

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

February 14-15, 2013

The Board of Directors of the State Compensation Insurance Fund met on February 14 and 15, 2013, at 333 Bush Street, San Francisco, California.

February 14, 2013

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

Mr. Mulryan requested Ms. Padua to call roll.

The meeting was called to order on February 14, 2013 at 2:10 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; and William M. Zachry.

Absent by prior arrangement: 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, 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. Machado

Second: Mr. Curtin

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: APPOINTMENT OF CHIEF OPERATING OFFICER

Mr. Mulryan requested a motion to appoint Beatriz Sanchez as Chief Operating Officer.

MOTION: Mr. Zachry

SECOND: Mr. Reid

To ratify the appointment of Beatriz Sanchez as Chief Operating Officer effective January 1, 2013 until such time as she resigns or is removed from the position.

Yes: 10

NO: 0

Motion carried.

AGENDA ITEM 5: PERSONNEL MATTERS

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

Mr. Acker reported on the status of the new program, Workforce Solutions. The program provides resources to work on a variety of projects and fill temporary staffing needs to support State Fund's mission, vision and goals. It also presents opportunities for individuals to perform a variety of work, develop new skills, and enhance organizational exposure. Mr. Acker reported that of the 598 employees in Workforce Solutions, as of January 20, 2013, there were a total of 176 internal moves (136 transitioned to core operations and 40 resulted in promotions); 72 separated from State Fund; and only 350 employees remain in Workforce Solutions.

Mr. Acker also reported that State Fund launched State Fund Academy, which is to ensure State Fund has qualified, engaged and trained staff for the roles that will be needed in the future. The four components consist of New Employee and New Leader on boarding; State Fund Refresh; Leadership Refresh; and Learning plans for each role.

a. Workforce Update

As of December 31, 2012 there were 1,118 separations. The annualized separation rate through December 31, 2012 was 19.84%. There were 43 new hires and 286 promotions.

b. Employee Leave Balance and Usage

There are a total of 183,769 annual leave and vacation hours over the 640 hour cap. There were 808 employees with leave balances exceeding the cap at the end of December 2012 compared to 760 employees from December 2011. More progress is needed to reduce the large leave balances. It has been more difficult to reduce the leave hours this year due to State Fund being included in the State of California's Personal Leave Program Ethics and Labor Relations will continue to monitor and implement leave usage plans.

AGENDA ITEM 6: UPDATE ON BUSINESS TRANSFORMATION

President and CEO Tom Rowe provided a recap on State Fund's Business Transformation Initiative survey. Mr. Rowe noted that the goal of the initiative is to help management better understand employee concerns, and more effectively manage change. Executive and senior leadership spent considerable time reviewing and discussing results, and what to do in light of employee feedback. The four major planned initiatives are:

- Define the future in a way that makes it relevant to every level of the enterprise
- Improve State Fund's project delivery skills
- Develop a project portfolio practice that captures all major projects and provides prioritization and timelines so they can be coordinated.
- Develop an action plan to change to a performance based culture.

A regular update will be provided to the Board at each meeting. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 7: FINANCIAL UPDATE - YEAR END 2012

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results for the year ended December 31, 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 132,600 policies, which was 10% less than budget and the year ended December 31, 2011. The average premium per policy was approximately \$7,000 or 1% less than the budget and 2% more than the prior year. Net premiums earned of \$923M were 4% more than budget and 8% less than the prior year. The loss and loss adjustment expense (LAE) ratio of 97.5% was on budget and 20 points lower than the prior year due to 2011 LAE reserve strengthening. The combined ratio of 137.7% was slightly higher than budget and 21 points lower than the prior year, and the related underwriting loss of \$334M was slightly more than budget while 43% less than the prior year.

Net investment income of \$760M was about the same as budget and 8% less than the prior year. State Fund realized capital gains of \$43M more than budget and \$15M higher than the prior year. Other expenses represent charge-offs of uncollectible premiums and were \$39M less than budget and \$87M less than the prior year.

Net income of \$458M was \$77M more than budget and \$279M more than the prior year, driven by the combination of improved underwriting results, realized gains and a reduction of other expenses. The Board approved \$100M in policyholder dividends, which resulted in net income of \$359M. Policyholders' surplus grew by 6% to over \$6B. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 8: UPDATE ON SCHEDULE II OPIOIDS USE IN CALIFORNIA

Chief Operating Officer Beatriz Sanchez and General Counsel Carol Newman provided the Board an update on Schedule II Opioids use, presenting State Fund's findings, analysis and response to the overuse of Opioids in California and the negative effects on injured workers. Ms. Sanchez and Ms. Newman reported that opioid painkiller abuse is a major problem nationwide. More people die every year from an opioid overdose than die in car accidents, and the Centers for Disease Control (CDC) calls opioid abuse an epidemic. Ms. Sanchez and Ms. Newman outlined an integrated plan to focus on getting the Injured Worker back to functionality by working with State Fund's medical provider and pharmacy benefit networks. State Fund has contracted with medical practitioners in its Medical Provider Network to only prescribe Opioids for acute pain and in no event longer than 60 days without having a Utilization Review conducted. Even though Opioid abuse is epidemic, the vast majority of medical providers are not the issue. However, if there is a reasonable belief of fraud or abuse in the overprescribing of Schedule II drugs, State Fund will alert law enforcement and licensing authorities. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 9: PRESIDENT'S REPORT

Mr. Rowe provided an update on the state of the workers' compensation market and State Fund's position in the market. Mr. Rowe reported State Fund has seen a change in its book of business in 4Q 2012. In November 2012, the rate of business loss was exceeded by the rate of new business, and State Fund had modest growth since—a trend expected to continue this year.

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

AGENDA ITEM 10: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

10a: GOVERNANCE COMMITTEE

10ai: GOVERNANCE AND COMPLIANCE UPDATE

Mr. Mulryan reported that as part of the 2013 Compliance Plan, the Code of Conduct and its supporting policies were reviewed. Policy and Code revisions align with current law, reflect organizational changes during the past year, and response to employee feedback. The changes include:

2013 - Code changes

- Simplifies Ethics Decision guidance
- Places additional emphasis on reporting concerns and State Fund's commitment to no retaliation
- Adds language about expanded online anonymous reporting methods for raising Ethics and Privacy concerns or questions.

Privacy and Confidentiality

- Alignment with Fair Information Practices Principles to reflect the maturing of Privacy at State Fund.
- The principles have been adopted at the national level and guide the collection, use and safeguarding of private information.

The Governance Committee recommended that the Board adopts the Code of Conduct as presented. Mr. Mulryan requested a motion and a second.

MOTION: Mr. Curtin

SECOND: Mr. Quinaln

To adopt the Code of Conduct and its supporting policies as presented and authorize the President to take all actions necessary to finalize and implement these policies in the best interest of State Compensation Insurance Fund.

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

YES: 10

NO: 0

Motion carried

10aii: APPROVAL OF BOARD COMMITTEE ASSIGNMENTS

Mr. Mulryan noted that the Board with its diverse background and experience has been doing an excellent job in its strategic oversight of the State Fund. Mr. Mulryan recognized Mr.

Machado's recent re-appointment for an additional term through January 1, 2018 and Mr. Curtin through January 15, 2017. Mr. Mulryan thanked all the Board members for their continued service to State Fund. The Governance Committee has reviewed and approved extending the Board Committee assignments as presented and now recommends those assignments for Board approval.

Mr. Mulryan requested a motion and a second.

MOTION: Mr. Quinlan

SECOND: Mr. Curtin

To extend the 2012 appointments to the State Compensation Insurance Fund Board Committees as presented for the period February 14, 2013 through the February 2014 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 public comment of which there was none. Mr. Mulryan called for the vote.

YES: 10

NO: 0

Motion carried

10a:iii: BOARD AND COMMITTEE EFFECTIVENESS

Mr. Mulryan noted that the report is included in the Board meeting materials and requested if there were any questions of which there were none.

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

10b: AUDIT COMMITTEE

10bi. UPDATE ON COMPLETED CLOSED AUDITS

Mr. Quinlan reported that under Internal Audit oversight, Price Waterhouse Coopers, LLP (PwC) conducted a review of State Fund's documentation, processes, and controls implemented in response to the California Department of Insurance Operational Review performed in 2007, with follow-up reviews conducted in 2008 and 2010. The Operational Review generated 145 findings; 104 had been remediated and 41 were identified as not remediated. He further reported that as of February 13, 2013, 17 of the 41 findings have been remediated. There were no major findings in any of the four reported closed audits.

External auditor KPMG provided an Actuarial review to the Committee. It appears that State Fund's reserves are close to KPMG's estimate. KPMG IT Audit Specialist reported on the scope for the audit approach. The Committee also received a report on State Fund's Disaster Recovery Plans and Model Audit Rule update. Mr. Quinlan requested Mr. Sevilla to provide an update on Pension and OPEB liabilities. Mr. Sevilla reported that management has reflected State Fund's estimated share of the State's unfunded pension and OPEB liabilities on the balance sheet as of December 2012. Mr. Sevilla further noted that management reviewed the accounting approach with the California Department of Insurance, which found it consistent with Statutory Accounting Principles. State Fund's external auditor, KPMG, concurred with the review.

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

10c: INVESTMENT COMMITTEE

10ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS

Senator Machado reported that the Committee heard a report from the Wellington Management Fund designated equity managers and a report on the Investment portfolio and strategy. The investment transactions and compliance reports for the period of October 1, 2012 to December 31, 2012, were approved by the Investment Committee pursuant to its delegated authority. Further, the Committee reviewed the Investment Policy Statement and Guidelines and Membership to the Federal Home Loan Bank of San Francisco. Both resolutions will be presented to the Board for approval during the Open session on Friday, February 15, 2013.

AGENDA ITEM 11: CHAIRMAN'S REPORT

Mr. Mulryan reported that the Board spent time reviewing the results of 2012. The year 2012 will be remembered at State Fund as a year of change and sacrifice for the employees. The past two years presented new and challenging experiences. Although many of the changes were difficult, State Fund took bold steps to reduce costs and create a structure that will deliver an excellent product at a competitive price. State Fund's 2012 results reflect increased value for policyholders and claimants in: 1) \$427M in net income; 2) \$100M in policyholder dividend; 3) improved performance in claims settlements resulting in faster resolution, and improved care for injured workers. Mr. Mulryan noted that these successes belong to the employees of State Fund and thanked them for their dedication and commitment to customers. Lastly, Mr. Mulryan noted that as he looks to 2013, he is confident in State Fund's future.

AGENDA ITEM 12: BOARD MEMBER REPORTS

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

AGENDA ITEM 13: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 16-23

Mr. Mulryan requested public comment on the appropriateness of closed session for items 16-23, of which there was none.

AGENDA ITEM 14: 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 3:00 p.m. to immediately reconvene in Closed Session.

February 15, 2013

The Board of Directors of State Compensation Insurance Fund continued their Open Session on February 15, 2013 at 333 Bush Street, San Francisco, California.

AGENDA ITEM 24: CALL TO ORDER AND ROLL CALL

The meeting was called to order on February 15, 2013 at 10:35 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 M. Quinlan; Steven L. Rank; Scott K. Reid; Thomas E. Rankin; and William M. Zachry.

Absent by prior arrangement: 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 25: APPROVAL OF INVESTMENT POLICY STATEMENT AND GUIDELINES

Mr. Mulryan reported that the Investment Committee recommends to the Board approval of the Investment Policy Statement and Guidelines as presented. Mr. Mulryan requested for a motion and a second.

MOTION: Mr. Reid

SECOND: Mr. Zachry

To approve the Investment Policy Statement and Guidelines Resolution No. 1068 as attached hereto.

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

YES: 10

NO: 0

Resolution carried

AGENDA ITEM 26: APPROVAL OF FEDERAL HOME LOAN BANK MEMBERSHIP

Mr. Mulryan reported that the Investment Committee recommends to the Board approval of State Fund's membership to the Federal Home Loan Bank of San Francisco and approval of authorized persons for transactions with the Federal Home Loan Bank of San Francisco. Mr. Mulryan requested a motion and a second.

MOTION: Mr. Zachry

SECOND: Ms. Chalupa

To approve the membership in the Federal Home Loan Bank of San Francisco, Resolution No. 1069 and to approve the authorized persons for transactions with the Federal Home loan Bank of San Francisco, Resolution No. 1070, as attached hereto.

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

YES: 10

NO: 0

Resolution carried

AGENDA ITEM 27: APPROVAL OF PERFORMANCE AWARDS PROGRAM

Mr. Mulryan noted that items 27 and 28 will be approved together since there is only one resolution for both Performance Awards and 2013 Compensation for Exempt Executives.

Mr. Mulryan reported that State Fund had an outstanding 2012. State Fund was able to issue a \$100M dividend, announced a 7% rate decrease for policyholders, and made significant progress in becoming a leaner and more agile insurance company. The Board recognized that these results would not be possible without the contributions of State Fund employees and approved the first-of-its kind Performance Awards program to recognize their good work.

Mr. Mulryan further reported that the Board approved a performance award pool not to exceed \$6.8M to be distributed to the employees of State Fund who have contributed to the outstanding results in 2012, including staff, supervisors, managers, program managers and executives. Mr. Mulryan noted that in the next couple of weeks management will communicate and distribute these performance awards across the organization and provide additional information to employees. Mr. Mulryan congratulated staff on their tremendous achievement and thanked them for the hard work they have done for State Fund and the people of California.

MOTION: Mr. Zachry

SECOND: Ms. Chalupa

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

YES: 10

NO: 0

Resolution carried

AGENDA ITEM 28: APPROVAL OF PRESIDENT AND EXECUTIVE LEADERSHIP 2012 PERFORMANCE AGAINST PLAN AND 2013 COMPENSATION FOR PRESIDENT AND EXEMPT EXECUTIVES

Mr. Mulryan reported that the Board of Directors has evaluated the performance of each executive for 2012. Mr. Mulryan noted that the compensation packages for exempt members of State Fund's executive committee contain both fixed and variable components designed to produce high performance. Ms. Newman to read proposed Resolution No. 1071.

Mr. Mulryan requested a motion and second.

MOTION: Mr. Rankin

SECOND: Mr. Garcia

APPROVAL OF 2012 PERFORMANCE AWARDS AND 2013 COMPENSATION FOR EXECUTIVES

WHEREAS, the Board has approved a Performance Awards program for State Fund staff, managers, supervisors, CEAs and Program Managers, with the total size of award pool subject to the Board's discretion, based on enterprise performance; and

WHEREAS, the Board has considered State Fund's enterprise performance for 2012, and now seeks to establish and approve the total size of the 2012 performance award pool for State Fund staff, managers, supervisors, CEAs and Program Managers.; and

WHEREAS, the annual compensation package for State Fund's president ("President"), chief financial officer, chief operating officer, chief information officer, chief investment officer, chief risk officer and general counsel ("Exempt Executives") includes an annual base salary, retention differentials and performance award potential based upon an annual performance evaluation conducted by the Board of Directors ("Board"); and

WHEREAS, the Board has completed its performance evaluations for each of the Exempt Executives and Non-Exempt Executive Committee Members for calendar year 2012; and the Board seeks to increase the base salary and retention differentials and approve 2012 performance awards for certain of the Exempt Executives for 2013 as identified in the attached Executive Committee Recommended Performance Award and Compensation Schedule.

NOW, THEREFORE,

IT IS RESOLVED that the Board hereby finds that State Fund's enterprise performance for 2012 exceeded expectations; and hereby approves a 2012 performance award pool not to exceed \$6.8 million for State Fund staff, managers, supervisors, and CEAs, Program Managers and Executives; and

BE IT FURTHER RESOLVED that the Board hereby adopts and approves the increases in base salaries and retention differentials and 2012 performance awards as identified in the attached Executive Committee Recommended Performance Award and Compensation Schedule.

**EXECUTIVE COMMITTEE RECOMMENDED PERFORMANCE AWARD AND
COMPENSATION SCHEDULE**

Position	2012 Annual Base Salary	Recommended 2013 Base Salary	Recommended Annual Retention for 2013	Recommended Performance Award for 2012
Chief Executive Officer/President (Thomas Rowe)	\$450,000	No change	\$18,000 (no change)	\$135,000
General Counsel (Carol Newman)	\$315,180	\$315,180	\$33,804 (\$23,640 in 2012)	\$63,000
Chief Information Officer (Marj Hutchings)	\$315,000	\$315,000	\$59,850 (no change)	\$15,600
Chief Financial Officer (Dan Sevilla)	\$296,640	\$305,540	\$32,472 (\$22,248 in 2012)	\$59,300
Chief Risk Officer (Ken Van Laar)	\$296,640	\$296,640	\$28,632 (\$22,248 in 2012)	\$29,700
Chief Investment Officer (Peter A. Guastamachio)	\$240,000	\$250,000	\$18,000 (no change)	\$48,000
*Chief Operating Officer (Beatriz Sanchez)	\$126,240	\$156,000	\$39,000	Paid in November
SVP Human Resources (Andreas Acker)	\$125,076	Pay adjustments based on State controls and guidelines	Not applicable	\$12,500
EVP Field Operations (Darlyn Regan)	\$120,264	Pay adjustments based on State controls and guidelines	Not applicable	\$12,000

SVP Marketing and Communications (Jennifer Vargen)	\$113,447	Pay adjustments based on State controls and guidelines	Not applicable	\$11,400
SVP Government Affairs (Brian Watson)	\$110,532	Pay adjustments based on State controls and guidelines	Not applicable	\$11,100

**Note: Beatriz Sanchez' award has already been paid as interim, no further award is recommended. Salary and Annual Retention action in support of her appointment to COO are presented above.*

***2013 Annual Base Salary and Annual Retention is effective January 1, 2013.*

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

YES: 10 NO: 0 Resolution carried

AGENDA ITEM 29: APPROVAL OF PRESIDENT'S EMPLOYMENT AGREEMENT

Mr. Mulryan reported that the Board approved an extension of the President's Employment Agreement. Ms. Newman read proposed Resolution No. 1072. Mr. Mulryan requested a motion and a second.

MOTION: Mr. Zachry

SECOND: Mr. Garcia

RESOLUTION REGARDING EXTENSION OF PRESIDENT'S EMPLOYMENT AGREEMENT

WHEREAS, the Board of Directors ("Board") of the State Compensation Insurance Fund ("State Fund") 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, the Board of State Fund is vested with the authority to appoint the President and set the salary for that position; and

WHEREAS, the Board previously appointed Thomas Rowe to a three-year term as President and Chief Executive Officer and entered into an employment agreement with Mr. Rowe with an effective date of August 2, 2010; and

WHEREAS, in recognition of Mr. Rowe's highly effective leadership, the Board now wishes to extend that employment agreement for an additional five years.

NOW, THEREFORE, BE IT RESOLVED:

That the Board of Directors hereby authorizes the Board Chair to enter into a new employment agreement with Mr. Rowe; and

BE IT FURTHER RESOLVED that the President's new employment agreement shall provide for the same compensation amounts and terms as the President's current employment

agreement, a five-year term with an effective date of August 2, 2013, and 23 hours per month of leave credit.

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

YES: 10 NO: 0 Resolution carried

AGENDA ITEM 30: PROPOSALS AND SUGGESTIONS FOR MAY 16-17, 2013 AGENDA

Mr. Mulryan requested additional items for the May 16-17, 2013 Board meeting, of which there were none. Mr. Mulryan requested public comment, of which there was none.

Ms. Newman reported that the March 2013 dates reserved for Board Continuing Education would be removed from the schedule and the members would engage in individual continuing education. There being no further business, Mr. Mulryan adjourned the meeting at 10:45 a.m.

The next regularly scheduled Board meeting will begin on Thursday, May 16, 2013 at 333 Bush Street in San Francisco unless noticed for a new date and time.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary