Fund continues to exercise disciplined pricing and wrote approximately 161,000 policies, which was 5% less than budget and 8% less than the prior period. Due to continued loss of larger premium accounts, the average premium per policy was approximately \$7,300 or 9% less than the budget and 6% less than prior period. Net premiums earned of \$1,002M were 9% less than budget and 12% less than the prior period.

During the third quarter State Fund completed a periodic analysis of the adequacy of the loss and loss adjustment expense (LAE) reserves. The analysis indicated that loss and LAE reserves overall remain adequate, but LAE reserves needed strengthening. Effective September 30, 2011, State Fund reallocated \$500M of reserves for prior accident years from loss reserves to LAE reserves. The reallocation had no effect on total reserves or net income, but did impact losses and LAE incurred (as well as related ratios) by offsetting amounts. The incurred losses of \$1,180M were 13% less than budget and 14% less than the prior year. State Fund's loss and LAE ratio of 118% was 6 points lower than budget and 3 points lower than prior year.

Underwriting expenses of \$401M were 4% higher than plan and 2% less than the prior year. The underwriting expense ratio of 40% was 5% higher than plan and 4% higher than the prior year due to premiums declining faster than expenses. There was an underwriting loss of \$580M, which was both 10% lower than budget and prior period. The underwriting loss included the accrual of \$50M of expenses related to the reduction in force plan. The combined ratio was 158%, which was comparable to budget but 1 point higher than the prior period.

Net investment income of \$829M was 10% more than budget and 4% less than the prior period. Investment yields were higher than planned. State Fund realized capital gains of \$28M, which

was \$28M more than budget and \$6M less than the prior period. Other expenses of \$98M consisted of charge-offs of uncollectible premiums and were \$23M more than budget and \$18M less than the prior period. As a result of the improved underwriting results, net investment income and realized gains, State Fund's income before dividends of \$179M was \$144M more than budget and \$8M more than the prior period. The Board of Directors approved \$50M in policyholders' dividends, which resulted in net income of \$130M. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 6: PRESIDENT'S REPORT

6a: STATE OF THE MARKET

Mr. Rowe provided an update on the state of the workers' compensation market. There continues to be intense competition especially in new business pricing but State Fund is well-positioned to withstand a market cycle change. Investment yields continue to deteriorate, putting stress on underwriting results. State Fund's strategic response is to maintain fair and adequate pricing and to deliver superior services. This strategy has led to State Fund's loss of business due to unsustainable pricing by competitors, but overall the decline in premium has been modest. State Fund did not increase overall pricing in its 2012 filing. The rate filings expected later in 2012 will continue to improve the ability to spread prices and more fairly price all employers. While it is impossible to predict when the market will begin to recognize the deteriorating results of the past several years and increase rates, the market is entering the later phases of the competitive cycle. Mr. Rowe noted State Fund's restructure process and transition opportunity led to the departure of nearly 1000 employees over one weekend at the end of 2011, leaving the Call Centers and Service Centers understaffed. There was a degradation of service for call responses and bill review. The staffing and service levels have been restored. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 8: REPORT BY CHAIR OF BOARD ACTIVITIES (TAKEN OUT OF ORDER)

Mr. Mulryan reported that industry experts agree that the soft market is entering its last stages. The market will harden considerably with other carriers significantly increasing rates to repair years of under pricing. This change poses a serious threat to California's fragile economic recovery. As a not for profit insurer with a mission to provide fair pricing to all California employers, State Fund will act to mitigate the impact of a hardening market. State Fund has the financial strength and disciplined pricing, and its declaration of a \$50M dividend for the 2011 policy year demonstrates progress in reshaping the organization to better serve California employers. However, for California's economic recovery to gain strength and grow, there is a need for balanced reform that is focused on those elements in the system that drive up costs without delivering benefit to injured workers. Revising the Permanent Disability Rating Schedule (PDRS) can improve permanent disability payments to injured employees, eliminate inconsistent determinations of impairment, and reduce litigation. The medical delivery system needs to be reformed to remove costs, reduce delays, and improve outcomes for injured employees. Comprehensive solutions are needed to speed both the payment of appropriate medical care and resolution of provider lien claims. These reforms if properly executed could result in a \$2B reduction in loss costs which is the economic equivalent of saving 67,000 California jobs.

AGENDA ITEM 7: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

7a: GOVERNANCE COMMITTEE

7ai: RECOMMENDATION ON BOARD TRAINING FOR MARCH 29 & 30, 2012

Mr. Mulryan reported on the recommended statutorily required Board training scheduled for March 29 & 30, 2012 at the Fairmont Sonoma Mission Inn. Different venues were evaluated including State Fund's contracted venue in San Francisco and the Fairmont was selected because it was less than the San Francisco option, within budget and will be most conducive for focused training on strategic issues directors need to consider. The National Association of Corporate Directors (NACD) is a primary presenter on corporate directorship issues, and will be joined by other presenters as well as State Fund executives to connect State Fund's strategic initiatives to the training. Mr. Mulryan requested public comment of which there was none.

7aii: BOARD COMMITTEE ASSIGNMENTS

Mr. Mulryan acknowledged the diverse background and experience of the current Board, and emphasized the strong quality of its strategic oversight. Mr. Mulryan recognized Tom Rankin's recent re-appointment for an additional term as a Board member through January 1, 2017. Mr. Mulryan thanked Mr. Rankin and all the Board members for their continued service to State Fund despite expiration of some of their terms and the existence of a vacancy. Mr. Mulryan evaluated the Board Committee appointments that were made last year based on Board member experience and interest and concluded the continuity of the committee membership supports the Board's effectiveness. The Governance Committee recommended extending the 2011 appointments.

MOTION: Mr. Curtin Second: Ms. Chalupa

To extend the 2011 appointments to the State Compensation Insurance Fund Board Committees as presented for the period February 16, 2012 through the February 2013 Board meetings unless there is a resignation by a Committee member or removal by the Board Chair or the appointing authority. In such an event the Board Chair will make a new appointment to be ratified at the next Board meeting.

Mr. Mulryan requested Board member and public comments of which there were none. Mr. Mulryan called for the vote.

YES: 10 NO: 0 Motion carried.

7aiii: GOVERNANCE AND COMPLIANCE UPDATE

Mr. Mulryan reported that the Governance Program Manager gave an update regarding the Governance Office initiatives, including the Privacy Office re-launch. State Fund's Privacy Office has developed Information Privacy and Privacy Breach Response protocols and support structure, including notification templates, to assure State Fund is informed, prepared and nimble in identifying and responding to any confidential data disclosure issues. It was also noted that continuing work on updating State Fund guidelines continues on track.

7b: AUDIT COMMITTEE

Mr. Quinlan reported on presenting a Certificate of Appreciation to Marie Wardell in recognition for her outstanding work and dedication as Assistant Corporate Secretary and Internal Audit Program Manager as she transitions into her new role as Corporate Claims Operations Manager. The Audit Committee welcomed Dante Robinson, State Fund's new Chief of Internal Affairs. Mr. Robinson was formerly Senior Vice President and Audit Director of Wells Fargo

Bank. He has significant experience and expertise which will support the formulation and implementation of the Internal Affairs Division's strategic policies, reinforce strong governance structure, and support State Fund's initiatives on privacy, transparency, accountability, and regulatory compliance.

Mr. Quinlan then reported on a completed closed audit that evaluated progress in achieving efficiencies by using the Information Technology Infrastructure Library approach to IT services. State Fund anticipates realizing costs savings over time through the use of Key Performance Indicators and tracking infrastructure. Mr. Quinlan also reported outstanding Audits and Investigations are on track and the backlog has been reduced almost completely. He noted the quality of reporting has greatly improved.

The Senior Vice President of Human Resources reported on several ongoing corporate investigations. The Chief Financial Officer reported that Model Audit Rule testing of State Fund's internal controls over statutory financial reporting and compliance is on track and State Fund's report and attestation will be issued along with the statutory financial statements in May 2012. KPMG, State Fund's external auditor presented an Actuarial update as of September 30, 2011 as part of its 2011 audit and review. The Committee heard from the Special Investigation Unit Program Manager regarding ongoing anti-fraud efforts with respect to claimant, provider and employer fraud.

7c: INVESTMENT COMMITTEE

7ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS

Sen. Machado discussed the investment transactions and compliance reports for the period of October 1, 2011 to December 31, 2011, which are now approved by the Investment Committee pursuant to its delegated authority.

Sen. Machado also reported the Committee approved the Investment Resolution as presented. The Investment Resolution has been revised to modestly expand the issuer limits and credit quality of bond purchases while maintaining a conservative, high credit quality portfolio.

MOTION: Mr. Quinlan

Second: Mr. Mulryan

To recommend that the Board approve and adopt the new Investment Policy Statement and Guidelines Resolution as presented.

Mr. Mulryan requested public comment of which there was none. Mr. Mulryan called for the vote.

YES: 10

NO: 0

Motion carried.

7ci: SELECTION OF INVESTMENT MANAGER

Sen. Machado reported in November 2011, the Board of Directors approved the hiring of Deutsche Asset Manager as an additional Investment manager for State Fund. There is now uncertainty over its sale by Deutsche Bank. The Investment Committee authorized contract negotiations with Wellington Management as an alternate. The Committee also approved renewing the contracts with Conning and New England Asset Management (NEAM) as Investment Managers for State Fund. Negotiations are ongoing and contracts will be signed on or after April 1st, 2012.

AGENDA ITEM 9: BOARD MEMBER REPORTS

Mr. Mulryan requested any Board Member reports of which there were none.

AGENDA ITEM 10: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 15-23

Mr. Mulryan requested public comment on the appropriateness of closed session for items 13-21. Carol Newman, Corporate Secretary and General Counsel explained the time limits for the public comments.

AGENDA ITEM 11: PUBLIC COMMENT

Ms. Margarita Maldonado, Vice President of Service Employees International Union (SEIU) Local 1000, commented on SEIU's dissatisfaction with State Fund over the discussions on geographic restructuring and layoffs. Ms. Maldonado distributed information about SEIU initiation of legal proceedings against State Fund.

State Fund Claims Liaison Ms. Bonnie Berger commented on the impact the layoff and staffing changes will have on State Fund's ability to detect and prosecute fraud and collect outstanding premium. Ms. Berger also commented on the use of private investigators.

State Fund Program Tech Ms. Estella Ambrose commented on the negative impact reduced staffing had on remaining employees' work load and ability to timely process and pay bills in compliance with Labor Code requirements.

State Fund Claims Adjuster Ms. Cathy Walters commented on adjuster concerns over potential layoffs and the need for constructive dialogue with employees and SEIU.

State Fund Program Tech Ms. Teresa Hubbard commented on disregard of employee rights and the unfair labor practice charges over the layoff process.

State Fund Claims Adjuster Ms. Jeanne Brigman commented on the impact reduced staffing will have on the ability to adjust cases, audit policies, retain business, and prevent fraud. There was no further public comment.

ADJOURNMENT

There being no further business, Mr. Mulryan adjourned the meeting at 3:20 p.m. to immediately reconvene in Closed Session.

February 17, 2012

The Board of Directors of State Compensation Insurance Fund continued their Open Session on February 17, 2012 at 333 Bush Street, San Francisco, California.

AGENDA ITEM 22: CALL TO ORDER AND ROLL CALL

The meeting was called to order on February 17, 2012 at 10:20 a.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Daniel M. Curtin; Donald E. Garcia; Sen. Michael J. Machado (Ret.); Francis E. Quinlan; Steven L. Rank; Scott K. Reid; Thomas Rankin; William M. Zachry and non voting member Christine Baker.

There was a quorum.

Also present: President and CEO Thomas E. Rowe; Chief Financial Officer Dan Sevilla; General Counsel and Corporate Secretary Carol R. Newman; Deputy Chief Counsel and Assistant Corporate Secretary Judith Sapper and Board Liaison and Assistant Corporate Secretary Hilda Padua.

AGENDA ITEM 24: APPROVAL OF PERFORMANCE AWARDS PROGRAM (TAKEN OUT OF ORDER)

Mr. Mulryan reported the Board supports fostering a performance based, results oriented culture at State Fund through providing an opportunity for all employees to be eligible for performance based awards. The Board will declare any performance award, which will be based on criteria to be developed by management each year. The Board will retain the discretion to fund the award pool each year. For represented employees this award pool must be bargained for and approved by union representatives. The recommendation is to have the Performance Award Program effective January 1, 2012. Mr. Mulryan requested for Board member comments of which there were none. Mr. Mulryan requested a motion and second.

MOTION: Mr. Curtin Second: Mr. Zachry

RESOLUTION REGARDING PERFORMANCE AWARDS PROGRAM

WHEREAS, pursuant to Insurance Code section 11873, the State Compensation Insurance Fund ("State Fund") is not subject to Government Code Section 19823, which authorizes the rewards programs established by the Department of Personnel Administration ("DPA") under which state employees are eligible for awards of up to \$5,000; and

WHEREAS, State Fund employees should be recognized for superior accomplishments, exceptional contributions to the efficiency, economy or other improvement in State Fund operations, and for identifying procedures or ideas which result in significantly improving State Fund operations; and

WHEREAS, the State Fund Board of Directors is vested with full power, authority and jurisdiction over State Fund and may perform all acts necessary or convenient in the exercise of any power, authority or jurisdiction over State Fund, as fully and completely as the governing body of a private insurance carrier; and

WHEREAS, private insurance carriers utilize performance-based rewards programs to recognize employees' exceptional contributions and achievements; and

WHEREAS, State Fund has adopted an aggressive strategic plan with financial targets that are projected to dramatically improve State Fund's financial performance, resulting in an operating model that will provide lower rates and superior services, thereby creating anticipated value in excess of \$1 billion annually for California's employers; and

WHEREAS, State Fund must be able to attract and retain employees with needed leadership, skills and experiences and reward those employees who attain challenging goals.

NOW, THEREFORE, BE IT RESOLVED:

That the Board of Directors hereby approves and adopts the Performance Awards Program with an effective date on January 1, 2012; and

BE IT FURTHER RESOLVED that the Performance Awards Program shall not entitle any State Fund employee to any award and that any awards provided through the Performance Awards Program shall be subject to the Board's discretion on the total size of the award pool, if any, based on enterprise performance, and shall be further subject to the decisions by the President of State Fund or his designee on eligibility and qualification for individual awards;

BE IT FURTHER RESOLVED that awards provided through the Performance Awards Program shall not be considered compensation for calculation of retirement or benefits;

BE IT FURTHER RESOLVED that the Board authorizes the President of State Fund to implement the Performance Awards Program for all State Fund employees; and

BE IT FURTHER RESOLVED that the President of State Fund is hereby granted the authority to take all action necessary including union bargaining and the establishment of any necessary policies and procedures to implement the Performance Awards Program as presented.

Mr. Mulryan asked for public comment of which there was none. Mr. Mulryan called for the vote.

YES: 10 NO: 0 Resolution carried

23: APPROVAL OF EXECUTIVE LEADERSHIP 2011 PERFORMANCE AGAINST PLAN

Mr. Mulryan reported the exempt executive positions are still relatively new at State Fund and their compensation packages contain both fixed and variable components designed to produce high performance. State Fund carefully benchmarked executive compensation and designed it to be relevant to the competitive market place without being excessive.

The Board of Directors evaluated the performance of State Fund's executives for 2011 to determine appropriate performance based compensation and reviewed both the overall performance of the business and the value of each executive's contribution. Mr. Mulryan requested for Board member comments of which there were none. Mr. Mulryan requested a motion and second.

MOTION: Mr. Curtin Second: Mr. Zachry

APPROVAL OF 2011 PERFORMANCE AWARDS AND 2012 COMPENSATION FOR EXECUTIVES

WHEREAS, the Board of Directors ("Board") of the State Compensation Insurance Fund ("State Fund") is authorized by California Insurance Code section 11785 to set the salary for State Fund's president ("President"), chief financial officer, chief operating officer, chief information technology officer, chief investment officer, chief risk officer and general counsel ("Exempt Executives"); and

WHEREAS, the annual compensation package for the Exempt Executives includes an annual base salary, retention differentials and Performance Award potential; and

WHEREAS, the Performance Award potential is based upon an annual performance evaluation conducted by the Board for each Exempt Executive; and

WHEREAS, the Board has completed its performance evaluations for each of the Exempt Executives and Non-Exempt Executive Committee Members for calendar year 2011; and

WHEREAS, the Board now seeks to approve the recommended Performance Award for each of the Exempt Executives; and

WHEREAS, the Board seeks to increase the base salary and retention differentials for certain of the Exempt Executives for 2012 as identified in the attached Exempt Executive Recommended Performance Award and Compensation Schedule; and

WHEREAS, the Board has approved a Performance Awards Program for Career Executive Assignment and Program Manager level staff as identified in the attached Non-Exempt Executive Performance Award Recommendations, and now seeks to establish the total size of the award pool for those positions for 2011 performance.

NOW, THEREFORE,

It is RESOLVED, that the Board hereby adopts and approves the Performance Awards, increases in base salaries and retention differentials as identified in the attached Exempt Executive Recommended Performance Award and Compensation Schedule; and

BE IT FURTHER RESOLVED that the Board hereby approves Performance Awards for 2011 performance for Career Executive Assignment and Program Manager level staff with awards and award levels as identified in the attached Non-Exempt Executive Performance Award Recommendations.

EXEMPT EXECUTIVE RECOMMENDED PERFORMANCE AWARD AND COMPENSATION SCHEDULE

Position	2011 Annual Base Salary	Recommended 2012 Base Salary	Recommended Annual Retention for 2012	Recommended Performance Award for 2011
Chief Executive Officer/President (Thomas Rowe)	\$450,000	no change	\$18,000 (no change)	\$135,000
Chief Information Officer (Shaun Coyne)	\$315,000	\$315,000 (no change)	\$59,850 (no change)	\$35,016
General Counsel (Carol Newman)	\$306,000	\$315,180	\$23,640 (\$15,300 in 2011)	\$45,000
Chief Financial Officer (Dan Sevilla)	\$288,000	\$296,640	\$22,248 (\$14,400 in 2011)	\$57,600
Chief Risk Officer (Ken Van Laar)	\$288,000	\$296,640	\$22,248 (\$14,400 in 2011)	\$39,600
Chief Investment Officer (Peter A. Guastamachio)	\$240,000	\$240,000	\$18,000 (\$12,000 in 2011)	\$35,438
Chief Operating Officer (Tom Clark)	\$180,000	\$180,000	\$27,000 (no change)	\$23,700

**NON-EXEMPT EXECUTIVE
2011 PERFORMANCE AWARD RECOMMENDATIONS**

Andreas Acker, SVP Human Resources	\$3,000
Beatriz Sanchez, SVP, Claims	\$5,000
Jennifer Vargen, SVP Marketing and Communications	\$3,000
Brian Watson, SVP Government Affairs	\$3,000

Mr. Mulryan asked for public comment of which there was none. Mr. Mulryan called for the vote.

YES: 10

NO: 0

Resolution carried

25: PROPOSALS AND SUGGESTIONS FOR MAY, 2012 AGENDA

Mr. Mulryan noted the upcoming Board meeting scheduled on March 29-30, 2012 to provide the required Board Continuing Education. Mr. Mulryan requested additional items for the May Board meeting. There was a suggestion to have a report on the organization and progress of the IT program. Mr. Mulryan requested public comment, of which there was none.

There being no further business, Chair Mulryan adjourned the meeting at 10:30 a.m.

The next regularly scheduled Board meeting will begin on Thursday, May 17, 2012 at 333 Bush Street in San Francisco.

Respectfully submitted,

Judith D. Sapper,
Assistant Corporate Secretary