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Date: July 1, 2011

**AGENDA ITEM 3a**

**TO: MEMBERS, BOARD OF DIRECTORS**

- I. SUBJECT:** Approval of May 12-13, 2011 Open Meeting Minutes
- II. PROGRAM:** Legal Department
- III. RECOMMENDATION:** Action: To approve.

Attached May 12-13, 2011 Open Meeting Minutes of the Board of Directors is presented for consideration and approval at the Board meeting of July 14, 2011.

*Judith D. Sapper*

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Deputy Chief Counsel and Assistant  
Corporate Secretary

Attachment

**STATE COMPENSATION INSURANCE FUND  
BOARD OF DIRECTORS**

**MINUTES OF OPEN SESSION MEETING**

**May 12, 2011**

The Board of Directors of the State Compensation Insurance Fund met on May 12, 2011 at the Omni San Francisco Hotel, 500 California Street, San Francisco, California.

**May 12, 2011**

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

The meeting was called to order on May 12, 2011 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; William M. Zachry; and non-voting member Christine Baker, joining at item 9. Absent: Daniel M. Curtin and Steven L. Rank.

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 Deputy Chief Counsel and Assistant Corporate Secretary Judith D. Sapper.

**AGENDA ITEM 2: RECOGNITION OF OUTGOING EX-OFFICIO MEMBER  
JOHN C. DUNCAN AND WELCOME TO EX-OFFICIO MEMBER CHRISTINE  
BAKER**

Mr. Mulryan announced the resignation of ex-officio Board Member John C. Duncan and read Resolution No. 980 honoring Mr. Duncan for his service to the Board since September 2007. He recommended the ratification of Mr. Duncan's resignation. He called for Board discussion of which there was none.

MOTION: Mr. Zachry

Second: Sen. Machado

To adopt Resolution No. 980 honoring John C. Duncan as presented and to ratify his resignation from the Board of Directors.

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

YES: 8

NO: 0

Motion carried.

Mr. Mulryan welcomed Christine Baker, Chief Deputy Director and Acting Director of the Department of Industrial Relations as new ex-officio Board Member and outlined her background in the workers' compensation industry.

### **AGENDA ITEM 3: ANTITRUST ADMONITION**

Mr. Mulryan called attention to and requested the Board members read State Fund's Antitrust Admonition, which is included in each Board member's meeting materials.

### **AGENDA ITEM 4: CONSENT CALENDAR**

Mr. Mulryan referred to the Consent Calendar matters, which are included with each member's agenda. He requested whether any Board member had any additional 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 5: LEGISLATIVE MATTERS AND STATUS**

Vice President of Government Affairs Brian Watson provided an update on workers' compensation legislation. He presented three bills related to State Fund: (1) AB 228, an amendment to existing law that is moving forward from the Assembly to the Senate to add furloughs to the list of State Fund exemptions from hiring freezes and staff cutbacks; (2) AB 974, opposed by State Fund and which failed to move out of committee, that would have characterized as discriminatory and disapproved any rates for workers' compensation insurance with a price differential because purchase was through a broker; and (3) AB 1263, which State Fund worked with SEIU to support and amend, prohibiting members of State Fund's Board of Directors and Board-appointed Officers from lobbying State Fund for two years after leaving State Fund and requiring Board approval before they can consult for State Fund. Mr. Watson reported on ten other bills relating to workers' compensation benefit increases or insurance issues, many of which were opposed by insurance carriers. State Fund is tracking 43 workers' compensation bills, the majority of which will likely fail to be enacted.

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

### **AGENDA ITEM 6: LOSS CONTROL AND SAFETY SERVICES STRUCTURE AND FUNCTION**

Chief Operating Officer Tom Clark provided information about State Fund's loss control and specialty safety services for claims prevention and reduction. State Fund has 100 individual loss control consultants in 14 field offices throughout California; 10 certified industrial hygienists; 5 certified industrial ergonomists; and 31 certified safety professionals, a high-level designation comprising the largest percentage among California workers' compensation carriers. State Fund's 2011 loss control servicing is focused on high claim frequency, potential for loss, and accounts with high experience modification ratings, and documenting services and measuring outcomes of claims frequency reduction. State Fund presents employer outreach safety seminars, often in partnership with other agencies including Cal/OSHA, the California Highway Patrol, and the Department of Health Services. The focus for 2011 is to determine State Fund's cost savings and return on investment in producing the seminars and safety products. There was Board discussion about the cost-benefit of the seminars. Mr. Mulryan requested public comment of which there was none.

### **AGENDA ITEM 7: CREDIT AND COLLECTIONS STRUCTURE AND FUNCTION**

Chief Investment Officer Peter Guastamachio reported about the structure and function of Credit and Collections at State Fund. Credit and Collections comprises two different groups, one which collects premium and the other which processes incoming checks daily. Credit and Collections is located primarily in Pleasanton, with additional collections offices in Vacaville and Monterey Park, and a back-up processing and lockbox office in Vacaville. Credit and Collections' primary focus was collecting premium from canceled and distressed accounts but as of April 2011 is concentrating on active accounts recently overdue or with premium audits due. Mr. Mulryan requested public comment of which there was none.

### **AGENDA ITEM 8: FINANCIAL UPDATE – 1<sup>ST</sup> QUARTER 2011**

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results for the first three months of 2011, which ended March 31, 2011. State Fund's financial results are significantly impacted by economic conditions, including unemployment and market pricing. State Fund continues to maintain pricing discipline with premiums. It wrote approximately 43,000 policies, which was 2% more than budget and 9% less than the prior period. Due to the continued loss of larger premium accounts, average premium per policy was approximately \$7,400 or 10% less than budget and 15% less than the prior period. Net premiums earned of \$234 million were 18% less than budget and 16% less than the prior period. The incurred losses of \$175 million were 18% less than budget and 16% less than the prior period. State Fund's incurred loss ratio of 75% was on budget and consistent with the prior period. Loss adjustment expenses and underwriting expenses totaled \$219 million, which

were 13% less than budget and 15% less than the prior period. State Fund's expense ratio of 93%, based on loss adjustment expenses and underwriting expenses, was 4 points higher than budget and 1 point lower than the prior period. There was an underwriting loss of \$160 million, which was 11% lower than budget and 15% lower than the prior period. The combined ratio was 168%, 4 points higher than budget and 1 point lower than the prior period. Net investment income of \$208 million was 11% more than budget and 6% less than the prior period. State Fund realized capital gains of \$3 million, which was \$3 million more than budget and the prior period. Other expenses of \$3 million consisted of charge-offs of uncollectible premiums and were \$16 million less than budget and \$3 million less than the prior period. Because of the improved underwriting results and net investment income, State Fund's net income of \$48 million was \$59 million more than budget and \$21 million more than the prior period. Mr. Mulryan requested public comment of which there was none.

Ms. Baker joined the meeting.

**AGENDA ITEM 9a: RATIFICATION OF INVESTMENT TRANSACTIONS –  
BOND TRANSACTIONS**

Treasury and Investments Program Manager Stephanie Chan, on behalf of the Investment Committee, recommended the ratification of investment transactions from February 1, 2011 to March 31, 2011. Investment transactions for the period were made in conformance with State Fund's Investment Policy at the time of purchase. During the months of February and March, State Fund purchased 85 bonds totaling \$911M. During this same time period, State Fund sold 4 bonds totaling \$50M. Year-to-date through March 31, 2011, State Fund has recognized a net gain of approximately \$3M. The book value of State Fund's portfolio as of March 31, 2011 was approximately \$19.1B.

MOTION: Sen. Machado

Second: Ms. Chalupa

To ratify the investment transactions from February 1, 2011 to March 31, 2011.

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

YES: 8

NO: 0

Motion carried.

**AGENDA ITEM 9b: RATIFICATION OF INVESTMENT TRANSACTIONS –  
COMPLIANCE REPORT**

Ms. Chan, on behalf of the Investment Committee, presented the Compliance Report. The Report includes securities not in compliance with State Fund's Investment Policy as of March 31, 2011. There is a Taxable Municipal, Rancho Cucamonga California Redevelopment, totaling approximately \$12.8M. The bond, which is rated below "A", was in compliance with State Fund's investment

guidelines at the time of purchase. This issue is insured by MBIA. MBIA's financial strength rating was subsequently downgraded to below "A-" and Moody's does not rate the underlying obligator. One of State Fund's Oregon State bond holdings totaling \$25M is not rated, but it was initially rated "AAA" based on the financial strength of insurance enhancement and subsequently the ratings were withdrawn. The underlying ratings for all the State of Oregon bonds are "Aa1/AA+". State Fund filed and received an NAIC 1 designation from SVO for this bond on December 30, 2009. At the end of March 2011, the total value of the securities listed on the Compliance Report is approximately \$37.8M, which represents less than .02% of State Fund's total investments.

MOTION: Sen. Machado

Second: Mr. Garcia

To ratify the Compliance Report for the period February 1, 2011 to March 31, 2011.

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

YES: 8

NO: 0

Motion carried.

#### **AGENDA ITEM 10a: PERSONNEL MATTERS – STAFFING UPDATE**

Mr. Mulryan introduced Senior Vice President of Human Resources and Organizational Development Andreas Acker. Mr. Acker reported that as of March 31, 2011, there were 7,218 employees at State Fund; 7,014 were available and 204 were on extended leaves of absence. There were 76 employees who left State Fund as of the end of Q1 2011, and an additional 40 employees left in April 2011, predominantly retirements but some voluntary resignations, with transfers to other state agencies greater than in than 2010, and a 4.7% separation rate consistent with budget. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 10b: PERSONNEL MATTERS – UPDATE ON GEOGRAPHIC STRATEGY**

Mr. Acker provided an update regarding State Fund's geographic strategy. State Fund has reached an agreement with SEIU on the impact of the moves. Pertinent terms include paid time off to seek other employment and housing, and an ability to cash-out up to 80 hours of leave credits to cover miscellaneous transition-related expenses. Retirement seminars have been made available to employees, and almost 2,000 employees have attended. State Fund has also provided training on surplus status and procuring employment elsewhere. The move dates are on schedule for September 2011. Mr. Mulryan requested public comment of which there was none.

## **AGENDA ITEM 11: PRESIDENT’S REPORT**

President and CEO Thomas E. Rowe provided an update on state of the workers’ compensation market since the last Board meeting. The competitive pressure in the workers’ compensation market continues, consistent with prior reports. The open market for workers’ compensation remains, with competitors taking business from State Fund although no longer the best risks, as would be expected in a soft market. The business is being lost at substantial discounts of more than 30% below State Fund’s expiring rates or at loss ratios greater than 100%, which will not cover loss costs, expenses, and reasonable returns. State Fund is maintaining its accident loss ratio at 75%. Its mission is to be an open and stable market for all California employers by presenting fair and adequate pricing. State Fund is maintaining pricing discipline, protecting its capital, and focusing on market change. Mr. Mulryan requested public comment of which there was none.

## **AGENDA ITEM 12: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES**

### **AGENDA ITEM 12a: GOVERNANCE COMMITTEE**

Mr. Mulryan reported that the Governance Committee is working with the Department of Personnel Administration on the development of a Performance-Based Incentive Tool for State Fund to attract and retain talent in leadership positions for the benefit of State Fund, employers, and injured workers.

#### **i. BOARD DELEGATED AUTHORITY TO BOARD COMMITTEES**

Mr. Mulryan called upon General Counsel Carol Newman to discuss the increased delegation of authority by the Board of Directors to the Committees of the Board. Ms. Newman reported that no changes were recommended to operational duties previously delegated to the President of State Fund. The Board’s current approval process requires the Board to consider many items already considered at length by the appropriate Committee. To improve the efficiency of the Board, the Governance Committee recommends the Board approve the delegation of power to ratify actions by the President and to make certain decisions on behalf of the Board, consistent with each Committee’s area of expertise and charter. This delegation of authority would allow each Committee the option of forwarding select issues to the Board for discussion and/or approval.

MOTION: Mr. Rankin

Second: Mr. Zachry

To delegate the authority to perform certain of the Board’s duties to the Committees of the Board of Directors, commensurate with each Committee’s subject matter expertise while retaining major policy issues and expenditures for Board consideration and approval.

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

YES: 8                      NO: 0                      Motion carried.

**AGENDA ITEM 12b: AUDIT COMMITTEE**

Mr. Quinlan reported that the Audit Committee adopted the revised Audit Charter, and recommended it be approved by the Board. The Charter was reformatted for clarity about the purpose, powers, duties, and meetings of the Audit Committee; specifies the Audit Committee's ability to meet with State Fund's internal and external actuary and auditors; and clarifies identification of Enterprise Risk Management as a Governance Committee function while the Audit Committee evaluates the controls and mitigation of risk.

MOTION: Mr. Zachry    Second: Mr. Reid

To approve the Audit Charter as amended.

Mr. Mulryan requested public comment. There was public comment about a typographical issue with the formatting of the revised Audit Charter. Mr. Mulryan called for the vote.

YES: 8                      NO: 0                      Motion carried.

The Audit Committee heard reports on completed closed audits regarding the Project Management Office and Loss Control Operational Review. Remediation plans and implementation schedules are in place for those audits. External auditor KPMG provided a preliminary report on State Fund's 2010 financial audit. It is on schedule and there are no significant deficiencies or material weaknesses in internal controls to report. The California Department of Insurance Operational Audit and Triennial Financial Exam are in progress and expected to be completed by June 30, 2011. The Committee was briefed on the progress of ongoing audits involving group program self-assessment, medical bill payments, and data integrity. Mr. Quinlan reported selection of the Senior Vice President of Internal Affairs is still ongoing and an examination for candidates is forthcoming. The Committee heard public comment on the propriety of a Closed Session discussion of a report and recommendations for the Special Investigation and Special Litigation Units but because the information involves State Fund's anti-fraud efforts it will not be publicly disclosed. Mr. Mulryan requested public comment of which there was none.

**AGENDA ITEM 12c: INVESTMENT COMMITTEE**

Sen. Machado reported adoption of the Investment Charter was deferred until the July Board meeting to allow further revisions following Board action on delegation of authority to the Committees. The Investment Committee reviewed State



Fund's investment portfolio and its performance. The annual review of the investment managers showed they are exceeding the bench mark. The Committee also discussed the schedule for Committee education, and State Fund's investment strategy and strategic plan. Topics for the July meeting include Committee education and investment manager selection process prior to the March 2012 expiration of the current investment manager contracts. Mr. Mulryan requested public comment of which there was none.

### **AGENDA ITEM 13: REPORT BY CHAIR OF BOARD ACTIVITIES**

Mr. Mulryan reported on State Fund's role in the California workers' compensation market. Mr. Mulryan provided a brief history about State Fund, which was created in 1914 by the Legislature after enactment of the no-fault workers' compensation system and charged with being an available market for employers and to be efficient and compete fairly with other insurers. State Fund was designed to be a self-supporting non-profit enterprise in which revenue is generated solely from premium and investment income. It is governed by an independent Board of Directors granted sole authority over State Fund's finances and operations by the state constitution and insurance code. Those laws dictate State Fund's Board must act as fully and completely as the governing board of a private insurer. State Fund's financial position remains strong thanks to a conservative investment portfolio. State Fund plays a critical role in the workers' compensation market, in that it is obligated and well-positioned to provide stability and fair pricing to California employers in a volatile market. State Fund strives to be a market for all California employers. Mr. Mulryan requested public comment of which there was none.

### **AGENDA ITEM 14: BOARD MEMBER REPORTS**

There were no reports by Board members. Mr. Mulryan requested public comment of which there was none.

### **AGENDA ITEM 15: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 18 THROUGH 27**

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

### **AGENDA ITEM 16: PUBLIC COMMENT**

Mr. Mulryan requested further public comment. Ms. Kathleen Collins, Vice President of Bargaining of SEIU Local 100 made public comment that SEIU is a policyholder with State Fund, and has had positive experience with the Loss Control and ergonomic services provided. She made objection to the plan for Performance Based Compensation to program managers because the criteria are undisclosed and the deliverables for management are unknown, some State Fund employees subject to geographic moves will lose their recruitment and retention differentials, and management bonuses exceed what many State Fund employees make in a year. Ms. Collins objected to Closed Session discussions of optimization studies, reports and recommendations because they may

significantly impact employees and she requested more transparency into the reports and reasons for business decisions. She advised if State Fund cannot provide the requested information SEIU will seek legislative change.

Mr. Randal Cheek, Legislative Advocate of SEIU Local 1000, made public comment on the condition of State Fund's financial report. He noted the expected savings of \$200 million under the three-year strategic plan, the potential for employees leaving, and the objective of improved premium collection, and asked whether State Fund will revise the restructuring plan if it exceeds its goals.

### **ADJOURNMENT**

There being no further business, Chair Mulryan adjourned the meeting at 3:05 p.m.

### **May 13, 2011**

The Board of Directors of State Compensation Insurance Fund continued their Open Session on May 13, 2011 at the Omni Hotel, 500 California Street, San Francisco, California.

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

The meeting was called to order on May 13, 2011 at 10:35 a.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Daniel M. Curtin, joining at item 30; Donald E. Garcia, joining at item 30; Sen. Michael J. Machado (Ret.); Francis E. Quinlan, joining at item 30; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; William M. Zachry; and non voting member Christine Baker.

There was a quorum.

Also present: President and CEO Thomas E. Rowe; Chief Financial Officer Dan Sevilla; Chief Risk Officer Ken Van Laar; General Counsel and Corporate Secretary Carol R. Newman; and Deputy Chief Counsel and Assistant Corporate Secretary Judith Sapper.

### **AGENDA ITEM 29: UPDATE ON PERFORMANCE BASED RETENTION TOOL**

Mr. Mulryan reported that the development of a performance-based retention tool for the exempt executives has been approved in concept by the Department of Personnel Administration. None of the members of the Executive Committee, including Mr. Rowe, are involved in the development of this plan and Mr. Mulryan is working on it with outside counsel in lieu of Mr. Rowe. Mr. Mulryan requested a motion to authorize the Board Chair to develop the plan instead of Mr. Rowe.

MOTION: Mr. Rankin

Second: Mr. Zachry

To approve the development of a Performance Based Retention Tool and to authorize the Chair of the Board of Directors of the State Compensation Insurance Fund to take such further actions as are necessary to develop a performance based retention tool for the Exempt Positions for further consideration by the Board of Directors.

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

YES: 7

NO: 0

Motion carried.

**AGENDA ITEM 30: STATEMENT OF ACTUARIAL OPINION**

Mr. Mulryan called on Mr. Guy Avagliano of Milliman, Inc., State Fund's independent actuary, to provide the actuarial opinion for State Fund. Mr. Avagliano reported as required by law the independent actuary has given an annual statement on State Fund's reserves and that Milliman's opinion was State Fund's reserves meet the requirements of the insurance laws of California; are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board; and make a reasonable provision for all unpaid loss and loss expense obligations under the terms of its contracts and agreements.

**AGENDA ITEM 31: PROPOSALS AND SUGGESTIONS FOR JULY, 2011  
AGENDA**

There were no proposals or suggestions in addition to the Board Standing Agenda items. Mr. Mulryan requested public comment of which there was none.

There being no further business, Chair Mulryan adjourned the meeting at 10:40 a.m. The next regularly scheduled Board meeting will begin on Thursday, July 14, 2011 in San Francisco.

Respectfully submitted,

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Judith D. Sapper,  
Assistant Corporate Secretary