

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

May 22-23, 2014

The Board of Directors of the State Compensation Insurance Fund met on May 22-23, 2014 at the Sheraton Grand Hotel, 1230 J Street, Sacramento, CA 95814.

May 22, 2014

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order on May 22, 2014 at 2:05 p.m.

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

Absent by prior arrangement: Christine Baker (non-voting member) and William Zachry.

There was a quorum.

Also present: Interim President and CEO Carol R. Newman; Acting Chief Financial Officer and Chief Investment Officer Peter Guastamachio; Board Liaison and Interim Corporate Secretary Hilda B. Padua; and Randall Keen with Manatt, Phelps & Phillips, LLP.

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 February 20-21, 2014 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Renewal of Expiring 3rd Quarter Insurance Policies**
- 3d. Annual Review and Approval of State Fund By-Laws**
- 3e. Annual Review and Approval of Committee Charters**
- 3f. Annual Review and Approval of Board Delegated Authority and Approval Levels**
- 3g. Approval of Retirement Resolutions**

Ms. Chalupa asked whether any Board member had any comments on the items on the Consent Calendar. Mr. Rankin noted for staff to review the State Fund By-Laws for grammar and punctuation before publishing.

Mr. Reid requested discussion on item 3f and for staff to provide a regular report on consultant/vendors selection and Request for Proposal process.

MOTION: Mr. Reid

SECOND: Ms. Rankin

To approve the Consent Calendar as presented.

Ms. Chalupa requested public comment on the appropriateness of closed session for item 6, of which there was none.

AGENDA ITEM 4: STAFFING UPDATE

Senior Vice President of Human Resources and Chief Administrative Officer Andreas Acker presented an update on staffing. Mr. Acker reported that State Fund permanent staffing levels continue to decline with 4,282 permanent employees at the end of the 1st quarter. Retirements (26) and transfers to other agencies (23) accounted for over 80% of the separations. It is projected that at the end of the year, the separation rate will be between 6% - 7%, a decrease from 2013, where the separation rate was 8.1%.

In addition, Mr. Acker reported that State Fund had a recent meeting with Julie Lee from the Governor's office regarding leave of absence. Ms. Lee and the Governor's office are aware of State Fund's plan to reduce leave balances. In the 1Q 2014, there was a modest increase of the total hours and employees over the 640 hour cap. However, 1Q tends to be a low usage month and will decline over the next three quarters. The State has authorized leave cash out for supervisors and managers of up to 20 hours. The number of supervisors and manager and total hours cashed out won't be known until June and will be reported at the next Board meeting. This will assist in lowering hours, but the 20 hours will be insufficient to lower the number of employees over the cap.

Lastly, Mr. Acker noted that in the Board packet is the year end Age and Service report for State Fund. Mr. Acker reported that State Fund continues to slowly age with approximately 31% of its employees being age 55 or older, and 15% of its employees over the age of 55 with 20+ years of service. Employees with 20+ years of service are eligible for the full employer contribution towards post-retirement health care. The projection for retirements over the next several years will be at a rate of 150 to 250 per year.

AGENDA ITEM 5: FINANCIAL UPDATE – 1ST QUARTER 2014

Acting Chief Financial Officer and Chief Investment Officer Peter Guastamachio reported on the 1st quarter financial results for 2014. 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 38,000 policies, which were 6% more than budget and 7% more than the same period in the prior year. Estimated annual premiums were 3% more than budget and 32% more than same period in the prior year. The strong growth in premiums in 2014 is due to a continued hardening market. The loss and loss adjustment expenses (LAE) ratio of 116.6% was 15 points higher than budget and 19 points higher than the same period in the prior year. This reflects a strengthening of LAE reserves by \$50 million.

The combined ratio of 140.3% was 8 points higher than budget and 9 points higher than the same period in prior year. The net income of \$48 million was \$14 million less than budget. Policyholders' surplus grew by \$28.5 million since December 31, 2013. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 6: LEGISLATIVE UPDATE

Government Affairs Manager Rhonda Myers reported that there are three months left in the session and it has been a quiet year with regard to worker's compensation issues. Some bills listed in the initial legislative update have failed key deadlines to progress but a few are still awaiting approval.

- AB 1035 was authored by John A. Pérez and signed into law by Governor Brown on May 13, 2014. This bill extends the time period to commence proceedings to collect death benefits from 240 weeks to 420 weeks from the date of injury, not to exceed one year after the date of death for the presumptive injuries of cancer, tuberculosis, blood-borne infectious disease, or MRSA skin infections.
- AB 1574 authored by Assembly Member Pan, prohibits a state agency from entering into a contract with specified provisions, including a contract that guarantees payment for services not provided. A contractor can't penalize a state agency for losses of revenue as a result of natural or man-made emergencies, including acts of terrorism or acts of nature. This bill also prohibits an increase in contract fees or charges without approval by the agency.
- AB 1575 authored by Assembly Member Pan, requires a personal services contractor to provide a state agency with quarterly performance and expense reports, and sets criteria for contract termination. This bill also allows cancellation of the contract if the contractor fails to comply with performance criteria and if annual costs exceed those established by the contract.
- AB 1921 authored by Assembly member Holden, requires personal services contracts in excess of \$25,000 between a state agency and a contractor to provide the agency with the right to review and copy any records related to the performance of the personal services contract and to indicate that those records are subject to the California Public Records Act and may be disclosed. It also requires any California Public Records Act requests pertaining to a personal services contract, to be submitted directly to the state agency.

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

AGENDA ITEM 7: STATEMENT OF ACTUARIAL OPINION

Mr. Guy Avagliano of Milliman reported State Fund's gross carried reserves were \$12.2B and \$12.1B net. A Loss Portfolio Transfer reduced \$318M from the reserves leaving an overall net reserve of \$11.8B. 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. Mr. Mulryan requested public comment of which there was none.

AGENDA ITEM 8: INTERIM PRESIDENT'S REPORT

Interim President Carol Newman reported that there are modest signs the market is hardening. As recently reported by the WCIRB, some Workers' Comp carriers are clearly retrenching and giving up market share while others are writing significantly more Workers' Comp than the previous year. State Fund remains the largest Workers' Comp carrier in California. State Fund estimated annual premiums for the 1Q 2014 was 32% more than same period in the prior year. There was also an increase in policy count by 26%. State Fund has conducted a review of its capacity for growth and it can sustain even greater market share with the current staffing levels.

Ms. Newman reported that State Fund strengthened its rates in tier C and introduced a fourth tier, D. Thus far 1% of both new and renewal policies have been written into tier D representing 2% of overall premium. Safety and loss prevention are reaching out to these accounts to work with them to improve their safety performance.

Furthermore, at the request of Senator William Monning, Chair of the Senate Insurance Committee, Ms. Newman appeared before members of the Senate and Assembly Insurance Committees on March 26, 2014 at an informational hearing to testify on the potential impacts of a catastrophic earthquake during business hours. Following Ms. Newman testimony, Senator Monning thanked State Fund for participating and expressed his appreciation for the insight that State Fund provided, and for the steps State Fund is taking to prepare for such a catastrophic event.

As part of State Fund's national initiative, Ms. Newman represented California State Fund at a meeting in Washington, DC with some Congressional members regarding the importance of continuing the Terrorism Risk Insurance Act that is to sunset at the end of the year.

In addition, Ms. Newman provided the following operational highlights. Ms. Newman noted that the Board directed staff to conduct a thorough assessment of State Fund's group insurance program. The review process is underway and staff will provide a report at the September Strategy meeting. Ms. Newman reported that a lot of work has been done on strengthening the organization's project and process governance. The enterprise project list was narrowed down to 15 enterprise projects currently in flight and it was ensured these projects were aligned with State Fund strategic goals. Ms. Newman noted that the most important effort of focus is the employee engagement and "unleashing the power" of employees. Significant investments were made to frontline supervisors, managers and senior leaders to complete "High Performing Team" workshops to strengthen and align State Fund leadership into one team that will embrace and lead the organization.

AGENDA ITEM 9: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

9a: GOVERNANCE COMMITTEE

9ai: GOVERNANCE AND COMPLIANCE UPDATE

Mr. Muryan reported on the following:

Compliance

Mr. Mulryan reported that State Fund achieved 100% compliance with the annual filing of Form 700 for active Board members, designated employees and consultants. He also noted that the Leaving and Assuming Office statements were filed within the appropriate 10-day statutory period for the acting President and CEO as required by regulation.

Ethics and Privacy Reports

Mr. Muryan noted that the Privacy/Data Security and Human Resources matters continue to be the most prevalent category of reported concerns. Privacy related reports were 45% of 1Q 2014 report volume while Human Resources volume remained consistent, which includes suspected misconduct, theft of time, discrimination, and conflict of interest.

2014 Code of Conduct

Mr. Muryan reported that the 2014 Code of Conduct training and certification was launched on April 16, 2014 and scheduled to be completed by June 1, 2014. The specific focus this year is what constitutes a breach in Privacy Information and/or Cyber Security. Participants learn to identify these situations and how to deal with and report possible misconduct.

9b: AUDIT COMMITTEE

9bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits - There were two completed closed audits, the Public Records Office (PRO) and Customer Service Center (CSC). The Public Records Office has an adequate internal control framework in place with no findings requiring action plans. The Customer Service Center audit resulted in twelve findings which relate to vendor contracts, accuracy of reports, performance management and management oversight. All the findings were correctible and there were no major findings in any of the two audits and no significant risks to State Fund.

Whistleblower Hotline – All reports made through the Ethics Hotline are investigated.

During the 1st quarter of 2014, there were 52 reports from all sources (Ethics Hotline - 20; Management referral – 9; Privacy Office – 23). There were 37 substantiated violations of the Code of Conduct with employees transmitting their own personal identifying information (PII) to a non-State Fund email account. None of the 37 substantiated allegations were material to State Fund's financial statements.

Privacy related issues are relatively new to State Fund. State Fund continues to educate its employees on the importance of protecting PII as well as State Fund's proprietary information.

9c: INVESTMENT COMMITTEE

9ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

Investment Chair Senator Machado (Ret.) noted the Committee heard a report from Deutsche Asset Management on the Market Outlook and Economic Update, providing a broad macroeconomic update on financial markets, monetary policy, housing, and employment. There will be continued gradual growth through 2014 and into 2015.

The investment transactions and compliance reports for the period of January 1, 2014 to March 31, 2014 were approved by the Investment Committee pursuant to its delegated authority, which includes the purchase of 62 bonds totaling \$623.5 million and sale of 4 bonds for \$28.3 million. In the equity portfolio \$118.5 million were purchased and \$140.6 million were sold for rebalancing. The total net gain from the entire portfolio was \$17.0 million as of March 31, 2014. The aggregate book value of all the investments was \$18.6 billion. There were two bonds no longer in compliance with State Fund's Investment Policy.

AGENDA ITEM 10: CHAIRMAN'S REPORT

Ms. Chalupa reported on the following activities:

Next Generation Initial Launch

Ms. Chalupa congratulated the staff on a very successful technology launch last month. State Fund launched the first phase of the Next Generation Policy and Billing Systems initiative. This particular launch was an important step in making it easier to do business with State Fund. The deployment included a redesigned www.statefundca.com that provides easier navigation and improved accessibility on smart phones and tablets; a Customer Portal that makes it easier for policyholders to manage their policies online and will replace State Fund Online by the end of 2015; and PriceNow Direct—a new submission engine for employers who are not represented by a broker. The deployments were expertly executed and experienced very few calls in the Customer Service Center following the launch. The roll out was well supported with a comprehensive communication and training plan.

Business Review Meetings

Ms. Chalupa shared her experience at the first quarter Business Review Meetings that occurred early in April. Ms. Chalupa noted it was a great opportunity for her to meet the leaders and staff who are responsible for managing State Fund's operations and to engage in a dialogue that was focused on the analysis of business results and performance metrics.

CWCI 50th Annual Meeting of Members

Ms. Chalupa reported that on March 20, 2014 several Board members and staff attended the 50th Annual Meeting of the California Workers' Compensation Institute. The agenda covered a number of interesting topics which include update on the California workers' compensation ecosystem; discussion on the future of the Labor/Management alliance; and presentation on how demographics and health care can reshape workers' compensation. Board member Larry Mulryan gave a terrific address on the Evolution of the CWCI over its 50 year history. The meeting was very informative and thought provoking.

Ms. Chalupa also announced that the CEO Search is still in an active process and the Board is working with Spencer Stuart. The Board is focused on finding and sustaining a long term vision and leadership. An announcement will be made at a future Board meeting.

AGENDA ITEM 11: BOARD MEMBER REPORTS

Ms. Chalupa requested any Board Member reports of which there were none.

AGENDA ITEM 12: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 15-26.

Ms. Chalupa requested public comment on the appropriateness of closed session for items 15-26, of which there was none.

AGENDA ITEM 13: PUBLIC COMMENT

Ms. Chalupa requested further public comment.

SEIU Vice President for Bargaining Margarita Maldonado expressed the on-going concerns about outsourcing and State Fund's IT Apprenticeship Program. Ms. Maldonado opined that

use of consultants overrides a desire to recruit the talent within the state of California needed to support State Fund's IT infrastructure. Ms. Maldonado questioned the steps for the IT apprenticeship program and the development of other IT employees. Ms. Maldonado also expressed concerns of the frontline staff in the billing and policy departments. She wanted to ensure that the processes are executed in the way that they should. The joint labor management process has helped in bringing issues forward and it is an ongoing relationship that SEIU Local 1000 would like to maintain. Lastly, Ms. Maldonado requested that adjustments be made to the location of classes in proximity to employees' residence.

Board member Steve Rank requested for reports of the apprenticeship program and how it has affected employees on the ground level. He inquired about further details in how the knowledge and skills acquired from the apprenticeship program has affected the technologies in State Fund.

Workers' Compensation Insurance Technician Susette M. Jumper from the Fresno Claims Processing Center spoke about issues that she has experienced working in the front line. Ms. Jumper reports duplicate work due to billing received by the Claims Processing Center (CPC), Customer Service Center (CSC) and Claims Adjusters. Providers and vendors are calling the CSC with billing questions, re-sending bills multiple times which gets routed to the CPC and to the claims adjuster. There is no filter to sort out the bills that have been denied or partially paid and as a result the same bills get reviewed multiple times by different individuals.

Workers' Compensation Insurance Technician Noreen Nelson from the Redding Customer Service Center (CSC) spoke about issues that she has experienced working at the call center. The CSC uses the Avaya phone system, which tracks calls and assigns calls to CSC agents. Ms. Nelson reported that there were instances where she was on a call with a policyholder and another call was sent through to her. She was unable to pick up the other call which becomes a rollover call and counted against her. Ms. Nelson also shared her concern regarding the functionality of State Fund Online (SFO). Ms. Nelson reported that she has been logged out of the system during calls while assisting customers. She has had to take down the name and phone number of the policyholder to return their call due to the system stall. It is Ms. Nelson's desire that there will be a collaborative effort in coming up with a solution for this issue.

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 3:00 p.m. to immediately reconvene in Closed Session.

May 23, 2014

AGENDA ITEM 27: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:25 a.m. following the conclusion of the Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Robin Baker; Daniel M. Curtin (joined at item 28); Marvin Kropke; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Jack Neureuter; Steven L. Rank; Thomas E. Rankin (joined at item 28); and Scott Reid.

Absent by prior arrangement: Christine Baker (non-voting member) and William Zachry.

There was a quorum.

Also present: Interim President and CEO Carol R. Newman; Acting Chief Financial Officer and Chief Investment Officer Peter Guastamachio; Board Liaison and Interim Corporate Secretary Hilda B. Padua; and Randall Keen with Manatt, Phelps & Phillips, LLP.

There was a quorum.

AGENDA ITEM 28: PROPOSALS AND SUGGESTIONS FOR SEPTEMBER 24, 2014
AGENDA

Ms. Chalupa requested additional items for the September 24, 2014 Board meeting of which there were none.

Ms. Chalupa requested public comment, of which there was none, and she noted that the next Board meeting is scheduled for September 24, 2014 at the Hyatt Regency Hotel, Monterey, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting.

Respectfully submitted,

Hilda Padua
Board Liaison and Interim Corporate Secretary