

**STATE COMPENSATION INSURANCE FUND  
BOARD OF DIRECTORS**

**MINUTES OF OPEN SESSION MEETING**

**August 14 & 16, 2013**

The Board of Directors of the State Compensation Insurance Fund met on August 14 and August 16, 2013 at the San Diego Marriott Marquis and Marina, 333 West Harbor Drive, San Diego, California.

**August 14, 2013**

**AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL**

The meeting was called to order on August 14, 2013 at 9:35 a.m.

Mr. Mulryan requested Ms. Padua to call roll. The following were present: Lawrence E. Mulryan, Chair; Robin Baker, Sheryl A. Chalupa; Daniel M. Curtin; Marvin Kropke; Sen. Michael J. Machado (Ret.); Francis E. Quinlan; Steven L. Rank; Thomas E. Rankin; William M. Zachry and Christine Baker (non-voting member).

Absent by prior arrangement: Scott Reid

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; 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. Zachry

Second: Mr. Quinlan

To approve the Consent Calendar as presented.

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

YES: 11

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 June 30, 2013 there were 153 separations. The annualized separation rate was 6.7%. There were 45 new hires and 198 promotions.

As for Workforce Solutions, there are 309 employees, including employees in extended leave and 215 employees assigned to projects.

### **b. Employee Leave Balance and Usage**

There are a total of 190,246 annual leave and vacation hours over the 640 hour cap. There were 870 employees with leave balances exceeding the cap at the end of June 2013, compared to 808 employees from December 2012. Mr. Acker noted that there will be reduction in the leave balances starting next month due to the elimination of the Personal Leave Program (PLP) as part of the new bargaining contract. The goal is to have all employees that are over the 640 hour cap use all leave accruing in 2013, plus 10% of their accrued time over the 640 hours cap. Ethics and Labor Relations will continue to monitor and implement leave usage plans.

### **c. Veteran Hiring**

State Fund is utilizing websites specific for recruitment of Veterans and has attended job fairs at Camp Pendleton and Las Vegas to attract leaders separating from the military. State Fund hired two veterans into Senior Leadership roles. Terrell Freeman, U.S. Air Force Major veteran was hired for to be the Premium Audit Program Manager. Mr. Freeman served for 25 years as an officer in the U.S. Air Force where he graduated from Officer Training School and received numerous Air Force Leadership certificates. He earned a BS in Computer Studies and Masters of Arts in Health Service Management. Doug Ziemer, Army Lt. Colonel veteran was hired to be the Regional Vice President of North Field Operations. Mr. Ziemer served for 25 years in the U.S. Army and retired from the military in 2011. Mr. Ziemer completed his MBA in June of this year. Several more veteran candidates are in the pipeline for roles at the senior leadership and mid management levels.

## **AGENDA ITEM 6: FINANCIAL UPDATE – 2nd QUARTER 2013**

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results for the year ended June 30, 2013. 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 69,000 policies, which approximated budget but was 5% less than the six months ended June 30, 2012. The average premium per policy was approximately \$8,200 or 6% more than the budget and 23% more than the same period in the prior year. Net premiums earned of \$452M were 6% more than budget and 6% less than the prior year. The loss and loss adjustment expense (LAE) ratio of 97.5% was on budget and consistent with the same period in the prior year. The combined ratio of 130.7% was five points lower than budget and 8 points lower than the prior year, and the related underwriting loss of \$140M was 9% lower than budget and 19% less than the prior year.

Net investment income of \$345M was 5% lower than budget and 13% less than the prior year. Reinvestment yields were lower than planned and investing in equities started later

than planned. State Fund realized capital gains of \$12M were \$12M more than budget and \$16M less than the prior year. Other expenses represent charge-offs of uncollectible premiums and were \$9M less than budget and \$2M less than the prior year.

Net income of \$224M was \$27M more than budget but \$21M less than the prior year. Policyholders' surplus grew by 3% to more than \$6.2B since December 31, 2012. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 6: LEGISLATIVE UPDATE**

Government Affairs Manager Rhonda Myers reported that the main legislative agenda this year is education funding reform, which was a cornerstone of the Governor's budget. Members are also focused on implementation of the Affordable Care Act, through California's exchange, Covered California.

As to workers' compensation issues, it has been a relatively quiet year, especially since major workers' compensation reform was enacted in 2012 (SB 863). However, one closely watched bill is AB 1309 (Perea), designed to close a loophole that provides workers' compensation benefits to out-of-state athletes that file for cumulative trauma claims in California. The bill is expected to pass and be signed by the Governor. AB 1394, the State Fund sponsored bill for appointment of four additional exempt positions is set for Senate third reading on August 19, 2013 and to date there is no opposition. The Legislature has until September 13, 2013 to pass bills, and the Governor has until October 13, 2013 to sign or veto those bills.

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

#### **AGENDA ITEM 7: REVIEW OF SB 863 REFORM**

Mr. Mulryan introduced State Fund ex-officio Board Member and Director of the Department of Industrial Relations Christine Baker and CWCI President Alex Swedlow. Ms. Baker has extensive expertise with labor and management having formerly served as Chief of the Division of Labor Statistics and Research (DLSR), deputy director for the Division of Workers' Compensation (DWC) and executive officer of the California Commission on Health and Safety and Workers' Compensation (CHSWC). Mr. Swedlow has more than 20 years experience in health services research, public policy analysis and data development and has published numerous research studies in various medical, disability and Workers' Compensation issues and trends.

Ms. Baker provided an update on SB 863, the historic reform package enacted in fall 2012. The bill was initiated by a labor management group, which focused on the best interest of workers and employers. The goals are as follows: i) improve injured workers' access to medical care; ii) increase benefits; iii) avoid delays and disputes; and iv) reduce costs for employers. Currently some provisions have taken effect but others are still in progress, including the appropriate fees for copy services, interpreters, home health care and vocational experts. Ms. Baker discussed the provisions that have taken effect as noted in the Board materials: timely and appropriate medical care; earlier return to work; increased Permanent Disability (PD) benefits; special earnings loss supplement; timely payments; and appropriate fees for medical practitioners, ambulatory surgical centers, and implantable spinal hardware.

Mr. Swedlow provided a report on pre-reform trends related to i) benefit development; ii) medical treatment utilization and cost by fee schedule; iii) medical provider networks; and iv) medical benefit cost drivers. Overall, early indications show a significant change as follows: i)

significant medical trend decrease in early 2012; ii) 5% decrease in medical cost containment; iii) erosion of two year temporary disability cap; iv) slow down in outpatient utilization; and v) 62% growth rate in Medical Provider Networks. The top 3 prevalent adjusted factors associated with increasing cost trend are claims with attorney involvement, indemnity claims, and claims with Opioid prescription.

Mr. Swedlow reported on the early returns of SB 863 with the most significant impact has been to discourage frivolous liens and objections. The lien volume for 2011 – 1Q 2013 was reduced by 55%.

## **AGENDA ITEM 8: PRESIDENT'S REPORT**

President and CEO Tom Rowe reported that State Fund premium volumes continue to exceed budget. This trend began near the end of last year as the California market began to harden and tiered rating is now also contributing to the growth. The estimated annual premium increased 16% over last year and is anticipated to end the year close to 20%.

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

## **AGENDA ITEM 9: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES**

### **9a: GOVERNANCE COMMITTEE**

#### **9ai: GOVERNANCE AND COMPLIANCE UPDATE**

Chief of Internal Affairs Dante Robinson reported on the Governance and Compliance Update.

The 2013 Code of Conduct Acknowledgement and Training by workforce members were completed with 99% of active employees and 95% of consultants trained.

All Ethics and Privacy issues are investigated. During 2Q 2013, there were 117 reports received from all sources which includes 80% related to suspected privacy or security breaches and 15% related to HR matters. The Privacy matters saw an uptick in referrals based on: (i) transmission of private information for non-business purposes, and (ii) increased awareness of the importance of data privacy through various channels of communication including Privacy road show presentations

The first report on State Fund's Procurement Diversity required by AB 53 was submitted July 1, 2013 to the California Department of Insurance (CDI). State Fund's Supplier Diversity mission is to provide equal opportunities for minority, women and disabled veteran owned businesses in sourcing and contracting initiatives. The identified diverse spending is reported as 4% of procurement spending. The report is public and posted by the CDI.

The notification about the California State Auditor's Whistleblower hotline was sent to employees in June 2013 and a compliance report was issued to the State Auditor as required by law. The Whistleblower hotline may be used to report suspected fraud, waste or abuse. The State Auditor's mandated 2013 posters about the hotline and the California Whistleblower Protection Act are displayed in locations throughout State Fund where other employee notices are posted.

The new corporate policy on Intellectual Property was issued which provides the organization framework for protection of State Fund's proprietary material and respect for copyrighted material of others.

## **9b: AUDIT COMMITTEE**

### **9bi. UPDATE ON COMPLETED CLOSED AUDITS**

Audit Chair Pro Tem, Mr. Zachry noted that at the May 2013 Audit meeting the Committee Chair, Mr. Qunlan recommended that other members of the Committee voluntarily serve as the Audit Chair for the experience, new perspectives and an opportunity to increase each member's involvement in preparation for the Audit Committee meeting.

Mr. Zachry reported on the following activities:

**Completed Closed Audits** - There were five completed closed audits. All the findings were correctible and there were no major findings in any of the five audits and no significant risks to State Fund.

**Whistleblower Hotline** – All reports made through the Ethics Hotline are investigated. The majority of the reports for the 2Q 2013 were related to privacy and security breaches. The Privacy matters saw an uptick in referrals based on: (i) transmission of private information for non-business purposes, and (ii) increased awareness of the importance of data privacy through various channels of communication including Privacy road show presentations

**Ratification of Engagement of External Auditor for 2013 Audit Plan** – The Audit Committee ratified the engagement of External Auditor KPMG for the 2013 Audit Plan at a cost of \$885,000 for audit and actuarial services, with \$750,000 for audit and \$135,000 for actuarial services. This is a savings of \$5,000 from last year's engagement fee.

**Internal Audit 2Q 2013 Report** – Mr. Dante Robinson provided a 2Q Internal Audit report. In addition, each member of the Audit Committee provided a report on the Open audits that have been assigned to them for their review.

**Pending and Potential Fraud, Criminal and Civil Litigation** – Special Investigation Unit (SIU) continues to work with internal business units, law enforcement and authorized governmental agencies to identify and eliminate fraud risks.

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

## **9c: INVESTMENT COMMITTEE**

### **9ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS**

Investment Chair, Senator Machado (Ret) noted the Committee heard a report from BlackRock Investment Management, LLC on the Market Outlook and Economic Update and on the Investment portfolio and strategy. Overall, the equities continue to be attractively valued and dividend paying stocks represent an opportunity for investors in a slow growth economy.

The investment transactions and compliance reports for the period of April 1, 2013 to June 30, 2013, were approved by the Investment Committee pursuant to its delegated authority. Sen. Machado noted that in the 2Q 2013, there was a substantial trade transaction in equities. State Fund purchased over \$200M in equity securities. The equity program was fully implemented

during 2Q 2013 and State Fund's Investment strategy is to reach the equity allocation target by year-end. Sen. Machado reported there were no changes to the compliance report from the May 2013 meeting.

#### **AGENDA ITEM10: CHAIRMAN'S REPORT**

Mr. Mulryan noted that State Fund serves a critical role in California's workers' compensation market. State Fund's premium volumes continue to exceed budget. State Fund's pricing strategy is not to grow premium per se but to fulfill its goal to offer fair prices to California's employers. The premium growth State Fund is experiencing is the byproduct of a hardening market and improved accuracy in pricing. State Fund's goal over the long term is to offer prices that best reflect State Fund's view of risk exposures at a loss ratio that reflects State Fund's status as a not for profit public enterprise.

In addition, in light of the changes happening at State Fund, the Executive team decided to revisit State Fund's mission statement. The previous mission statement covered the purpose well enough but was a bit long. A shorter more "portable" purpose statement would be easier for everyone to remember and could become a focal point for State Fund's transformation. Employee feedback was solicited. The new purpose statement that emerged is "State Fund's purpose is to provide fairly priced workers' compensation insurance, make workplace safe, and restored injured workers".

On business transformation, effective project management was identified as a core competency that is integral to State Fund's success, an area in which State Fund needs to improve. Mr. Mulryan reported that Tom Rowe and the Board have engaged an expert in project management to help State Fund improve project management practices to make sure projects reflect more stakeholder input and that projects deliver better results. There has been a lot of work done to strengthen the foundation in this area and some of the highlights include: i) project managers have been identified and are in place for all key initiatives that are focused on technology and process improvements; ii) business analyst positions have been filled and a curriculum was designed to improve their expertise; and iii) a project plan and road map for Customer Service Center has been completed and a State Fund project manager is in place to coordinate the activities. This work is leading to important and measureable improvements in service levels and productivity. Mr. Mulryan thanked the State Fund teams that are leading these important efforts and the employees who serve California's employers and workers every day.

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

#### **AGENDA ITEM 11: BOARD MEMBER REPORTS**

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

#### **AGENDA ITEM 12: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 15-27**

Mr. Mulryan requested public comment on the appropriateness of closed session for items 15-27, of which there was none.

#### **AGENDA ITEM 13: PUBLIC COMMENT**

Mr. Mulryan requested further public comment. Duane Johnson from State Fund San Diego Legal noted that he was impressed with the revision of the State Fund mission statement.

Mr. Johnson requested that the Board review his proposed "Draft Purpose (Mission) Statement for the State Fund Legal Department". Each Board member received a copy of the proposed Mission statement for the Legal department.

### **ADJOURNMENT**

There being no further business, Mr. Mulryan adjourned the meeting at 10:55 a.m. to immediately reconvene in Closed Session.

### **August 16, 2013**

The Board of Directors of State Compensation Insurance Fund continued their Open Session on August 16, 2013 at the San Diego Marriott Marquis and Marina, 333 West Harbor Drive, San Diego, California.

### **AGENDA ITEM 28: CALL TO ORDER AND ROLL CALL**

The meeting was called to order on August 16, 2013 at 10:30 a.m. and the following were present: Lawrence E. Mulryan, Chair; Robin Baker; Marvin Kropke; Francis M. Quinlan; Steven L. Rank; Thomas E. Rankin; and William M. Zachry.

Absent by prior arrangement: Sheryl A. Chalupa, Daniel M. Curtin, Scott Reid, Sen. Michael J. Machado (Ret.) 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; and Board Liaison and Assistant Corporate Secretary Hilda Padua.

### **AGENDA ITEM 29: APPROVAL OF MEDICARE SET ASIDE AGREEMENT**

This agenda item was deferred to the November 2013 meeting.

### **AGENDA ITEM 30: PROPOSALS AND SUGGESTIONS FOR NOVEMBER 14, 2013 AGENDA**

Mr. Mulryan requested additional items for the November 14, 2013, Board meeting. Mr. Zachry requested to add on the agenda for Audit and Board meetings "Bill Review: Duplicate Payments."

Mr. Mulryan requested public comment, of which there was none, and he noted that the next Board meeting is scheduled for November 14, 2013 at the State Fund Corporate Office, San Francisco, California unless noticed for a new date and time.

Respectfully submitted,

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Hilda B. Padua  
Board Liaison and Assistant Corporate Secretary