

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

November 15-16, 2012

The Board of Directors of the State Compensation Insurance Fund met on November 15 and 16, 2012, at 333 Bush Street, San Francisco, California.

November 15, 2012

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

Mr. Mulryan requested Ms. Padua to call roll.

The meeting was called to order on November 15, 2012 at 2:00 p.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Donald E. Garcia; Sen. Michael J. Machado (Ret.); Francis E. Quinlan; Thomas E. Rankin; Scott K. Reid; and William M. Zachry.

Absent: by prior arrangement: Steve L. Rank and Daniel M. Curtin; and nonvoting 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 D. Sapper; and Board Liaison and Assistant Corporate Secretary Hilda B. Padua.

AGENDA ITEM 2: ANTITRUST ADMONITION

Mr. Mulryan called attention to and requested confirmation that the Board members read State Fund's Antitrust Admonition 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: Ms. Chalupa

Second: Mr. Zachry

To approve the Consent Calendar as presented.

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

YES: 8

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 September 30, 2012 there were 949 separations. The annualized separation rate through September 30, 2012 was 22.45%. Some employees who transferred to other agencies have returned to State Fund exercising their reinstatement rights. Attrition remains strong and additional separations due to retirements are forecast for 2012.

b. Employee Leave Balance and Usage

There are a total of 187,926 annual leave and vacation hours over the 640 hour cap. There were 758 employees with leave balances exceeding the cap at the end of September 2012 compared to 763 employees from August 30, 2012. More progress is needed to reduce the large leave balances. With PLP and work demands, reducing leave hours has been difficult but State Fund has aggressively followed-up on the reduction plan. Ethics and Labor Relations will continue to monitor and implement leave usage plans.

AGENDA ITEM 5: FINANCIAL UPDATE - 3RD QUARTER 2012

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results for the nine months ending September 30, 2012. State Fund's financial results are significantly impacted by economic conditions, including unemployment and market pricing. State Fund continues to maintain disciplined pricing and wrote approximately 102,000 policies, which was 9% less than budget and 11% less than the nine months ended September 30, 2011. The average premium per policy was approximately \$6,700 or 3% less than the budget and comparable to the same period in the prior year. Net premiums earned of \$705M were 7% more than budget and 4% less than the same period in the prior year. The loss and loss adjustment expense (LAE) ratio of 98% was on budget and 27 points lower than the same period in the prior year due to 2011 LAE reserve strengthening. The combined ratio of 137% was 1 point lower than budget and 27 points lower than the same period in the prior year, and the related underwriting loss of \$248M was 3% less than budget and 47% less than the same period in the prior year.

Net investment income of \$583M was 1% more than budget and 7% less than the same period in the prior year. Reinvestment yields were higher than planned. State Fund realized capital gains of \$31M was \$31M more than budget and \$17M higher than the same period in the prior year. Other expenses represent charge-offs of uncollectible premiums and were \$23M less than budget and \$45M less than the same period in the prior year.

Net income of \$352M was \$65M more than budget and \$239M more than the same period in the prior year. Policyholders' surplus grew by 6% to over \$6B. Mr. Mulryan requested public comment of which there was none.

Mr. Sevilla also noted that on October 4, 2012, the Board of Directors declared a \$100M or 10% dividend to qualifying policyholders for the 2012 policy year as a result of improved efficiencies, disciplined pricing and sound investment returns.

AGENDA ITEM 6: PRESIDENT'S REPORT

Mr. Rowe provided an update on the state of the workers' compensation market and State Fund's position in the market. Premiums are still down by 10% less than what was forecast. The number of new business policies is increasing while renewals are declining. As noted at the August meeting, an analysis was conducted to study the trends between broker and direct business. In the broker business the competitive market is beginning to turn while the direct business is struggling due to the state of the economy. The State Fund broker book of business is down by 1% compared to the same period last year while the direct book has declined by 20% compared to the same period last year. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 7: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

7a: GOVERNANCE COMMITTEE

7ai: GOVERNANCE AND COMPLIANCE UPDATE

Mr. Mulryan reported that the Governance Committee was provided information on the compliance model alignment and completion of Code of Conduct and Privacy and Data Security Training. Mr. Mulryan also reported that AB 53 is effective January 1, 2012 which requires insurance carriers to report starting in July 1, 2013 to the California Insurance Commissioner on their diversity contracting outreach for women, minorities and veterans.

7aii: BOARD MEMBER EDUCATION AND TRAVEL EXPENSE REIMBURSEMENT POLICY UPDATE

Mr. Mulryan reported that the Board Continuing Education Update was part of the Consent Calendar in Governance. The Committee approved as presented and now recommends for Board approval.

Mr. Mulryan called for a Motion.

MOTION: Ms. Chalupa

SECOND: Mr. Reid

To approve the Board Member Education and Travel Expense Reimbursement Policy as presented.

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

YES: 8

NO: 0

Motion carried

7aiii: APPROVAL OF 2013 BOARD AND COMMITTEE MEETING SCHEDULE AND 2013 BOARD AND COMMITTEE AGENDA ITEMS

Mr. Mulryan reported that the 2013 Board and Committee Meeting Schedule was part of the Consent Calendar in Governance. The Committee approved as presented. The Committee reviewed and recommended for Board approval the proposed 2013 Agenda items for the Governance, Audit, and Investment Committees, as well as the Board of Directors 2013 substantive agenda items. Each agenda identifies the regular Standing items, as well as the anticipated substantive agenda items for each of the four (4) quarterly meetings. The

Strategic meeting would be combined with the August meeting and the March meeting remains available if needed but will not be scheduled as a stand-alone training.

Mr. Mulryan called for a Motion.

MOTION: Ms. Chalupa

SECOND: Mr. Reid

To approve the 2013 Board and Committee Meeting Schedule and 2013 Board and Committee Agenda items as presented.

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

YES: 8

NO: 0

Motion carried

7iv. BOARD AND COMMITTEE EFFECTIVENESS

Mr. Mulryan reported that the Committee received a status update on the Board Evaluation. At the August Governance meeting, the Committee instructed staff to engage in a competitive bid process with vendors that provide Board evaluations. In October, a request to bid was sent to potential vendors that have experience in providing board evaluations.

7b: AUDIT COMMITTEE

7bi. UPDATE ON COMPLETED CLOSED AUDITS

Mr. Quinlan reported on three completed closed audits. There were no major findings in any of the three audits.

PAO 621 – 2011 MAR (Model Audit Rule)

In compliance with the NAIC Model Audit Rule for financial reporting, Internal Audit reviewed and tested key controls as identified by the MAR Compliance unit for the 2011 reporting requirements. The testing was completed and the results were reported to the MAR Compliance Team.

PAO 637 – Payroll Audit

Internal Audit evaluated controls over payroll audits for the period of January through November 2011. Improvements were noted in the audit cycle time, new audit review procedures are being developed, and training will be developed and implemented by year's end.

PAO 676 – Dividend Payment Implementation Process

Internal Audit assessed the procedures and controls which are in place to ensure that the objectives of the dividend payment process are met.

In addition, Mr. Quinlan reported that the Committee ratified the engagement of external auditor, KPMG for the 2013 audit. The engagement fee is \$890,000 for audit and actuarial services (\$755k audit and \$135k actuarial).

Mr. Quinlan also reported that State Fund continues to receive whistleblower hotline and integrity in action complaints and reports of privacy breaches. Each of these complaints/reports is investigated.

7c: INVESTMENT COMMITTEE

7ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS

Senator Machado noted that the Committee heard a report from the General Re New England Asset Management (NEAM) State Fund designated investment managers and a report on the Investment portfolio and strategy. Senator Machado presented the investment transactions and compliance reports for the period of July 1, 2012 to September 30, 2012, which were approved by the Investment Committee pursuant to its delegated authority.

7cii: APPROVAL OF INVESTMENT POLICY STATEMENT AND GUIDELINES

Senator Machado noted that the Committee reviewed the Investment Policy Statement and Guidelines and recommended to the Board of Directors that it be approved as presented, with the understanding that it will be reviewed again at the February 2013 meeting. The Review of the Investment Policy Statement and Guidelines will be added as a standing agenda item for the February 2013 Investment meeting.

Mr. Mulryan called for a Motion.

MOTION: Mr. Quinlan

SECOND: Mr. Garcia

To approve the Investment Policy Statement and Guidelines as presented.

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

YES: 8

NO: 0

Motion carried

AGENDA ITEM 8: CHAIRMAN'S REPORT

Mr. Mulryan reported that at the October Strategic meeting, the Board approved a \$100M dividend to qualifying policyholders for the 2012 policy year representing approximately 10 percent of policyholders' 2012 estimated annual premium. The Board also authorized a seven percent rate reduction that reflects the projected savings of SB 863. State Fund has amended its filing that is currently under review with the California Department of Insurance (CDI) with a target effective date in the first quarter of 2013.

Mr. Mulryan also noted that State Fund has made significant progress in its restructuring plan to reduce annual expense by \$300M over a three-year period. Mr. Mulryan thanked all the staff of State Fund for their hard work, ensuring State Fund can deliver its commitments to all Californians.

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 13-21

Mr. Mulryan requested public comment on the appropriateness of closed session for items 13-21, of which there was none.

AGENDA ITEM 11: PUBLIC COMMENT

Mr. Mulryan requested further public comment of which there was none.

ADJOURNMENT

There being no further business, Mr. Mulryan adjourned the meeting at 2:30 p.m. to immediately reconvene in Closed Session.

November 16, 2012

The Board of Directors of State Compensation Insurance Fund continued their Open Session on November 16, 2012 at 333 Bush Street, San Francisco, California.

AGENDA ITEM 22: CALL TO ORDER AND ROLL CALL

The meeting was called to order on November 16, 2012 at 10:50 a.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Donald E. Garcia; Sen. Michael J. Machado (Ret.); Scott K. Reid; Thomas E. Rankin; and William M. Zachry

Absent by prior arrangement: Daniel M. Curtin; Francis E. Quinlan; Steve L. Rank; and nonvoting 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 23: PERFORMANCE AWARDS

Mr. Mulryan reported that the Board approves an interim Performance Award of 20% of annual salary for 2012 for Beatriz Sanchez, Executive Vice President of Claims Operations, in recognition of her exceptional performance in 2012. Mr. Mulryan requested a motion and second.

MOTION: Mr. Zachry

SECOND: Mr. Reid

APPROVAL OF INTERIM 2012 PERFORMANCE AWARD FOR BEATRIZ SANCHEZ

WHEREAS, the Board of Directors ("Board") of the State Compensation Insurance Fund ("State Fund") approved and adopted the Performance Awards Program with an effective date on January 1, 2012; and

WHEREAS, the Performance Awards Program is designed to recognize State Fund employees 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;

WHEREAS, Beatriz Sanchez, the Executive Vice President of Claims Operations, has made significant contributions to State Fund, including but not limited to performance improvements in claims operations and has achieved excellence in claims processing and handling;

WHEREAS, Beatriz Sanchez's significant contributions merit an interim Performance Award for 2012.

NOW, THEREFORE,

BE IT RESOLVED that the Board hereby approves an interim Performance Award of 20% of annual salary for 2012 for Beatriz Sanchez, Executive Vice President of Claims Operations.

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

YES: 7

NO: 0

Resolution carried

AGENDA ITEM 24: APPROVAL OF EXECUTIVE LEADERSHIP 2012 PERFORMANCE AGAINST PLAN

Mr. Mulryan reported that the Board of Directors has evaluated the performance of Chief Operating Officer Tom Clark for 2012. Mr. Mulryan requested a motion and second.

MOTION: Mr. Rankin

SECOND: Mr. Garcia

APPROVAL OF 2012 PERFORMANCE AWARD FOR CHIEF OPERATING OFFICER TOM CLARK

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 evaluation for Chief Operating Officer for calendar year 2012; and

WHEREAS, the Board now seeks to approve the recommended Performance Award for Chief Operating Officer;

NOW, THEREFORE,

It is RESOLVED, that the Board hereby adopts and approves the Performance Award of 10% of annual salary for 2012 for Chief Operating Officer Tom Clark.

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

YES: 7 NO: 0 Resolution carried

AGENDA ITEM 25: PROPOSALS AND SUGGESTIONS FOR FEBRUARY 14-15, 2013
AGENDA

Mr. Mulryan requested additional items for the February 14-15, 2013 Board meeting, of which there were none. Mr. Mulryan requested public comment, of which there was none.

There being no further business, Mr. Mulryan adjourned the meeting at 10:55 a.m.

The next regularly scheduled Board meeting will begin on Thursday, February 14, 2013 at 333 Bush Street in San Francisco.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary