

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

August 16-17, 2012

The Board of Directors of the State Compensation Insurance Fund met on August 16 and 17, 2012, at 333 Bush Street, San Francisco, California.

August 16, 2012

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

Mr. Mulryan requested Ms. Padua to call roll.

The meeting was called to order on August 16, 2012 at 2:25 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; Thomas E. Rankin; Scott K. Reid; and William M. Zachry.

Absent: Steve L. Rank and Christine Baker 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 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 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: Ms. Chalupa

Second: Mr. Machado

To approve the Consent Calendar as presented.

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

YES: 9

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, 2012 there were 710 separations. The annualized separation rate through June 30, 2012 was 25% of which 2/3 of the employees transferred to other agencies and 1/3 of the employees retired or resigned. There was a drop in the separation rate after the cancellation of layoffs. Attrition remains strong and additional separations due to retirements are forecast for 2012.

b. Capacity Planning

State Fund participated in a recent benchmarking study of the American Association of State Compensation Insurance Funds (AASCIF) and other workers' compensation carriers,. The AASCIF companies are much smaller with premiums of about \$250M. so in addition the the AASCIF staffing benchmarks, State Fund projected its 2012 staffing based on 2012 Gross Premiums Written (GPW) and claims inventory. . The productivity improvements in re-engineered business process and investments in technology has enabled a transition of excess staff to the Talent Retention Program (TRP) for cross-training and redeployment to support future growth. With improvement in productivity, State Fund 2012 staffing is sufficient for double the 2012 premium volume.. Approximately 1100 FTEs (Full Time Equivalents) are available to respond to an increase in market share..

c. Training and Development Initiatives

The Talent Retention Program (TRP) and Learning and Development (L&D) are working with business units to determine short and long term training needs. In addition, TRP and L&D are already working on developing existing staff in TRP starting with an assessment of their current and past skills, experiences and capabilities. The TRP will provide training and experience for those employees who desire to have a long-term career with State Fund and are willing to take on new jobs over time.

d. Employee Leave Balance and Usage

There are a total of 189,267 annual leave and vacation hours over the 640 hour cap. There were 763 employees with leave balances exceeding the cap at the end of June 2012 compared to 760 employees at year end 2011. 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 for the six months ending June 30, 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 73,100 policies, which was 6% 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 \$6,600 or 4% less than the budget and 1% less than prior period. Net premiums earned of \$480M were 11% more than

budget and 3% 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 2 points lower than budget and 1 point higher than the prior period. The combined ratio of 139% was 2 points lower than budget and 30 points lower than the prior period, and the related underwriting loss of \$173M was 2% less than budget and 46% less than the prior period.

Net investment income of \$395M was 2% more than budget and 6% less than the prior period. Reinvestment yields were higher than planned. State Fund realized capital gains of \$28M, which was \$28M more than budget and \$17M higher than the prior period. Other expenses represent charge-offs of uncollectible premiums and were \$19M less than budget and \$8M less than the prior period.

Net income of \$245M was \$56M more than budget and \$145M more than the prior period. Policyholders' surplus grew by 4% to over \$5.8B. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 6: CHALLENGES IN REFORMING WORKERS' COMPENSATION AND GROUP HEALTHCARE

Executive Vice President of Claims Beatriz Sanchez introduced CWCI Vice President of Research Alex Swedlow. Mr. Swedlow has more than 20 years of 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.

Mr. Swedlow reported and commented on the U.S. healthcare system, national cost trends in Workers' Compensation and how key factors continue to impact the Workers' Compensation bottom line. Mr. Swedlow also reported on two federal programs that cross the Workers' Compensation arena: (a) Medicare's interest and stake in the future medical payments as a result of a Workers' Compensation injury and (b) the unknown impact of the 2010-2015 implementation of the Patient Protection and Affordable Care Act.

The following factors contribute to the challenges in reforming workers' compensation and group healthcare: (i) The Medical Management Paradigm; (ii) Affordable Care Act and Workers' Compensation; (iii) Medical Benefit and Cost Containment Trends; and (iv) increasing pressure from Medicare.

Under the Medical Management Paradigm Cost and Quality of Care, six categories account for between 21% and 47% of U.S. health care spending in 2011. They are as follows: (i) failures of care delivery which included medical errors and inefficient practice models; (ii) failures of care coordination resulting in duplicate testing and avoidable readmissions; (iii) over treatment; (iv) administrative complexity; (v) pricing failures resulting in lack of transparency and unexplainable variation; and (vi) fraud abuse. As for comparative pricing, the Organization for Economic Co-operation and Development (OECD) concluded that the higher cost of U.S. healthcare spending results from prices charged by American doctors and hospitals; health coverage which shields patients from price sensitivity; greater reliance on specialty care; and high tech care. In the area of coordination of care, Congressional Budget Office (CBO) Medicare meta-analysis finds that most programs did not reduce Medicare spending, there was little improvement in facilitating communication or coordination, and results suggest substantial changes to payment and delivery systems are needed to significantly reduce spending and either maintain or improve the quality of care.

In addition, Mr. Swedlow commented while the Patient Protection and Affordable Care Act does not formally combine Workers' Compensation medical treatment with general health care there is abundant debate on the indirect influence on claims frequency, medical cost containment, access to care, and greater emphasis on wellness and prevention.

Mr. Swedlow also provided an update on Workers' Compensation National trends. Medical costs continue to rise faster than inflation. There is an increased interest in guidelines, employer interest in limited networks, and pharmacy issues over Opioids and physician dispensed drugs predominated in 2011.

Mr. Swedlow commented on intersections and uncertainties between Medicare and Workers' Compensation. Medicare is the secondary payer whereas Workers' Compensation insurers are primary payers. Medicare seeks recoupment of conditional payments when a primary payer has been identified and protection of its interests when future medical care is being settled.

Mr. Mulryan requested public comment of which there was none. Senator Machado left during agenda item 6.

AGENDA ITEM 7: PRESIDENT'S REPORT

Mr. Rowe provided an update on the state of the workers' compensation market. Premiums are down by 10% less than what was forecasted. In order to gain additional insights on market conditions, an analysis was conducted to study the trends between broker and direct business. The broker business has grown to 66% of Estimated Annual Premium (EAP) and 46% of policies. The new business trends are driven by brokers and policies written are improving. The renewal business trends are a mixture with average EAP per policy improving as well. In conclusion, in the broker business you see the competitive market beginning to turn while the direct business is struggling due to the state of the economy. Mr. Mulryan 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

Mr. Mulryan reported that the State Fund's 2012 Code of Conduct was published to the organization on July 23, 2012. The annual training and certification period concludes on August 31, 2012. The 2012 Code and key supporting policies are available to employees internally and to the public on State Fund's website. In addition, effective September 3, 2012 Navex Global will provide the confidential and anonymous ethics and privacy hotline. There were 133 reports through July 2012, of which 11% were submitted through the hotline. All were investigated and findings were reported to the Audit Committee.

Mr. Mulryan further reported that as required by law, notification about the California State Auditor's Whistleblower hotline was sent to employees in July. The State Auditor's 2012 posters about the hotline and the California Whistleblower Protection Act are displayed in locations throughout State Fund where other employee notices are posted.

Mr. Mulryan reported that a privacy inventory of private information collected, used, and maintained by State Fund in all formats was conducted by the Privacy Office as one of its 2012 initiatives. Privacy messaging to the organization is ongoing to improve privacy awareness and private information protection.

Lastly, Mr. Mulryan reported that review of corporate policy library was conducted and the Committee learned that the term “corporate” has been widely used at State Fund for a decade and does not detract from State Fund’s status as a public enterprise fund. At the last May meeting, there was a motion to change the title of State Compensation Insurance Fund’s internal policies from “Corporate” to “Enterprise”. After further review, the Committee recommended that the Board repeal the action taken at the May Board meeting resulting in retaining the use of term “corporate” for cross functional organizational reference, policies and guidelines.

MOTION: Mr. Quinlan Second: Mr. Zachry

To repeal the action taken at the May 2012 Board meeting and retain the use of “corporate” for cross functional organizational reference, policies and guidelines.

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

YES: 8 NO: 0 Motion carried.

8a ii: REVIEW OF BOARD AND COMMITTEE AGENDAS

Mr. Mulryan reported Committee reviewed the Board and Committee Governance Agendas and there were no recommended changes. Mr. Mulryan noted that the review of annual agenda will be revisited again at the November meeting when staff presents the 2013 proposed annual agenda.

8a iii: REVIEW OF STATE FUND BY-LAWS AND COMMITTEE CHARTER

Mr. Mulryan reported that the Governance Committee reviewed the State Fund By-Laws and Committee Charter in alignment with best practices. Mr. Mulryan called on Assistant Chief Counsel and Assistant Corporate Secretary Ms. Vera De Martini to present the changes. Ms. De Martini reported that the proposed change to the By-Laws was to delete and replace any reference to the officer title “Chief Information Technology Officer,” referenced in the enabling statutes Insurance Code sections 11785 and 11785.5, with the preferred “Chief Information Officer” working title. There were no changes to the duties, responsibilities and authority of the officers, which remain as prescribed by the President from time to time, or the power of the Board to designate additional officers as the affairs of State Fund may so require.

The Governance Charter was last reviewed in May 2011, and Committee discussion regarding the Charter was deferred from the May 12, 2012 meeting. Recommended changes to the Governance Committee Charter included: formatting and structural alignment to enhance consistency with the Audit and Investment Committee Charters and improve readability; describing the Delegated Authority and Approval Levels to the Governance Committee as approved by the Board of Directors on May 12, 2011 to (i) oversee and assist HR operations regarding personnel compliance, performance and compensation; (ii) review and approve President’s proposals for setting compensation for exempt appointments; and (iii) approve procurement contracts with an aggregate value in excess of \$25 million; as well as adding a concluding section entitled “Powers” broadly describing the general powers of the Governance Committee, including the power to meet separately with employees outside of the presence of management to facilitate communication in fulfilling its oversight responsibilities.

Following discussion by the members, the Committee proposed further amendments: 1) changing any reference from “Chief Information Technology Officer” to “Chief Information Officer” consistent with the amendment to the By-Laws; 2) to be consistent with the amended Audit Charter, i) adding to the enumerated “Powers” to give the Committee authority to initiate, direct and conduct investigations using outside experts of any kind at the direct cost of the State Fund and ii) adding a new paragraph stating “In discharging its oversight role, the Governance Committee may investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the State Fund and the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties (including the approval of the fees and other retention terms of such independent counsel and advisers;” and 3) retaining the term “Corporate” for cross functional reference, policies and guidelines.

Mr. Mulryan called for a Motion.

MOTION: Ms. Chalupa

SECOND: Mr. Reid

To adopt the proposed changes to the By-Laws and to adopt the proposed changes to the Governance Charter, as further amended.

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

YES: 8

NO: 0

Motion carried

8aiv: REVIEW BOARD DELEGATED AUTHORITY AND APPROVAL LEVELS

Mr. Mulryan reported that the Committee reviewed the Board Delegated Authority and Approval Levels and there were no recommended changes.

8b: AUDIT COMMITTEE

Senator Machado returned during agenda item 8b.

8bi. UPDATE ON COMPLETED CLOSED AUDITS

Mr. Quinlan reported on one completed closed audit. The Payroll Reporting Integrity audit evaluated the viability of using State Fund policy information to create a policy profile data analytics model that can spotlight premium reporting abnormalities worthy of further investigation. Internal Audit developed an audit methodology using data analytics to identify policies that may have been under reporting payroll. A total of 48,000 active non-audited policies were reviewed and application of the data analytics model identified 66 policies for possible audit. Internal Audit shared the audit results and methodology with Field Services, suggesting how the analysis could benefit Premium Audit Services in identifying policies that may have underreported payroll. Internal Audit offered support to the business unit to assess and integrate this analytical process into their current methodology.

8bii: REVIEW OF AUDIT CHARTER

Mr. Quinlan reported that the Committee reviewed its Committee charter to assure that it properly reflect the duties, responsibilities and powers of the Committee. The recommended changes included non substantive changes to make it more readable and align it with the structure and format of the other Committee Charters; streamlining the introductory section

title and content to focus on the Committee's legal, ethical and regulatory compliance obligations and responsibilities; adding a concluding section entitled "Powers" broadly describing the general powers of the Audit Committee, including the power to meet separately with Internal Auditors to facilitate communication in fulfilling its oversight responsibilities. In addition, further, revision was made to the enumerated "Powers" to give the Committee authority to "initiate, direct and conduct investigations using outside experts of any kind at the direct cost of the State Fund".

Mr. Mulryan called for a motion.

MOTION: Mr. Zachry

SECOND: Sen. Machado

To adopt the Audit Committee Charter as further amended.

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

YES: 9

NO: 0

Motion carried

8c: INVESTMENT COMMITTEE

8ci: BOND TRANSACTIONS AND COMPLIANCE REPORTS

Sen. Machado noted that the Committee heard a report from the Deutsche Bank and a report on the Investment portfolio and strategy. Sen. Machado presented the investment transactions and compliance reports for the period of April 1, 2012 to June 30, 2012, which were approved by the Investment Committee pursuant to its delegated authority.

AGENDA ITEM 9: CHAIRMAN'S REPORT

Mr. Mulryan reported that over the past year State Fund has been a strong advocate for balanced worker's compensation reforms. Mr. Mulryan noted that the Department of Industrial Relations (DIR) has worked tirelessly with labor and management to put together a proposal for sweeping reform. The proposed reform is quite comprehensive and bold and some of the highlights include:

- An increase in permanent disability benefits
- A new Expedited Medical Care Decision Process that includes an Independent Medical Review conducted by doctors rather than Administrative Law Judges
- Updates to some of the current medical fee schedules and the introduction of new ones
- Increased quality review and oversight of Medical Provider Networks
- An administrative solution to resolving billing disputes between providers and payers.

Mr. Mulryan applauded the Department of Industrial Relations (DIR) and the Administration for getting this proposal in front of California's policymakers. State Fund believes this reform is substantive and meaningful and is reviewing data to identify the financial impact of the proposal on the workers' compensation system.

In addition, Mr. Mulryan reported on status of the Personal Leave Program (PLP). He noted that in the past State Fund has been excluded from these types of actions, but this time a

trailer bill was passed with the budget that specifically included State Fund. Mr. Mulryan acknowledges that while he understands this is not easy for State Fund employees and can create financial hardship, State Fund will manage through this and continue to fulfill its mission to California employers and injured workers. Mr. Mulryan further noted that as an enterprise independent from the state's General Fund budget, State Fund's participation in the PLP 2012 program will be used to accelerate its existing plans to improve productivity and reduce expense. These savings will directly contribute to the success in keeping cost down for California employers.

Mr. Mulryan also reported on the financial status of State Fund. As the mid year financial results demonstrate, State Fund is making real progress in the expense reduction efforts and is poised to double net income over 2011 by year's end, which further strengthens its ability to handle any demands for services the future may bring in this highly cyclical market.

Lastly, Mr. Muryan provided an update on the geo strategy. State Fund is now entering the second phase of the geographic restructuring, which is scheduled to be finished by the end of 2012. The process has been painful for employees but necessary for State Fund to improve its effectiveness over time and reduce excess real estate. Mr. Mulryan noted that as State Fund comes to the end of restructuring initiatives, it faces very real challenges in building the future State Fund. There is still significant work to do improving business processes and technology platforms to make work more productive and services easier to access. Mr. Mulryan also noted State Fund has initiated a new program, Talent Retention Program (TRP), which is just beginning to take shape but is already playing a key role in filling gaps that were created by the restructure, redeploying staff into critical areas such as customer service and medical bill pay. The TRP will also provide training and experience for employees to take on new jobs. The TRP will form a vital part of how State Fund builds the agile workforce needed to fulfill its mission in the 21st Century.

AGENDA ITEM 10: BOARD MEMBER REPORTS

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

AGENDA ITEM 11: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 14-23

Mr. Mulryan requested public comment on the appropriateness of closed session for items 14-23, of which there was none.

AGENDA ITEM 12: 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 3:35 p.m. to immediately reconvene in Closed Session.

August 17, 2012

The Board of Directors of State Compensation Insurance Fund continued their Open Session on August 17, 2012 at 333 Bush Street, San Francisco, California.

AGENDA ITEM 24: CALL TO ORDER AND ROLL CALL

The meeting was called to order on August 17, 2012 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 E. Quinlan; and Scott K. Reid;

Absent: Steve L. Rank, Thomas E. Rankin, William M. Zachry and Christine Baker 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 25: APPOINTMENT OF CHIEF INFORMATION OFFICER

Mr. Mulryan reported that Shaun Coyne, Chief Information Officer has resigned from State Fund effective August 31, 2012. State Fund requires the services of a Chief Information Officer. The Board has reviewed Marjorie Hutchings' background and experience and requests a motion to adopt the appointment of Marjorie Hutchings as Chief Information Officer effective September 1, 2012. Mr. Mulryan requested Carol Newman to read the Resolution.

MOTION: Ms. Chalupa

SECOND: Mr. Curtin

RESOLUTION TO APPOINT THE CHIEF INFORMATION OFFICER

WHEREAS, Shaun J. Coyne resigned his position as Chief Information Officer of the State Compensation Insurance Fund ("State Fund"), effective August 31, 2012; and

WHEREAS, the State Fund requires the services of a Chief Information Officer;

WHEREAS, the President and Chief Executive Officer (President) has determined that Marjorie D. Hutchings has the qualifications to serve as the Chief Information Officer of State Fund;

WHEREAS, the Board of Directors ("Board") of the State Fund is authorized by California Insurance Code section 11785 to appoint and set the salary for State Fund's Chief Information Officer.

NOW, THEREFORE,

IT IS RESOLVED, that the Board appoints Marjorie D. Hutchings to serve as the Chief Information Officer of State Fund, effective September 1, 2012 or such other date as to be determined by the President of State Fund, at a base salary of \$315,000, a recruitment and retention differential of \$59,850 (19% of base salary) on an annual basis, and a potential discretionary annual incentive performance award of \$47,250 (15% of base salary), subject

to approval by the Board, and based on the Chief Information Officer's achievement of specifically defined metrics and performance goals; and

IT IS FURTHER RESOLVED, that the President of State Fund is hereby granted the authority to enter into an employment agreement with Marjorie D. Hutchings and any amendments that may be necessary from time to time except that any change in compensation must be presented to the Board of Directors for approval; and

IT IS FURTHER RESOLVED, that all actions taken by the President of State Fund as were necessary to appoint Marjorie D. Hutchings to serve as the Chief Information Officer are ratified.

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

YES: 7 NO: 0 Resolution carried

AGENDA ITEM 26: PROPOSALS AND SUGGESTIONS FOR NOVEMBER 15-16, 2012
AGENDA

Mr. Mulryan requested additional items for the November Board meeting. Ms. Newman noted further updates on Workers' Compensation Reform would be included in the agenda for the Strategic Board Meeting and possibly for the November Board meeting. Mr. Mulryan requested public comment, of which there was none.

Mr. Mulryan announced the Strategic Board Meeting was scheduled for October 4-5, 2012 at the Napa Marriott.

There being no further business, Mr. Mulryan adjourned the meeting at 11:10 a.m.

The next regularly scheduled Board meeting will begin on Thursday, November 15, 2012 at 333 Bush Street in San Francisco.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary