

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

May 18-19, 2017

The Board of Directors of the State Compensation Insurance Fund met on May 18-19, 2017 at the State Fund San Francisco Office, 333 Bush Street, 7th floor (Board Room), San Francisco, California.

May 18, 2017

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:00 p.m.

Ms. Chalupa requested Ms. Padua to call roll. The following were present: Sheryl A. Chalupa (Chair); Daniel M. Curtin; Marvin P. Kropke; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Jack L. Neureuter; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; and William M. Zachry.

Absent by prior arrangement: Robin L. Baker and Christine Baker (non-voting member).

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter A. Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

AGENDA ITEM 2: ANTITRUST ADMONITION

Ms. Chalupa 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

- 3a. Approval of March 2 and 3, 2017 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Annual Review and Approval of State Fund By-Laws**
- 3d. Annual Review and Approval of Board Delegated Authority and Approval Levels**
- 3e. Board Education and Travel Expense Reimbursement Policy**
- 3f. Annual Review and Approval of Committee Charters**
- 3g. Authorization to Secure Renewal of the September 2017 Expiring Policies**
- 3h. Approval of Retirement Resolutions**

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

MOTION: Mr. Kropke

SECOND: Mr. Mulryan

To approve the Consent Calendar as presented.

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

YES: 10

NO: 0

Abstain: 0

Motion carried.

AGENDA ITEM 4: STAFFING UPDATE

Executive Vice President and Chief Administrative Officer Andreas Acker presented an update on staffing. Mr. Acker reported that State Fund ended first quarter of 2017 with 4,304 employees, 56 separations, 53 new hires, and 92 promotions. Of the 56 separations, 18 were retirements, 15 were resignations, 11 were transfers to other agencies, and 12 were others (death or dismissal). The overall separation rate was 5.7% with the primary driver being retirements, which is on track for the predicted 7% separation by the end of the year.

Mr. Acker reported as of March 30, 2017 there was a 4.8% overall increase in the number of hours over the 640 hour cap. In the first quarter, employees don't normally take leave. In the second quarter, a Leave Buy-Back Program was offered to all employees, which allows cash out of up to 80 hours of unused leave. The Leave Buy-Back Program ends on May 31, 2017 and payment will be issued in the June 2017 pay period. It is expected that the overall number of hours should decrease by the end of the year.

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

AGENDA ITEM 5: FINANCIAL UPDATE – 1st Quarter 2017

Chief Financial Officer Peter Guastamachio reported on the 1Q 2017 financial results.

State Fund continues to see a decline in new business and in renewals. The net premium earned of \$354 million was 3.7% less than the prior year. The loss and loss adjustment expense (LAE) ratio of 100.6% was 6 points lower than last year. The combined ratio of 132.6% was 4 points higher than the same period last year due to the net effect of the increase in underwriting expense ratio and decrease in LAE ratio. The underwriting expense ratio of 32% was 10 points higher than the same period last year due to a change in an IT component. The net investment income of \$159 million was \$3 million lower than in 2015 and realized capital gains of \$93 million was \$71 million higher than the same period in 2016. The net income of \$127 million was \$60 million higher in the same period in the prior year as a result of the liquidation of holdings from termination of an equity portfolio manager. There was an increase in policyholders' surplus of \$57 million since December 31, 2016.

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

AGENDA ITEM 6: STATEMENT OF ACTUARIAL OPINION

Mr. Guy Avagliano, FCAS, MAAA of Milliman, State Fund's Appointed Actuary, reviewed the Loss and Loss Adjustment Expense reserves as of December 31, 2016. He reported State Fund's booked loss reserves for Statutory Claim and Claim Adjustment Expense Reserves were: unpaid losses at \$11.1B, unpaid loss adjustment expense at \$1.78B, unpaid losses – direct and assumed at \$11.2B, and unpaid loss adjustment expense – direct and assumed at \$1.78B. Milliman provided a clean Actuarial opinion, noting the reserves set were consistent with California State standards;

consistent with Actuarial standards; and reasonable provisions were made for unpaid loss and loss adjustment expense obligations.

AGENDA ITEM 7: PRESIDENT'S REPORT

President and CEO Vern Steiner provided an update on the following:

Market Condition

The market continues to be soft with several carriers in the marketplace competing aggressively for market share. At the November 2017 broker roundtable meetings, brokers informed State Fund that typically in the industry, business is marketed every three years or more. However, under this market climate, competition requires that brokers shop accounts annually. Aggressive business practices including requesting "last look" at pricing continue to be employed by most carriers.

Rates

While State Fund filed a 9.50% reduction to its pure premium rate on September 1, 2017, carriers have chosen to follow with single and double digit reductions to their January 1, 2017 rates (5% - 20.50%). Brokers shared that carriers are applying significant schedule credits to obtain new business. In addition, where State Fund has routinely served as the primary carrier to provide a market for companies who have had a lapse of coverage, State Fund is seeing other carriers expand that appetite to take on this segment of the market. In addition, some carriers are becoming more open to write contractors despite the size of the business and employers' experience in the industry.

New Business and Retention

Through April 2017 new business submissions match 2016 levels. However, bind rates have dropped due to aggressive pricing and expanded appetite. This trend is most noticeable in middle-market accounts (\$25k - \$250k). Although State Fund wants to serve California employers directly, it is critical that State Fund maintain appropriate pricing discipline. The California market has a long track record of overheating and carriers underpricing to gain market share. State Fund can best use this time to continue its work to strengthen its operations and make it easy to do business with State Fund.

EASE OF DOING BUSINESS

Payroll Reporting

State Fund has made it easier for more policyholders to pay their insurance via payroll reporting by lowering deposit and premium requirements on May 1, 2017. This has been well-received by brokers and supports ease of doing business. While it is too early to measure if the changes will have a significant impact to business growth, the changes are designed to bring State Fund back in line with the rest of the marketplace and eliminate a competitive disadvantage.

Everyone Drives Great Experiences (EDGE)

In early April 2017, State Fund rolled out customer service workshops for all employees. The workshops are called EDGE, which stands for Everyone Drives Great Experiences, and are designed to help employees change how they work in order to create a more customer-centric culture. The EDGE concepts work for all employees, whether customers are external or internal.

The workshops began in Eureka and the trainers conducted sessions every week, making their way to the south, and will wrap up at the end of May 2017.

EDGE was created to help support our ongoing efforts to improve the culture at State Fund and make State Fund a customer-focused organization. State Fund plays a unique role in the marketplace and employees have shared that sometimes it isn't always obvious what the right answer is in every situation. The goal is to provide excellent customer service while maintaining fair pricing for California employers and EDGE gives employees some tools to use in their everyday work to improve customers' experience.

In addition, EDGE was designed with a robust sustainability plan. Following the workshop, there are 18 weeks of follow-up activities, a combination of short, team huddles and custom-crafted videos to reinforce the concepts introduced in the workshop. These activities will allow employees to continue to practice the topics learned in EDGE. Overall employees seemed to have embraced the workshop. More than $\frac{3}{4}$ of the employees responding to a survey rated it above average or outstanding and said the techniques would be useful in performing their job.

AGENDA ITEM 8: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

8a: GOVERNANCE COMMITTEE

8ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported on the following activities:

2017 Code of Conduct and Material Revisions to Policies Supporting the Code of Conduct

The Code of Conduct's look and feel has been re-designed, aligning its topics with State Fund's values to reflect continuing commitment to purpose and culture. The Code of Conduct promotes State Fund's values, standards, and behavior expectations to support a culture encouraging ethical conduct and a commitment to compliance with the law. Ms. Simmons, Governance, Compliance and Privacy Program Manager, reported the Code of Conduct training schedule has been published for employees to complete.

Corporate policies supporting the Code of Conduct (HR 4.1 Equal Employment Opportunity; HR 4.2 – Reasonable Accommodation; and HR 4.3 – Sexual Harassment Prevention) were revised to clarify across the policies: involved parties, workplace settings, and criteria for policy violation; managerial and employee reporting venues and responsibilities; State Fund's responsibility to conduct fair and objective investigations; and maintenance of confidentiality to the extent possible.

Mr. Mulryan called for a Motion.

MOTION: Mr. Zachry

SECOND: Mr. Kropke

To approve the proposed changes to the Code of Conduct and Corporate Policies supporting the Code of Conduct as presented.

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

YES: 10

NO: 0

Abstain: 0

Motion carried.

Statement of Economic Interest Annual Filing (Form 700)

State Fund achieved 100% compliance by active employees and 99% for consultants who are designated filers. Physical and logical access for the three consultants who failed to file was disabled and they have separated from State Fund.

2017 Compliance Training

For 2017, compliance training includes regulatory-based training on Anti-Fraud, Security and Privacy Awareness, Code of Conduct training, and Workplace Harassment Prevention training.

National Data Privacy Day

This is State Fund's fifth year of participation in National Privacy Day. This year, the theme is "*Stop.Think.Connect.*", which raises awareness about what each workforce member can do before sharing information to assure it goes to the right person, in the right place, and is limited to what is needed for business.

Ethics Hotline Benchmark

The reporting rate per 100 employees exceeded the benchmark. The increase in management referrals can be attributed to HR's increased availability, training, and client outreach. There are no significant deviations in reporting categories and the top reporting category continues to be Human Resources. State Fund's rate of anonymous reporting is lower than the benchmark (52% v. 58%).

8b: AUDIT COMMITTEE

8bi: UPDATE ON COMPLETED CLOSED AUDITS

Mr. Reid reported on the following activities:

Completed Closed Audits

There were 18 projects reported in the March 2017 closed session and only one was non-proprietary. In the 2016 Counterfeit Check Investigations, 99 potential counterfeit checks were investigated. Two State Fund providers were victims of a check endorsement scheme during which perpetrators cashed 41 State Fund checks issued to the providers. The perpetrators were provider employees during the fraudulent schemes.

Lastly, the Audit Committee heard reports from staff on Data Analytics, Personnel Investigations, and Model Audit Rule; and a report from the External Auditor during Closed Session.

8c: INVESTMENT COMMITTEE

8ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

Investment Chair Senator Machado (Ret.) reported on the following:

The investment transactions and compliance reports for the periods of January 1, 2017 to March 31, 2017 were approved by the Investment Committee pursuant to its delegated

authority. Sen. Machado also reported the Investment Committee heard a report from New England Asset Management on the market and economic outlook and State Fund's portfolio performance results.

8d: AD HOC SAFETY AND LOSS PREVENTION COMMITTEE

Mr. Kropke reported the Committee is evaluating different safety approaches to consider and is on target to make recommendations to the full Board in 2018.

AGENDA ITEM 9: CHAIRWOMAN'S REPORT

Ms. Chalupa reported that some of the Board Members attended the California Workers' Compensation Institute (CWCI) Annual meeting held in Oakland on March 23, 2017. Current research findings regarding effective medical care in workers' compensation were discussed as well as other current issues. Mr. Zachry noted that the theme was "Rethinking Disability Management: Lessons Learned from Research and the Field". He noted there was a good presentation regarding return-to-work. One assumption is that if an injured worker is off of work for 6 months or more that the individual will not return to work. The time frame is only 4-5 weeks to get the injured worker back to work before there is a serious chance that individual won't return to work.

Ms. Chalupa reported that State Fund leadership held the first Business Review Meetings (BRM's) of 2017 in April. Ms. Chalupa acknowledged Mr. Neureuter's attendance at the BRM's. The BRM's provide a great opportunity to better understand State Fund's operations and to hear directly from the people who are leading various functions and initiatives. Lastly, Ms. Chalupa noted that Memorial Day marks the unofficial beginning of summer and wished everyone a happy and safe summer.

AGENDA ITEM 10: BOARD MEMBER REPORTS

Ms. Chalupa requested any Board member reports. Mr. Zachry reported on a Prescription Opioid and Heroin Abuse Summit he attended. Addiction and drug abuse are in the top five cost drivers for workers' compensation. The Summit addressed preventing injured workers from becoming addicted and remediating the current abuse situation. He noted State Fund's attention to this issue is very well-received. Ms. Chalupa asked Mr. Steiner to convey the Board's appreciation to staff.

AGENDA ITEM 11: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 14 through 25

Ms. Chalupa requested public comment on the appropriateness of Closed Session for agenda items 14 through 25, of which there was none.

AGENDA ITEM 12: PUBLIC COMMENT

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

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:45 p.m. to immediately reconvene in Closed Session.

May 19, 2017

AGENDA ITEM 26: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 10:00 a.m. at the State Fund San Francisco Office, 333 Bush Street, 7th floor (Board Room), San Francisco, California following the conclusion of the Board Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Marvin P. Kropke; Lawrence E. Mulryan; Jack L. Neureuter; Thomas E. Rankin; Scott K. Reid; and William Zachry.

Absent by prior arrangement: Robin L. Baker; Daniel M. Curtin; Sen. Michael J. Machado (Ret.); Steven L. Rank; and Christine Baker (non-voting member).

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter A. Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

AGENDA ITEM 27: PROPOSALS AND SUGGESTIONS FOR AUGUST 29, 2017 AGENDA

Ms. Chalupa requested suggestions for agenda items for the August 29, 2017 Board meeting. Ms. Padua noted that the proposed agenda items are for Closed Session.

Ms. Chalupa requested public comment, of which there was none, and she noted that the next Board meeting is scheduled for August 29, 2017 and the Board will also hold its Strategic meeting on August 29-31, 2017 at the Napa Valley Marriott Hotel and Spa, Napa, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting at 10:05 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary