

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

May 17-18, 2012

The Board of Directors of the State Compensation Insurance Fund met on May 17 and 18, 2012, at 333 Bush Street, San Francisco, California.

May 17, 2012

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

Ms. Sheryl Chalupa noted that Chair Lawrence Mulryan sends his regrets that he will not be able to attend the meeting and as is provided in State Fund's by-laws, as the longest term Board member, Ms. Chalupa will be the Chair for the meeting. Ms. Chalupa then requested Ms. Padua to call roll.

The meeting was called to order on May 17, 2012 at 2:00 p.m. and the following were present: Sheryl A. Chalupa, Acting Chair; Daniel M. Curtin (joining at item 4), 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 (joining at item 3).

Absent: Lawrence E. Mulryan, Chair by prior arrangement.

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

Ms. Chalupa 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

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

MOTION: Mr. Zachry

Second: Mr. Garcia

To approve the Consent Calendar as presented.

Ms. Chalupa requested public comment of which there was none. Ms. Chalupa called for the vote.

YES: 7

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 March 31, 2012 there were 5291 active employees with 12 promotions, and 367 separations. The annualized separation rate through March 31, 2012 was 26%. Through April 27, 2012 there were 449 separations of which 337 transferred to other agencies and 112 were due to resignations and retirements. State Fund achieved sufficient reduction in staff to cancel the layoff. Attrition remains very strong and additional separations due to retirements are forecast for 2012.

b. Accrued Leave Balances

There are a total of 200,505 annual leave and vacation hours over the 640 hour cap. There were 789 employees with leave balances exceeding the cap at the end of March 2012 compared to 760 employees at year end 2011. The slight increase in hours and number of employees was not unexpected. Few employees take vacation during the first quarter of the year, which is consistent with past years' trend. The number of hours is expected to drop substantially during the summer. Ethics and Labor Relations will continue to monitor and implement leave usage.

AGENDA ITEM 5: FINANCIAL UPDATE - 1st QUARTER 2012

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results from January 1, 2012 through March 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 38,900 policies, which was 4% less than budget and 10% less than the prior period. Due to continued loss of larger premium accounts, the average premium per policy was approximately \$7,200 or 3% less than the budget and 4% less than prior period. Net premiums earned of \$235M were 6% more than budget and 1% more than the prior period. The incurred loss ratio of 75% was on budget and consistent with the prior period. The loss adjustment expense (LAE) ratio of 23% was on budget and 30 points lower than the prior period due to 2011 LAE reserve strengthening. The underwriting expense ratio was 3 points lower than budget and 1 point higher than the prior period. The combined ratio of 139% was 3 points lower than budget and 29 points lower than the prior period, and the related underwriting loss of \$87M was 7% less than budget and 46% less than the prior period.

Net investment income of \$201M was 1% more than budget and 4% less than the prior period. Investment yields were higher than planned. State Fund realized capital gains of \$9M, which was \$9M more than budget and \$6M higher than the prior period. Other expenses represent charge-offs of uncollectible premiums and were \$12M less than budget and \$2M less than the prior period.

Net income of \$122M was \$29M more than budget and \$74M more than the prior period. Policyholder's surplus grew by 2% to over \$5.7B. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 6: STATEMENT OF ACTUARIAL OPINION

Chief Risk Officer Ken Van Laar introduced Principal and Consulting Actuary Mr. Guy Avagliano of Milliman to present the annual Statement of Actuarial Opinion. Mr. Avagliano reported State Fund's gross carried reserves were \$14.5B and \$14.3B net. A Loss Portfolio Transfer reduced \$500,000 from the reserves leaving an overall net reserve of \$13.8B. Milliman's reserve estimate was slightly below that amount. Milliman provided a clean opinion, noting the reserves set were consistent with California State standards; consistent with Actuarial standards; and were reasonable. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 7: PRESIDENT'S REPORT

Mr. Rowe provided an update on the state of the workers' compensation market. There continues to be intense competition but State Fund is well-positioned to withstand a market cycle change. 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. 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. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 8: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

8a: GOVERNANCE COMMITTEE

8ai: GOVERNANCE AND COMPLIANCE UPDATE

Ms. Chalupa reported that as part of the 2012 Compliance Plan, the Code of Conduct and its supporting policies were reviewed. Compliance Week was celebrated the week of May 8th to increase compliance awareness. Policy and Code revisions align with current law, reflect organizational change during the past year, and took into account employee feedback. The changes include re-emphasizing compliance accountability for all members of the workforce, the availability of anonymous reporting, and no tolerance for retaliation. The additions to the Code of Conduct include an Ethics Decision Tree; Protecting and Respecting Information section and an expanded Conflicts of Interest section. All eight key policies were reviewed and the following policy revisions are recommended:

- Sexual Harassment – Section 6: updated definition of sexual harassment to align with current law.
- Equal Employment Opportunity – Updated definition of protected group to align with current law in sections 2.1 & 6.
- Privacy and Confidentiality – Added sections 2.2.1 Private Information Collection & Use; and 2.2.6 Safeguards; Revised section 2.3.2 by adding “stored or transmitted on or through State Fund's Information System”.

- Complaint Reporting & Anti-Retaliation – Added definitions for retaliation and use of official authority; re-organized policy statements to present a logical complaint reporting progression.
- Business Ethics – Clarified section 2.2: avoiding the appearance of impropriety.

The Governance Committee recommends that the Board adopts the Code of Conduct and its supporting policies as presented.

MOTION: Mr. Rankin Second: Sen. Machado

To approve the Code of Conduct and supporting policies as amended, with all references to “Corporate” changed to “Enterprise”, and to authorize the President to take all actions necessary to finalize and implement these policies in the best interest of State Compensation Insurance Fund.

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

YES: 9 NO: 0 Motion carried.

8aii: REVIEW OF COMMITTEE SIZE

Ms. Chalupa reported that the Audit Committee reviewed the current committee composition in alignment with best practices and discussed the opportunities and risks associated with increasing the Audit Committee composition as well as limitations imposed by Bagley-Keene. It is the recommendation of the Governance Committee to defer the discussion.

8aiii: REVIEW OF BOARD AND COMMITTEE AGENDAS

Ms. Chalupa reported that it is the recommendation of the Governance Committee for the Board and Committee agendas to be reviewed in conjunction with the charters and action to be deferred to the August meeting.

8b: AUDIT COMMITTEE

Mr. Quinlan reported on two completed closed audits. Internal Audit performed an audit of the Adjusting Journal Entries process. The audit’s objective was to assess if adjusting journal entries were necessary and accurate, supported by sufficient documentation and had appropriate approvals. Sixty adjusting journal entries were reviewed. Financial Operations have developed and adopted workflow procedures to strengthen the documentation for the initiation, review and posting of all adjusting journal entries. The second audit was the review of the Ultimate Claims System. The purpose of the review was to assess what was being done to replace the current claims management system and to provide a status report, including project timeline. Two reported benefits that the new claims management system is expected to deliver are a 50% reduction in IT related support and maintenance costs and providing our claims adjusting staff with ONE claims management system to handle all of their adjusting needs.

Mr. Quinlan also reported that Mr. Dante Robinson, Chief of Internal Affairs, provided an update on the 2012 Audit Plan and Outstanding Audits with a new reporting format. The Audit Committee also received an update on State Fund’s research, investigatory discussions and continuing evaluation of its potential liability for pension and other post employment benefits.

The KMPG auditors presented an update regarding the in-process audit and reported no change to its timetable or areas of focus.

8c: INVESTMENT COMMITTEE

7ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS

Sen. Machado discussed the investment transactions and compliance reports for the period of January 1, 2012 to March 31, 2012, which are now approved by the Investment Committee pursuant to its delegated authority.

7ci: APPROVAL OF INVESTMENT POLICY STATEMENT AND GUIDELINES RESOLUTION

Sen. Machado reported the Committee approved the Investment Resolution as presented. The Investment Resolution has been revised to include item 11 under Section E, Credit Rating Standards and Limitations, which reads, "The Investment manager shall not purchase any Build America Bonds issued directly by the State of California."

MOTION: Mr. Reid

Second: Mr. Quinlan

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

Ms. Chalupa requested public comment of which there was none. Ms. Chalupa called for the vote.

YES: 9

NO: 0

Motion carried.

AGENDA ITEM 9: REPORT BY CHAIR OF BOARD ACTIVITIES

Ms. Chalupa noted that Mr. Mulryan sends his regrets that he couldn't be here today. On his behalf, she is presenting the Chair's report.

Ms. Chalupa read the report which focuses on State Fund's progress in restructuring its operations to better serve California as an efficient and fairly priced worker's compensation carrier. It also emphasized the work underway to champion broader reform within the workers' compensation system.

State Fund's Restructure

In the fall of 2011 State Fund announced that it would implement a layoff of 1500 to 1800 employees to reduce significant overstaffing in certain classifications. At the time of the announcement State Fund also said they were committed to providing assistance to affected employees. Through the combined efforts of the Department of Personnel Administration, HR team and SEIU, State Fund was able to offer affected employees tangible support during this layoff period. By April 2012, the combined impact of transition payments (a first in civil service), access to SROA and Surplus status, job fairs, job search and resume writing classes resulted in more than 1600 employees transitioning out of State Fund eliminating the need to layoff a single employee. Of the approximately 1600 employees who left State Fund, 997 accepted the transition package, 365 have found work

with other state agencies; 140 chose to retire; and more than 100 have resigned to work in the private sector.

Ms. Chalupa noted that the Board recognizes that downsizing and geographic relocation is very difficult for employees no matter how much support and assistance they receive and the Board has heard directly from employees of the personal toll the restructure plans have taken on staff. However painful, these have been necessary steps to prepare State Fund to carry out its mission more effectively. State Fund is already seeing the positive results in first quarter's results. As State Fund moves forward, it focuses on improving State Fund's infrastructure, business process and technology to support a highly efficient and customer focused company.

Workers' Compensation Reform

There is a storm gathering in California workers' compensation market. State Fund has limited ability to mitigate a dramatic shift in the market. State Fund believes reforming the system in a way that "rebalances" it is far better option to just passing increasing costs to employers. For California's economic recovery to gain strength and grow, it needs balanced reform that is focused on those elements in the system that drive up costs without delivering benefit to injured workers. Christine Baker and her staff at the DWC have been engaged in a state-wide listening tour hearing first-hand from stakeholders about the problems in the current system and proposed solutions. State Fund testified at this hearing about the crisis of inefficiency and runaway waste that create obstacles to substantial justice for injured workers and employers. State Fund's testimony highlighted the three critical areas that need reform: Permanent Disability, Medical Management, and Liens. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 10: BOARD MEMBER REPORTS

Ms. Chalupa reported on her April 24th visit to the Fresno office. She thanked the SEIU staff who coordinated the visit and staff in the Fresno office for their hospitality. Ms. Chalupa reported that there are 460 employees located in two facilities. Ms. Chalupa toured the facility owned by State Fund, which houses the Legal and Claims staff. At the end of 2012, the two facilities will be consolidated. Some of the themes expressed by staff are requests for training to improve skill sets; provide industry benchmarks for workloads; and overcome challenges in IT tools. Ms. Chalupa noted the employees she met had all worked for State Fund for lengthy periods and were grieving the loss of their co-workers.

Mr. Quinlan presented a clarification by the Government Accounting Standards Board (GASB) that funding for Other Post-Employment Benefits (OPEB) is not required to be set aside but must be reported in financial statements. He also reported that he attended a Cyber Security conference that provided good insight to issues facing all organizations. He noted that as State Fund improves its IT structure, platform and moves some applications to cloud hosting, it requires a diligent review of associated risks with mitigation controls implemented to address those risks.

Mr. Rankin reported on his tour of the Rohnert Park office, which houses State Contracts. He noted there are many dedicated employees at State Fund and they have a general understanding of the need for the layoff and downsizing. There is an opportunity for State Fund to explore lessons learned from the downsizing with consideration of unintended consequences, such as incurring penalties in the 1Q of 2012 for late bill payments. Mr. Rankin recommended improving Labor Relations between State Fund, SEIU and employees.

Mr. Zachry reported on his March 29th visit to the Pleasanton office. Mr. Zachry noted that he had the same experience as Ms. Chalupa in observing the dedication and courtesy of the employees and their grief over the loss of their co-workers. Mr. Zachry also reported that as former head of the Fraud Assessment Commission he testified on behalf of State Fund against disclosure of Special Investigation Unit information in a physician fraud case. There is not a decision on the matter yet.

AGENDA ITEM 11: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 14-22

Ms. Chalupa requested public comment on the appropriateness of closed session for items 14-22, of which there was none.

AGENDA ITEM 12: PUBLIC COMMENT

Ms. Chalupa requested further public comment of which there was none.

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:50 p.m. to immediately reconvene in Closed Session.

May 18, 2012

The Board of Directors of State Compensation Insurance Fund continued their Open Session on May 18, 2012 at 333 Bush Street, San Francisco, California.

AGENDA ITEM 23: CALL TO ORDER AND ROLL CALL

The meeting was called to order on May 18, 2012 at 10:35 a.m. and the following were present: Sheryl A. Chalupa, Acting Chair; 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.

Absent: Lawrence E. Mulryan, Chair and Daniel M. Curtin by prior arrangement.

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: PROPOSALS AND SUGGESTIONS FOR AUGUST 16-17, 2012 AGENDA

Ms. Chalupa requested additional items for the August Board meeting. Ms. Newman reported that Board members had requested a more thorough report on IT operations and to move the strategic updates on Claims and IT to the Thursday Closed Board agenda; and to hear a report of pending and potential litigation in the Closed Audit Committee. Ms. Chalupa requested public comment, of which there was none.

There being no further business, Acting Chair Ms. Chalupa adjourned the meeting at 10:40 a.m.

The next regularly scheduled Board meeting will begin on Thursday, August 16, 2012 at 333 Bush Street in San Francisco.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary