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Date: May 2, 2011

**AGENDA ITEM 4a**

**TO: MEMBERS, BOARD OF DIRECTORS**

- I. SUBJECT:** Approval of March 16-18, 2011 Open Meeting Minutes
- II. PROGRAM:** Legal Department
- III. RECOMMENDATION:** Action: To approve.

Attached March 16 - 18, 2011 Open Meeting Minutes of the Board of Directors is presented for consideration and approval at the Board meeting of May 12, 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**

**March 16, 2011**

The Board of Directors of the State Compensation Insurance Fund met on March 16, 2011 at 1010 Vaquero Circle, Cabernet/Chardonnay Rooms, Building A, First Floor, Vacaville, California.

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

The meeting was called to order on March 16, 2011 at 2:10 p.m. and the following were present: Lawrence E. Mulryan, Chair; Francis E. Quinlan; Thomas E. Rankin; and William M. Zachry.

There was not a quorum present. The meeting was adjourned and the Board members present toured the Vacaville facilities.

**March 17, 2011**

The Board of Directors of the State Compensation Insurance Fund met on March 17, 2011 at the Milton Marks Conference Center, State Building, 455 Golden Gate Avenue, San Francisco, California.

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

The meeting was called to order on March 17, 2011 at 2:15 p.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Daniel M. Curtin; non-voting member John C. Duncan; Donald E. Garcia joining at Item 3; Sen. Michael J. Machado (Ret.) joining at Item 3; Francis E. Quinlan joining at Item 3; Steven L. Rank; Thomas E. Rankin joining at Item 3; Scott K. Reid; and William M. Zachry.

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 Sapper.

Mr. Mulryan announced the resignation of Board Member James Richardson and read Resolution No. 978 honoring Mr. Richardson for his service to the Board since November 2009. He recommended the ratification of James Richardson's resignation. He called for Board discussion of which there was none.

MOTION: Mr. Curtin

Second: Mr. Rank

To adopt Resolution No. 978 honoring James Richardson 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: 6

NO: 0

Motion carried.

## **AGENDA ITEM 2: 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 3: CONSENT CALENDAR**

Mr. Mulryan referred to the Consent Calendar matters, which are included with each member's agenda. He read Retirement Resolution No. 968 in appreciation of Suzanne Ah-Tye retiring as Chief Counsel and Assistant Corporate Secretary and thanked her for serving State Fund with distinction for more than 28 years.

Mr. Mulryan requested whether any Board member had any additional comments on the items on the Consent Calendar of which there were none.

MOTION: Mr. Zachry

Second: Sen. Machado

To approve the Resolution of Appreciation for retiring Chief Counsel and Assistant Corporate Secretary Suzanne Ah-Tye.

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

YES: 10

NO: 0

Motion carried.

MOTION: Mr. Zachry

Second: Ms. Chalupa

To approve the January 20-21, 2011 Open Meeting Minutes as presented.

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

YES: 10

NO: 0

Motion carried.

MOTION: Mr. Quinlan

Second: Ms. Chalupa

To approve the remainder of the Consent Calendar as presented.

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

YES: 10

NO: 0

Motion carried.

#### **AGENDA ITEM 4: FINANCIAL UPDATE – 2010 YEAR END RESULTS**

Chief Financial Officer Dan Sevilla reported on State Fund's unaudited statutory financial results for 2010. The financial results were significantly impacted by economic conditions, including unemployment and market pricing. Approximately 161,000 policies were written, which was 4% less than budget and 11% less than the prior year. Net premiums earned of \$1.136B slightly exceeded the forecast of \$1.1B and were 11% less than budget and 9% less than the prior year. The incurred losses of \$850M were 11% less than budget and 10% less than the prior year. The loss ratio of 75% was on budget and consistent with 2009. Loss adjustment expenses and underwriting expenses totaled \$930M and were 12% less than budget and 10% less than the prior year. Other expenses of \$80M represented charge-offs of uncollectible premiums, including \$33M related to fraud and were \$32M more than budget and \$33M more than the prior year. The expense ratio of 90% was 4 points higher than 2009. Mr. Sevilla noted beginning with 2011 results State Fund will follow industry standards and exclude other expenses from the calculation of the expense ratio. There was an underwriting loss of \$645M, which was 12% lower than budget and 11% lower than the prior year. The combined ratio was 165%, while the industry standard approach of excluding other expenses from the calculation of the combined ratio was 157%. Net investment income of \$861M was 3% more than budget and 5% less than the prior year resulting in net income of \$171M which was \$28M more than the prior year. There was Board discussion regarding expenses, income, and the move toward the industry standard approach. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 5: OVERVIEW OF THE SELECTION CRITERIA AND MANAGEMENT OF INVESTMENTS**

Chief Investment Officer Peter Guastamachio provided an overview of the selection criteria and management of investments to maintain the status and quality of State Fund's investment portfolio according to the Investment Charter and Investment Policy. State Fund has two investment managers, Conning Asset Management and New England Asset Management. The Investment Charter was developed by the Investment Committee, which oversees and approves all transactions, develops selection criteria with the Chief Investment Officer, selects investment managers, and evaluates the investment managers' performance, fees, and service. The Committee also developed the Investment Policy/Guidelines, the purpose of which is to preserve State Fund's principal and

surplus, as well as maximize income. The Chief Investment Officer reviews every trade for compliance with State Fund's Investment Policy. The Treasury & Investments Department monitors cash flow and investment income, meets weekly with the investment managers, strategizes about the portfolio, discusses accounting issues, and reconciles every trade in its and the investment managers' books. The investment managers purchase bonds per the Investment Policy, monitor the portfolio to keep in compliance with the Investment Policy, and prepare Board reports. Mr. Mulryan requested public comment of which there was none.

## **AGENDA ITEM 6: CALIFORNIA & PROPERTY CASUALTY INSURANCE OUTLOOK**

Chief Investment Officer Peter Guastamachio introduced Conning Asset Management CIO Rich Sega and Head of Municipal Research Paul Mansour, who presented the U.S. and California economic and property casualty insurance outlook. Mr. Sega reported on the national economy and the effect of recent international events. He predicted fears over nuclear fallout from Japan will lead to increased U.S. Treasury rates. The insured losses in Japan are estimated to be between \$15B-\$35B. The actual losses beyond insured losses are estimated at \$350B, excluding water damage. There is also concern about oil supply in the Middle East. Electric utilities will likely face higher cost, whereas regulated utilities will have less of a problem. The unemployment rate is elevated and residential real estate appears to have bottomed following government stimulus. Without employment recovery, however, it is unlikely that the housing market will recover. There is a concern that a soft monetary policy will result in higher inflation in the coming years as well as higher interest rates.

Mr. Mansour discussed the current and prospective state of the California economy. California has large budget gaps approximating \$25B. The unemployment rate, which is currently very high at over 12%, is expected to remain high in the coming years, negatively affecting the housing market. Home sales and prices will significantly affect munis. The state of unemployment and housing mean lower revenue growth for California; the revenue forecast for 2011 is anticipated to be below what it was in 2006. California's Gross Domestic Product growth is forecasted to be below 4%, which is less than the rest of the country as a whole. There was Board discussion regarding the potential effect unfunded pension liability may have on state rating levels.

Mr. Sega also provided an update regarding workers' compensation. Workers' compensation loss and combined ratios are expected to climb in 2011 and will be significant in California because of high unemployment, erosion of the 2004 reforms and uncertainty over pending legislation. GAAP return-on-equity is expected to remain in the 4% to 5% range over the next few years. Mr. Sega emphasized that circumstances will continue to get more difficult.

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

**AGENDA ITEM 7a: 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 December 1, 2010 to January 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 December and January, State Fund purchased 92 bonds totaling \$838.6M. During this same time period, State Fund sold 5 bonds totaling \$141.2M. Year-to-date through January 31, 2011, State Fund has recognized a net gain of approximately \$184,000. The book value of State Fund's portfolio as of January 31, 2011 was approximately \$18.9B.

MOTION: Sen. Machado

Second: Mr. Curtin

To ratify the investment transactions from December 1, 2010 to January 31, 2011.

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

YES: 10

NO: 0

Motion carried.

**AGENDA ITEM 7b: 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 January 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 the State of Oregon bonds overall are rated "Aa2/AA". At the end of January 2011, the total value of the securities listed on the Compliance Report is approximately \$37.8M, which represents less than .2% of State Fund's total investments.

MOTION: Mr. Rankin

Second: Ms. Chalupa

To ratify the Compliance Report for the period December 1, 2010 to January 31, 2011.

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

YES: 10

NO: 0

Motion carried.

## **AGENDA ITEM 8: 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, 2010, there were 7,382 employees at State Fund, and at the end of 2010 there were 7,096. In 2010, there were 374 separations resulting in a 4.9% turnover rate, which was higher than projected at the beginning of the year. The increase was driven by a higher number of retirements, which was not out of line with the rest of California. Mr. Mulryan requested public comment of which there was none.

## **AGENDA ITEM 9: PRESIDENT'S REPORT**

President and CEO Thomas E. Rowe reported on the workers' compensation market. There is a general deterioration in workers' compensation nationally. While California is a market that tends to accelerate deterioration, there was nevertheless a continuation of competition in the workers' compensation market throughout 2010. State Fund's competitors can be split into three categories: (1) workers' compensation dedicated specialists who have been in California for at least 20 years and for whom California is their largest market; (2) large national multi-line insurers; and (3) smaller, newer workers' compensation specialists who entered the market within the last 10 years. State Fund's competitors aggressively took market share away in 2010, but in January 2011 this began changing and State Fund lost very little business particularly with the first two categories of competitors and at price differentials that are rapidly narrowing. Overwhelmingly, the business lost has been to smaller newer insurers and at price differentials that exceed State Fund's filed ability to compete. State Fund is focused on maintaining a fair price that is sufficient to cover operating costs. There was Board discussion about competitors leaving California, expenses removed from the loss ratio in the coming year, and premium write-offs. Mr. Mulryan requested public comment of which there was none.

## **AGENDA ITEM 10: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES**

### **AGENDA ITEM 10a: GOVERNANCE COMMITTEE**

#### **i. Governance Charter**

Mr. Mulryan reported that the Governance Committee reviewed the Governance Charter and amended it to expand the number of committee members from 3 to 5; provide more particularity on the Committee meetings, duties and powers; included a statement regarding unrestricted access to management and outlined the role of the Committee in overseeing governance reviews, assessments and examinations, as well as Board policies. Mr. Mulryan requested public comment of which there was none.

**ii: Approval Of Code Of Conduct, Business Ethics And Incompatible Activities Policies**

Mr. Mulryan asked Governance & PRO Manager Barbara Simmons for an overview of the Code of Conduct, Business Ethics and Incompatible Activities policies. Ms. Simmons provided an update about the Code of Conduct. Under the Governance Committee's oversight the Code of Conduct and policies were posted for the 30 day comment period and 40 responses were received and addressed. The Code of Conduct was revised to state that it applies to the members of the Board of Directors, officers, management, and rank and file employees; and to emphasize bad faith accusations against coworkers will not be tolerated. It also was revised as to functions involving alcohol and clarified personal responsibility for conduct at events; added violations are subject to disciplinary action up to and including termination; added a statement regarding conflicts of interest; added a gambling prohibition; and added the Department of Insurance as a contact and resource under the section concerning state agencies. The Incompatible Activities Policy appeals process was changed to coordinate with applicable collective bargaining agreements.

MOTION: Mr. Curtin

Second: Mr. Zachry

To approve State Fund's Code of Conduct, Business Ethics and Incompatible Activities policies.

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

YES: 10

NO: 0

Motion carried.

**AGENDA ITEM 10b: AUDIT COMMITTEE**

**i: Completed Closed Audits**

Mr. Quinlan welcomed and issued a standing invitation to Chief Risk Officer Ken Van Laar to the Audit Committee meetings. He reported that the Audit Committee approved the delegated authority to the Audit Chair to hire external auditor KPMG to perform external audits of contracting parties as needed and report back for ratification at the next meeting. The Audit Committee obtained a clean report from KPMG on its system of controls. The Closed Audit Reports involved accounts payable; and the procurement function. Greater attention is required to excel in performing audits.

**ii: Audit Charter**

Mr. Quinlan reported that approval of the revised Audit Charter was deferred to the May 2011 meeting for further revisions based on other models. The Committee approved the Internal Audit Activities Charter outlining Internal Audit Department purpose, responsibilities, standards, independence, and



accountability. The Committee received a briefing by Chief Financial Officer Dan Sevilla on Model Audit Rule (MAR) status which was implemented and working well. State Fund is trying to prevent losses through inattention or lapses in control. The Committee was also briefed by the Special Investigations Unit on anti-fraud and efforts to strengthen the program. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 10c: INVESTMENT COMMITTEE**

Sen. Machado reported that the Investment Committee reviewed State Fund's portfolio for year end 2010 and through January 31, 2011. State Fund continues to exceed standards on the quality of the portfolio and returns exceed benchmarks. The Committee received a presentation from Standard and Poor's and Conning Asset Management. Because of legislation enacted last year that allowed State Fund to invest in corporate bonds, investment returns exceeded budget. Because of recent events in Japan, the Committee will review State Fund's holdings with nuclear-related exposure and will have a report at the May 2011 meeting. There was Board discussion about Japan's nuclear crisis and issues in the Middle East. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 11: REPORT BY CHAIR OF BOARD ACTIVITIES**

Mr. Mulryan reported that State Fund has laid out an ambitious strategic plan which includes consolidating its real estate foot print. This strategic plan is necessary for State Fund to operate efficiently and be in conformity with its Charter. Mr. Mulryan requested public comment of which there was none.

#### **AGENDA ITEM 12: BOARD MEMBER REPORTS**

Mr. Zachry reported that he toured State Fund's Vacaville facility and saw areas of control weaknesses. There was Board discussion regarding the foresight of the facility's construction and safety features.

Mr. Quinlan reported that he attended a briefing at State Fund's Santa Ana office by Southern California District Attorneys regarding anti-fraud. There appears to be good cooperation between State Fund employees and the District Attorneys with a training session on Prosecuting Premium Fraud. He recommended future opportunity for similar briefings.

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

#### **AGENDA ITEM 13: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 16 THROUGH 22**

Mr. Mulryan requested public comment. Mr. Randal Cheek, Legislative Advocate of SEIU Local 1000, made public comment on the appropriateness of holding a closed session for Item 18c: Personnel Matters – Strategic Plan: Employee Utilization and Workload. He expressed employees' concern about what is

happening and the desire to know more about it. Mr. Rowe and Mr. Mulryan reported State Fund is actively in dialogue with SEIU but the closed session discussion concerns State Fund strategy and not the mechanics of implementing the strategic plan.

#### **AGENDA ITEM 14: PUBLIC COMMENT**

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

#### **ADJOURNMENT**

There being no further business, Chair Mulryan adjourned the meeting at 3:45 p.m.

#### **March 18, 2011**

The Board of Directors of State Compensation Insurance Fund continued their Open Session on March 18, 2011 at the Omni Hotel, 500 California Street, San Francisco, California.

#### **AGENDA ITEM 23: CALL TO ORDER AND ROLL CALL**

The meeting was called to order on March 18, 2011 at 11:30 a.m. and the following were present: Lawrence E. Mulryan, Chair; Sheryl A. Chalupa; Daniel M. Curtin; Sen. Michael J. Machado (Ret.); Francis E. Quinlan; Steven L. Rank; Scott K. Reid; William M. Zachry; and non voting member John C. Duncan. Absent: Donald E. Garcia; and Thomas E. Rankin.

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 24: BOARD COMMITTEE ASSIGNMENTS**

Mr. Mulryan presented changes to the Board Committee assignments based on Board members' experience and preference. In addition to the current Governance Committee members Sen. Machado and Mr. Rankin have been added. Mr. Reid has been added to the Investment Committee. Ms. Chalupa has been asked to serve as an Alternate to the Audit Committee in view of Mr. Richardson's resignation. The Board members have agreed to serve on the Committees to which they have been appointed.

MOTION: Mr. Zachry

Second: Ms. Chalupa

To approve the appointments to the State Compensation Insurance Fund Board Committees as presented for the period of March 18, 2011 through the March 2012 Board meetings unless there is a resignation by a Committee member or removal by the Board Chair; in such an event the Board Chair will make a new appointment to be ratified at the next Board meeting.

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

YES: 8

NO: 0

Motion carried.

**AGENDA ITEM 25: PRESIDENT AND EXEMPT EXECUTIVES EMPLOYMENT TERMS, CONDITIONS AND COMPENSATION:**

Mr. Mulryan reported that the compensation packages for exempt Executive Committee members contain both fixed and variable components designed to produce high performance. To further the goal of attracting experienced executive-level talent the Board has carefully benchmarked State Fund's executive compensation to be relevant to the market place without being excessive. The Board has evaluated the performance of the exempt executives for 2010 to determine appropriate bonuses and reviewed both the overall performance of State Fund and the value of each exempt executive's contribution. Collectively, the maximum bonus potential of executive salary in 2010 was 19% and 13% was awarded overall. The Board also reviewed 2011 increases to base salary for certain exempt executives and reductions to the Recruitment & Retention differentials. A handout was available with the details on the 2010 bonuses and 2011 increases to compensation for exempt employees.

Resolution No. 979

MOTION: Mr. Zachry

Second: Sen. Machado

WHEREAS, The Board of Directors ("Board") of State Compensation Insurance Fund ("State Fund") is authorized by California Insurance Code section 11785 to set the salary for State Fund's president ("President"), chief financial officer, chief operating officer, chief information technology officer, chief investment officer, chief risk officer and general counsel ("Exempt Positions"); and

WHEREAS, the annual compensation package for the Exempt Positions includes an annual base salary, Recruitment & Retention ("R&R") differentials and bonus potential; and

WHEREAS, the bonus potential is based upon an annual performance evaluation conducted by the Board for each Exempt Position; and

WHEREAS, the Board has completed its performance evaluations for each of the Exempt Positions for calendar year 2010; and

WHEREAS, the Board now seeks to approve the recommended bonus for each of the Exempt Positions; and

WHEREAS, the Board seeks to increase the base salary and reduce the R&R differentials for the Chief Information Technology Officer, Chief Investment Officer and General Counsel.

NOW, THEREFORE,

It is RESOLVED, that the Board hereby adopts and approves the recommended bonuses, increases in base salaries, and reductions in R&R differentials identified in the attached Exempt Position Recommended Bonus and Compensation Schedule.

Position	2010 Annual Base Salary	Recommended 2011 Base Salary	Recommended Annual R&R	Recommended Bonus for 2010
Chief Executive Officer/President (Thomas Rowe)	\$450,000	No change	No change	\$56,250
Chief Information Officer (Shaun Coyne)	\$300,000	\$315,000	\$59,850 (reduced from \$75,000)	\$36,000
General Counsel (Carol Newman)	\$285,000	\$306,000	\$15,300 (reduced from \$21,375)	\$42,750
Chief Investment Officer (Peter Guastamachio)	\$225,000	\$240,000	\$12,000 (reduced from \$16,875)	\$33,750

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

YES: 7      NO: 0      Abstain: 1 (Mr. Reid)      Motion carried.

Mr. Mulryan reported the Governance Committee recommended two additional proposals relating to employee compensation incentive programs to compensate and invest in State Fund's present and future leaders who are leading organizational change and performance accountability to improve State Fund's business practices. The first proposal is for the development of a performance-based retention tool for the exempt executives to protect against future recruitment. The second proposal was to investigate expanding the bonus pool to include CEA and Program Manager positions. Mr. Mulryan requested Board discussion of these proposals of which there was none.

MOTION: Sen. Machado

Second: Mr. Quinlan

To authorize the President and Chief Executive Officer of State Fund to take all actions necessary to develop a performance based retention tool for the exempt executive positions, consistent with his recommendations, 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: 8

NO: 0

Motion carried.

MOTION: Mr. Curtin

Second: Mr. Zachry

To authorize the President and Chief Executive Officer to take all actions necessary to develop a written plan to expand the bonus pool to include CEA positions and Program Manager positions, consistent with his recommendations, 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: 8

NO: 0

Motion carried.

**AGENDA ITEM 26: PROPOSALS AND SUGGESTIONS FOR MAY, 2011**  
**AGENDA:**

The Board suggested inviting the Orange County District Attorney to speak on anti-fraud; and to receive a briefing on legislative matters. Mr. Mulryan requested public comment of which there was none.

There being no further business, Chair Mulryan adjourned the meeting at 11:40 a.m. The next regularly scheduled Board meeting will begin on Thursday, May 12, 2011 in San Francisco.

Respectfully submitted,

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Judith D. Sapper,  
Assistant Corporate Secretary