

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

February 14 and 15, 2019

The Board of Directors of the State Compensation Insurance Fund met on February 14-15, 2019 at the State Fund Pleasanton Office, 5890 Owens Drive (Atlantic and Pacific conference rooms), Pleasanton, California.

February 14, 2019

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order on February 14, 2019 at 1:00 p.m.

Board Chair David Lanier welcomed the new board members, Sen. Thomas Berryhill (Ret.), Arthur Pulaski, and Angela Tate and noted their appointment terms. Sen. Berryhill was appointed on January 4, 2019 by Governor Edmund Brown, Jr. for a term expiring on January 15, 2022. The oath was administered on January 7, 2019 and submitted to State Fund on January 23, 2019.

Mr. Pulaski was appointed on January 4, 2019 by Governor Edmund Brown Jr. for a term expiring on January 15, 2019. The oath was administered on January 5, 2019 and was submitted to State Fund on January 7, 2019. Mr. Pulaski then was reappointed by Governor Gavin Newsom on February 6, 2019 for a term through January 15, 2024. The oath was administered and submitted to State Fund on February 13, 2019.

Ms. Tate was appointed on January 4, 2019 by Governor Edmund Brown Jr. for a term expiring on January 15, 2019. The oath was administered on January 14, 2019 and submitted to State Fund on the same day. Ms. Tate was then reappointed by Governor Gavin Newsom on February 6, 2019 for a term through January 15, 2024. The oath was administered on February 8, 2019 and submitted to State Fund on February 14, 2019.

Mr. Lanier also congratulated Mr. Curtin and Mr. Kropke on their reappointments. On January 4, 2019 Governor Edmund Brown Jr. reappointed Mr. Curtin for a term through January 15, 2022 and Mr. Kropke for a term through January 15, 2020. The oath for Mr. Curtin was administered on January 4, 2019 and submitted to State Fund on January 10, 2019 and the oath for Mr. Kropke was administered on January 7, 2019 and submitted to State Fund Executive Office on January 9, 2019.

Lastly, Mr. Lanier also recognized outgoing Board members Sheryl Chalupa, Scott Reid, Lawrence Mulryan, and Steve Rank for their contributions to the Board in advancing the best interests of California employers and the people and programs of State Fund.

Mr. Lanier requested Ms. Padua to call roll. The following were present: David M. Lanier (Chair); Robin L. Baker; Sen. Thomas C. Berryhill (Ret.); Daniel M. Curtin; Marvin P. Kropke; Sen. Michael J. Machado (Ret.); Jack L. Neureuter; Arthur H. Pulaski; Thomas E. Rankin; Angela Tate; and William M. Zachry.

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

AGENDA ITEM 2: ANTITRUST ADMONITION

Mr. Lanier 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 November 15 and 16, 2018 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Approval of Retirement Resolutions**
- 3d. Recognition of Outgoing Board Members**
- 3e. Approval of Investment Policy Statement and Guidelines**
- 3f. Review and Approval of Board Committee Assignments for 2019**

Mr. Lanier asked whether any Board member had any other comments on the items on the Consent Calendar of which there were none. Mr. Lanier called for a Motion.

MOTION: Mr. Zachry SECOND: Mr. Kropke

To approve the Consent Calendar as presented.

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

YES: 11 NO: 0 Abstain: 0 Motion carried.

AGENDA ITEM 4: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 7 THROUGH 17

Mr. Lanier requested public comment on the appropriateness of Closed Session for agenda items 7 through 17, of which there was none.

AGENDA ITEM 5: PUBLIC COMMENT

Mr. Lanier requested public comment, of which there was none.

ADJOURNMENT

There being no further business, Mr. Lanier adjourned the meeting at 1:05 p.m. to immediately reconvene in Closed Session.

February 15, 2019

AGENDA ITEM 18: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:50 a.m. at the State Fund Pleasanton Office (Atlantic and Pacific conference rooms), Pleasanton, California and the following Members were present: David M. Lanier (Chair); Robin L. Baker; Sen. Thomas Berryhill (Ret.); Daniel M. Curtin (joined during item 21b); Marvin P. Kropke (joined during item 19); Sen. Michael J. Machado (Ret.); Jack L. Neureuter; Arthur H. Pulaski; Thomas E. Rankin; Angela Tate; and William M. Zachry.

There was a quorum.

Also present: President and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; Chief Financial Officer Peter Guastamachio; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

AGENDA ITEM 19: STAFFING UPDATE

Executive Vice President and Chief Administrative Officer Andreas Acker presented an update on staffing. Mr. Acker reported that State Fund ended 4Q 2019 with 4,248 employees, 368 separations, 321 new hires, and 524 promotions. Of the 368 separations, 239 or 64.9% were due to retirements, 63 were resignations, 41 were transfers to other agencies, and 25 were others (death or dismissals). The overall separation rate was 8.6% and the primary driver was retirements.

Mr. Acker noted that included in the Board materials was a report on age and state service as of December 31, 2018. The report showed that 660 Employees (15.5%) were over 55 and have 20 or more years of service and 1,269 employees (29.8%) were over 55 and have 10 or more years of service.

Mr. Acker reported as of December 31, 2018 there was a decrease of 23.4% in the number of hours over the 640 hour cap and a 6.9% decrease in the number of employees over the cap. Mr. Acker noted there was great progress in reducing the leave hours over the 640 cap. State Fund required employees over the cap to have a plan to reduce their leave hours. This is a liability which is important to State Fund to monitor and maintain.

Discussion ensued on the vacancy rate and timeline to fill vacancies.

Mr. Kropke left the meeting.

Mr. Lanier requested public comment, of which there was none.

AGENDA ITEM 20: FINANCIAL AND PRESIDENT'S REPORT

President and CEO Vernon Steiner provided the following updates:

Premiums

The Estimated Annual Premium (EAP) of \$1.138B was 5.9% lower than last year. State Fund continued to see a decline in new business and renewal business. The EAP in new business was \$216M for 2018, down slightly from \$227M in 2017, and the EAP on renewal business was \$921M, down from \$981M last year, which is attributed to a filed rate decrease of 8% in September 2017.

As for the net premiums earned, it was up slightly at \$1.33B versus \$1.31B last year. The main reason the net premiums earned were performing better than EAP was due to audited premium of \$193M this year versus \$146M last year.

At the end of 2018, State Fund wrote about 116,820 policies, which was 5.4% lower than the prior year.

Losses and Loss Adjustment Expense (LAE)

State Fund had \$961M in Losses and an LAE of \$364M in 2018 versus \$521M and \$1,014M in 2017. In 2017, State Fund reallocated \$448M from Loss Reserves to LAE and further strengthened LAE by \$271M. The 2018 year-end Loss and LAE ratios were 72% and 27.3% and overall combined Loss and Loss Adjustment Expense Ratio of 99.3% was 17.9 points lower than the prior year.

The underwriting expense ratio of 35.4% was 3.2 points higher than the same period last year. The Underwriting expenses were up by \$36M from last year primarily from increases in salary and benefits. Commissions were also up slightly.

The combined ratio for 2018 ended at 134.7%, and underwriting loss was \$460M. The combined ratio and underwriting loss for the same period last year was 149.4% and \$658M, which reflected the strengthening of LAE. Offsetting the underwriting loss, net investment income was \$622M plus realized gains of \$72M. Overall State Fund ended the year with net income of \$187M, which was \$146M higher than in 2017. The policyholders' surplus grew by \$60M since year-end 2017.

Operational Update

Mr. Steiner highlighted the following 2018 operational achievements:

Claims

Mr. Steiner noted that the State Fund Claims department has been moving through a significant transformation that started with a restructure of how they are organized to manage cases. Today their focus is on specialization and the results have been impressive. In addition to improved case handling and customer service, the Claims team was able to reduce the inventory of open cases by 14% in 2018, which represented a 7,000-case reduction. Mr. Steiner congratulated the Claims team for the outstanding result.

Also, Mr. Steiner reported that last year Claims launched Claims Tours in key locations across the state and began inviting brokers and employers to visit and learn about how the Specialization Model works and the benefits it's delivering to employers and injured workers. Claims continue to do these tours and find them a very effective way of bringing brokers up to speed on how State Fund claims handling works today.

Premium Audit

In policy operations, Mr. Steiner reported that the Premium Audit team did a great job reducing the backlog of delayed audits that was created by changes to the law that governs how an employer qualifies for exclusion on their policy. In 2018, Premium Audit completed 50,589 audits, which was a 14% increase over the previous year. Their audits identified \$192.7M in additional premium owed to State Fund, which was almost \$50M higher than the previous year.

As of August 2018, Premium Audit achieved and has maintained their goal of less than 10% of the audit inventory being more than 90 days old. In addition to reducing that backlog, the Audit Team

achieved a two-year exemption from the Workers' Compensation Insurance Rating Bureau Test Audit program after passing their Test Audits with flying colors. Mr. Steiner noted that this was a great result for Premium Audit, from both a quality and a production standpoint.

Regional Structure

Mr. Steiner noted that the implementation of the Regional Restructure of the Policy Team over the past year has been key to helping engage brokers and policyholders more proactively and positively. Under the leadership of the Regional Vice Presidents, the team has done very good work creating a better experience for brokers and clients. As a result of the refreshed approach, State Fund has seen a shift in its book mix to larger middle market business—a segment of business that often has many choices in the marketplace. State Fund has seen earned premium grow in spite of several rate reductions over the past few years.

Combined Small Commercial Operations and Service Center

Mr. Steiner reported that last year a large number of customer service representatives were consolidated into the Small Commercial Operation to improve responsiveness to its small commercial customers. The new design is already showing significant improvements in the timeliness and responsiveness of handling questions and concerns from brokers and employers.

Chatbot

Mr. Steiner reported that the Customer Service Operations Support Team has also spent a lot of time in 2018 preparing to launch a pilot project for Chatbots. The first pilot launched in late January 2019, allowing medical vendors to use the Chatbot channel to quickly and easily obtain information on the status on their bills and payments. If this is successful, management will consider expanding the service channel in more areas of the operation.

Customer Experience

Mr. Steiner reported that throughout 2018 State Fund did some important, foundational work to improve the customer experience at State Fund. First, State Fund built a platform for capturing the voices of its customers at various touchpoints in the life of a policy. The Customer Experience team also led employees through more than 20 customer journey mapping sessions aimed at helping State Fund become more customer focused and identifying opportunities to make it easier and more rewarding to do business with.

Beginning in 2019, State Fund had taken the insights gleaned from that work and followed up with Customer Co-Creation sessions—inviting policyholders and brokers to walk staff through their service experiences with State Fund and provide both honest feedback and ideas for improvements. During the rest of 2019, the State Fund will begin to more systematically redesign many of these journeys with this customer feedback in mind.

Lastly, Mr. Steiner acknowledged the significant progress of State Fund employees made toward improving culture, corporate governance, operational effectiveness, customer service, and quality. Their hard work yielded significant positive results and provided important benefits to California's businesses and injured workers.

Mr. Lanier requested public comment, of which there was none.

AGENDA ITEM 21: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

21a: GOVERNANCE COMMITTEE

21ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Governance Acting Chair Mr. Rankin reported on the following:

2018 Compliance Training – Security Awareness Training, Privacy, Code of Conduct, and Anti-Fraud

State Fund achieved its mandatory compliance goal, with a completion rate of 98% for active employees and 100% for consultants for all compliance training (Security Awareness, Privacy, Ethics, Code of Conduct, and Anti-Fraud).

Ethics and Privacy Reported Issues

The total number of hotline reports increased by 23% (109 in 2017 vs. 142 in 2018) while total number of Ethics hotline reports declined from 17 in 2017 to 10 in 2018. The decline in hotline reporting may be a result of the change in vendor effective March 1, 2018.

Similar to 2017 (99 of 109 cases), Human Resources (HR) related issues remain the most reported category in 2018:

- HR related issues (123 of 142) – 87% of total incidents reported.
- Of the 123 HR related issues, Equal Employment Opportunity complaints/issues is the highest reported category, 45% (55 of 123).

Oversight, Accountability, and Resources

State Fund's *Compliance Framework (Framework)* reflects State Fund's commitment to be an honest, legally compliant, and responsible organization. The *Framework* aligns with the United States Sentencing Guidelines' (USSG) seven essential elements of an effective compliance and ethics program:

1. Oversight, Accountability & Resources – Board and Executive Management oversight
2. Standards of conduct, Policies and Procedures – There should be standards of conduct, policies and procedures to prevent and detect criminal conduct
3. Effective Training, Communications & Awareness – Take reasonable steps to communicate effectively and provide training to State Fund staff
4. Consistent monitoring, evaluation & reporting – Partner with Internal Audit to monitor and audit the effectiveness of ethics and compliance program. Publicized systems in place for anonymous and confidential reporting.
5. Due Care in Delegating Authority – Use reasonable efforts to exclude from substantial authority those who were previously engaged in past illegal or unethical conduct. Make sure that there is an effective background check in place.
6. Consistent Promotion & Enforcement – Consistent disciplinary actions are taken against individuals who have committed misconduct.

7. Risk Assessment, Response, Continuous Improvement & Auditing – Root cause analysis of what went wrong and reasonable steps are taken to prevent and detect similar conduct.

Mr. Rankin noted that to assist the Board in overseeing the execution of the Framework, a series of questions to ask, arranged by the Guidelines' seven elements, has been compiled and was available upon request.

Corporate Policy EC&F 2.2 Incompatible Activities Statement

Mr. Rankin noted that the Governance Committee received a report that the Corporate Policy on Incompatible Activities was revised to include a policy statement regarding nepotism, which is expressly prohibited by the State of California because it is antithetical to a merit-based personnel system.

Mr. Rankin noted that the Governance Committee directed the staff to clarify the following two provisions:

1. There was a proposed revision on notifications, to change it From: State Fund Workforce members must notify their *program manager* regarding close personal relationships with other State Fund employees and/or contractors working in the same program area, activity, or location

To: State Fund Workforce members must notify their *supervisors* regarding close personal relationships with other State Fund employees and/or contractors working in the same program area, activity, or location

Mr. Rankin noted that the Committee recommended changing "supervisors" to "supervisor".

2. The policy includes a definition of "close personal relationship" and the Committee recommended alternative language subject to confirmation a definition from CalHR could be revised. The staff confirmed the Committee's recommended language could be used.

Mr. Rankin noted that copies of the revised policy are available upon request.

Ms. Lariviere clarified that the Governance Committee's recommendation for item 1 was changing "supervisors" to "any supervisor".

Mr. Lanier asked whether any Board member had any other comments on the items on the Consent Calendar of which there were none. Mr. Lanier called for a Motion.

MOTION: Mr. Neureuter

SECOND: Mr. Pulaski

To approve the revised Corporate Policy EC&F 2.2 Incompatible Activities Statement and Policy supporting the Code of Conduct with the Committee's revision as presented.

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

YES: 9

NO: 0

Abstain: 0

Motion carried.

Mr. Kropke and Mr. Curtin were not present when the vote was taken.

21b: AUDIT COMMITTEE

21bi: UPDATE ON COMPLETED CLOSED AUDITS

Audit Acting Chair Mr. Zachry reported on the following activities:

Completed Closed Audits

Mr. Zachry reported that twelve projects were reported in the second quarter of 2018 in the Closed Session in August 2018, of which eight new issues identified were added to the issue track database. Of the eight new issues, two were high risk, three moderate and three were low. Internal Audit Department continues to monitor Management's progress in addressing these issues until Management implements an action plan to mitigate the risk identified.

All the completed project reports were deemed to be proprietary. There are no non-proprietary projects to report in Open Session.

21c: INVESTMENT and RISK COMMITTEE

21ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

Investment & Risk Committee Chair Senator Machado (Ret.) reported on the following:

The investment transactions and compliance reports for the periods of October 1, 2018 to December 31, 2018 were approved by the Investment and Risk Committee pursuant to its delegated authority. The revised Investment Policy Statement and Guidelines Resolution was also reviewed and approved. Sen. Machado also reported the Investment and Risk Committee heard a report from staff on portfolio performance. As of December 31, 2018 there was a \$77M gain from the aggregate portfolio.

Sen. Machado also noted that the Committee received a report from the Enterprise Risk Management (ERM) program and noted there were no significant changes in the overall risk position of State Fund over the 4Q 2018. The ERM program continues to progress in implementing changes to the framework and methodologies to improve alignment with State Fund's functional and enterprise objectives and is working on an ERM primer to present to the Board at the May 2019 meeting.

21d: AD HOC SAFETY AND LOSS PREVENTION COMMITTEE

Chair Robin Baker noted there was nothing to report.

AGENDA ITEM 22: CHAIRPERSON'S'S REPORT

Board Chair Mr. Lanier welcomed again the new Board members and thanked the staff and Board members for a successful meeting.

AGENDA ITEM 23: BOARD MEMBER REPORTS

Mr. Lanier requested any Board member reports.

Mr. Zachry spoke about the California Subsequent Injuries Fund, which is a program that encourages employers across all industries to hire disabled workers. Mr. Zachry noted that worker's compensation cases dealing with the Subsequent Injuries Fund have tripled in the last

few years. As a result, the assessments against employers also increased, although the exposure has not changed.

Mr. Lanier requested any other Board member reports, of which there were none.

AGENDA ITEM 24: 2018 PERFORMANCE AWARDS

Agenda items 24 and 25 were reported together.

Mr. Lanier noted that on behalf of the Board, he wanted to extend congratulations again to State Fund employees on their excellent performance in 2018. Pursuant to the November 2018 Board Resolutions, Performance Awards and Executive At-Risk compensation were being processed and will be paid in mid-March 2019.

AGENDA ITEM 25: PRESIDENT AND EXEMPT LEADERSHIP 2018 AT-RISK COMPENSATION DIFFERENTIAL

Agenda items 24 and 25 were reported together.

AGENDA ITEM 26: PROPOSALS AND SUGGESTIONS FOR MAY 23-24, 2019 AGENDA

Mr. Lanier requested suggestions for agenda items for the May 23-24, 2019 Board meeting. Ms. Padua noted that the proposed agenda items are for Closed Session.

Mr. Lanier requested public comment, of which there was none, and he noted that the next Board meeting is scheduled for May 23-24, 2019 at the State Compensation Insurance Fund Office, Pleasanton, California unless noticed for a new date and time.

Mr. Lanier adjourned the meeting at 12:30 p.m.

Respectfully submitted,



Hilda B. Padua
Board Liaison and Assistant Corporate Secretary