

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

February 19-20, 2015

The Board of Directors of the State Compensation Insurance Fund met on February 19-20, 2015 at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA.

February 19, 2015

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order on February 19, 2015 at 2:00 p.m.

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

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

There was a quorum.

Also present: President & CEO Vernon L. Steiner; Chief Financial Officer Peter Guastamachio; Board Liaison and Interim Corporate Secretary Hilda B. Padua; Counsel and Assistant Corporate Secretary Judith D. Sapper; and Randall Keen of 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 November 20-21, 2014 and January 7, 2015 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Legislative Update**
- 3d. Approval of Retirement Resolutions**

Ms. Chalupa noted that there is no approval of an action for item 3c, "Legislative Update."

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

MOTION: Mr. Kropke

SECOND: Mr. Zachry

To approve the Consent Calendar as presented.

Ms. Chalupa requested public comment of which there was none. Ms. Chalupa called for the vote.

YES: 11

NO: 0

Motion carried.

AGENDA ITEM 4: STAFFING UPDATE

Executive Vice President and Chief Administrative Officer Andreas Acker presented an update on staffing. Mr. Acker reported that State Fund ended 2014 with 4,066 employees, 365 separations, 92 new hires, and 416 promotions. Of the 365 separations, 194 or 53% were due to retirements. For 2015, Mr. Acker projected an overall separation rate of around 9% and the primary driver will continue to be retirements. The Board expressed concern with the number of employees in retirement range and requested information on proposed retirement and recruitment strategies. Mr. Acker will provide an "Aging report" at the May Board meeting. Mr. Acker also noted that part of the recruitment plan strategy includes attending career/job fairs, job postings on LinkedIn, and attracting and hiring new college graduates.

Mr. Acker reported as of December 31, 2014 there was a 14.8% reduction in accrued leave hours over the 640 hour cap and 13.9% reduction in the number of employees over the cap. Mr. Acker noted that all employees who are above the 640 hour cap must use all of their yearly accrued leave, plus 10% of their leave (as of 12/31/14) over the 640 hour cap. Managers work with these employees to develop a written plan every year to manage and reduce any large leave balances. The Board commended the staff with the significant progress made on reducing leave balances. Mr. Acker noted that reducing leave balances remains a high priority for State Fund.

AGENDA ITEM 5: FINANCIAL UPDATE – YEAR END 2014

Chief Financial Officer Peter Guastamachio reported on the year-end 2014 financial results. 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 139,000 policies, which were 6% more than the year ended December 31, 2013. Estimated annual premiums of \$1.465B were 24% more than the prior year. The strong growth in premiums in 2014 is due to a hardened market and the impact of tiered pricing. The loss and loss adjustment expenses (LAE) ratio of 118% was 16 points higher than budget and 16 points higher than the same period in the prior year. There are several reasons for this increase. In the first quarter State Fund strengthened LAE reserves by \$50M for Medical Cost Containment and in the second quarter increased reserves by \$16M for the company's self-insurance program. As part of State Fund's overall Enterprise Risk Management policy and State Fund's unique role in the marketplace, the Board adopted a more conservative posture related to reserving by strengthening both LAE and loss reserves by \$100M each in the fourth quarter.

The combined ratio of 143% was 15 points higher than budget and 16 points higher than the same period in the prior year. The increase in the combined ratio is primarily attributed to the increases in loss and LAE. The related underwriting loss for the year was \$681M. The net investment income of \$656M was 4% lower than the prior year. The Board of Directors approved \$37M in 2014 policyholders' dividends. The net income of \$37M after reserve strengthening and dividends was \$242M lower than the prior year. Policyholders' surplus grew by \$22M since December 31, 2013. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 6: PRESIDENT'S REPORT

President and CEO Vern Steiner reported on the following activities:

Market

Mr. Steiner reported that the California workers' compensation market has stopped hardening though is not softening and there is some stability in pricing. The number of submissions to State Fund has declined in the past several months and the target rate of growth has slowed significantly. This may be attributed to the nature of the market and the ongoing soft spots where there is intense competition; and tiered rating.

Rate Filing

Mr. Steiner reported that following the Board approval at the January 2015 meeting, State Fund submitted a new rate filing with the California Department of Insurance (CDI) to increase collectable premium by 9% for policies effective on or after April 1, 2015. The primary drivers for the rate increase are: i) the need to continue to refine tiers; ii) the adoption of the WCIRB rate recommendations; and iii) the dynamic of geographic differences in claims activity between Southern and Northern California.

2015 Strategic Plan

Mr. Steiner noted the need to provide staff with an understanding of State Fund's vision, strategy, and goals and how to accomplish them. He reported he unveiled State Fund's 2015 Strategic Plan to management at the January Senior Leadership Team meeting and released a video to employees explaining the long-term changes to achieve State Fund's vision and the 2015 goals and the reasons behind selecting them. There will be further communication on progress with the Strategic Plan and staff participation in reaching the goals.

Pain Management Online Training

Mr. Steiner reported that State Fund has implemented a cutting-edge strategy to tackle the epidemic of opioid prescribing within the workers' compensation system by providing physicians with free online pain management training and provider education credits. The initiative has been effective in reducing the amount of opioid prescription inventory and has been very well received. Mr. Steiner commended Chief Medical Director Dinesh Govindarao and the Claims team.

AGENDA ITEM 7: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

7a: GOVERNANCE COMMITTEE

7ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported that the Governance Committee heard a report from Governance, Compliance and Privacy Program Manager Barbara Simmons on the recommended changes to the 2015 Code of Conduct and supporting policies. Policy and Code revisions align with current law and respond to employee and manager feedback and ethics/privacy topics that were raised during 2014. The 2015 revisions include State Fund's revised Vision, a simplified Ethics Decision Tree, general revisions to all Code sections in support of trust, focus on the individual and improved tone and readability.

Ms. Padua noted that the draft 2015 Code of Conduct and supporting polices were included as part of the Board materials.

Ms. Chalupa called for a Motion.

MOTION: Mr. Zachry

SECOND: Ms. R. Baker

To approve the Code of Conduct and supporting policies as presented.

Ms. Chalupa requested public comment of which there was none. Ms. Chalupa called for the vote.

YES: 11

NO: 0

Motion carried.

7b: AUDIT COMMITTEE

7bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits – There were four completed closed audits: Proxy Settings Observation, Premium Audit Services, Enterprise Procurement and Claims Operations Site visit.

The Proxy Settings Observation audit identified two issues. The issues and action plans relate to improving the control activities over internet access and tracking internet activity.

The Premium Audit Services audit identified 12 issues, which relate to improving control activities over written procedures, updating the reference manual, security of records, records retention, training of regional staff, system assigning of audits, back-up support, timely completion of audits, in-house audits, vendor management and consistent quality assurance reviews.

The Enterprise Procurement audit identified five issues which relate to improving control activities over tracking spending by contract, consistent contract and vendor management, active contracts and maintenance of Certificates of Insurance.

The Claims Operations Site visit audit identified one issue which related to improving the control activities for processing disability payments.

All of the closed audits are correctable in the normal course of business and do not represent significant risk to State Fund. Management has provided their corrective action plans and Internal Audit monitors the completion of the corrective action plans.

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

During 4Q 2014 there were 67 reports from all sources (Ethics Hotline - 31; Management referral – 17; Privacy – 19). There were 43 substantiated allegations; 24 involved employees transmitting their own personal identifying information (PII) or that of their family members, relatives, policyholders, and claimants to a non-State Fund e-mail account. None of the 24 substantiated privacy allegations were material to State Fund's financial statements.

State Fund continues to educate its employees on the importance of protecting PII and proprietary information. This education is completed through various training courses including annual Code of Conduct training.

7c: INVESTMENT COMMITTEE

7ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

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

The investment transactions and compliance reports for the period of October 1, 2014 to December 31, 2014 were approved by the Investment Committee pursuant to its delegated authority, which included the purchase of 68 bonds totaling \$703.2M and sale of 20 bonds for \$209.6M. In the equity portfolio \$54.7M were purchased and \$42.5M were sold for rebalancing. The total net gain from the entire portfolio was \$68.4M as of December 31, 2014. The aggregate book value of all the investments was \$18.9B. There were two bonds no longer in compliance with State Fund's Investment Policy.

Sen. Machado also reported the Investment Committee heard a report on Economic and Investment outlook, Portfolio Performance results and Investment Managers' Investment strategy.

AGENDA ITEM 8: CHAIRWOMAN'S REPORT

Ms. Chalupa reported on the following activities from the January 2015 Board meeting:

Dividend

Ms. Chalupa reported that the Board declared a \$37M dividend for 2014, which is approximately 2.6% of estimated annual premium. The Board determined that there is divisible surplus based on the projected loss experience, expenses and investment results for calendar year 2014 and that assets exceed liabilities, necessary reserves and a reasonable surplus for catastrophic hazard. The Board further resolved to give Mr. Steiner the authority to establish the necessary policies and procedures to implement the 2014 dividend plan including establishing qualifying criteria and the timing of the payments.

Strategic Plan

In January the Board approved the strategic plan and budget for 2015. The strategies in 2015 are focused on strengthening the organization's operational foundation to improve efficiency and quality, empower employees, improve leadership and strengthen State Fund's ability to fulfill its unique purpose.

Rick Law

Ms. Chalupa publicly welcomed Rick Law into State Fund as Chief Operating Officer. Ms. Chalupa noted that Mr. Law's deep insurance background, leadership experience and collaborative approach to enterprise management will serve the organization well as State Fund works to strengthen the foundation of its insurance operations, launch new technologies and improve the customer experience with State Fund. Mr. Law has a political economics degree from Johns Hopkins University and began his insurance career with The Hartford as an underwriter and for 25 years has served in a variety of key positions. Prior to joining State Fund,

Mr. Law was the President of Allstate Business Insurance where he had responsibility for profit/loss management, product/market strategy, business development and talent management for the commercial insurance division. Mr. Law also served for a time as the President of Zurich Small Business.

Department of Industrial Relations (DIR) Event

Ms. Chalupa congratulated Ms. Christine Baker and her staff for the celebration event that marked DIR's 100th anniversary. Ms. Chalupa reported that many of the Board members attended the event in December. Ms. Chalupa recognized Ms. Baker and the DIR for the good start in their first 100 years and wished them well for the next 100 years. In addition, Ms. Chalupa thanked Mr. Steiner and Mr. Rankin for their participation in the event and to all State Fund staff who attended. State Fund was definitely well represented and it was good to share its mutual centennial observations.

AGENDA ITEM 9: BOARD MEMBER REPORTS

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

AGENDA ITEM 10: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 13-20

Ms. Chalupa requested public comment on the appropriateness of closed session for items 13-20, of which there was none.

AGENDA ITEM 11: PUBLIC COMMENT

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

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:30 p.m. to immediately reconvene in Closed Session.

February 20, 2015

AGENDA ITEM 21: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 9:45 a.m. following the conclusion of the Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Robin L. Baker; Daniel M. Curtin; Marvin P. Kropke; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Jack L. Neureuter; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; and William M. Zachry.

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

There was a quorum.

Also present: President & CEO Vernon L. Steiner; Chief Financial Officer Peter Guastamachio; Board Liaison and Interim Corporate Secretary Hilda B. Padua; Counsel and Assistant Corporate Secretary Judith D. Sapper; and Randall Keen of Manatt, Phelps & Phillips, LLP.

Ms. Chalupa noted that the Board received a letter from SEIU Local 1000 Vice President Margarita Maldonado expressing support for an across-the-board performance award. Ms. Maldonado also expressed concern regarding the Anthem security breach and interest in State Fund's plan to improve or replace its IT infrastructure to protect from such breach.

AGENDA ITEM 22: APPROVAL OF PERFORMANCE AWARDS

Ms. Chalupa noted that items 22 and 23 would be approved together since there is only one resolution for both Performance Awards and 2015 Compensation for Exempt Executives. Copies of the Resolution No. 2049 were available for the public.

Ms. Chalupa reported that the Board has approved Performance Awards for 2014. Ms. Chalupa noted the Board established Performance Awards to ensure that State Fund has the tools necessary to successfully compete with the market for talent, including the ability to recognize and reward performance. State Fund has been moving through a large-scale business transformation to become a more efficient and agile insurance organization. A big part of that transformation has been focused on building a performance-based culture that can support and sustain State Fund's unique role in California's workers' compensation market. Although there is still much work to do to achieve its long-term objectives, State Fund continues to make important strides in this multi-year business transformation process. Highlights for 2014 results include:

- Writing \$1.5B in premium, exceeding planned goals. This is due in large part to a new pricing model and improved quote delivery.
- State Fund took a more conservative reserving position and action in a number of areas to increase its overall reserve position by \$266M. This decision significantly strengthens State Fund's long-term financial position, but created a short-term impact to the combined ratio, which was 143% at the end of the year. Had State Fund not taken this action, it would have exceeded financial targets for the year. Rather than focus on the short-term numbers in the 2014 financial statement, the Board chose to strengthen State Fund's overall reserve position, which is consistent with the organization's unique role in California.
- Brokers' ratings of State Fund exceeded targeted improvement goals, led by more responsive and timely underwriting, pricing and quote turnaround times.
- The Customer Service Center consistently exceeded its goals in areas such as call wait times and abandonment rates.

Based on the results for this year, the Board has funded \$7 million in Performance Awards. Communication will be going out to staff shortly regarding the distribution of the awards. Ms. Chalupa congratulated and thanked the staff on their continued efforts toward the success of State Fund and the positive impact they have on California's employers and injured workers.

Ms. Chalupa requested a Motion and Second.

MOTION: Mr. Kropke

SECOND: Mr. Neureuter

To approve the 2014 Performance Award program as presented.

Ms. Chalupa asked for public comment of which there was none. Ms. Chalupa called for the vote.

YES: 11

NO: 0

Resolution carried.

The certified Resolution No. 2049 is attached hereto.

AGENDA ITEM 23: APPROVAL OF PRESIDENT AND EXECUTIVE LEADERSHIP 2014 PERFORMANCE AGAINST PLAN AND 2015 EXECUTIVE COMPENSATION

Ms. Chalupa reported that the Board of Directors has evaluated the performance of each executive for 2014. Ms. Chalupa noted that the compensation packages for exempt members of State Fund's executive committee contain both fixed and variable components designed to produce high performance. Since the goal is to attract experienced executive level talent, the Board has carefully benchmarked State Fund's executive compensation and designed it to be relevant to the competitive market place without being excessive. Ms. Chalupa reported that in the performance-based compensation determination process, the Board reviewed both the overall performance of the business and the value of each exempt executive's contribution.

Ms. Chalupa requested a Motion and Second.

MOTION: Mr. Kropke

SECOND: Mr. Neureuter

To approve the 2014 At-Risk Compensation Differential and 2015 Compensation for Executives as presented.

Ms. Chalupa asked for public comment of which there was none. Ms. Chalupa called for the vote.

YES: 11

NO: 0

Resolution carried.

The certified Resolution No. 2049 is attached hereto.

AGENDA ITEM 24: PROPOSALS AND SUGGESTIONS FOR MAY 21-22, 2015 AGENDA

Ms. Chalupa requested additional items for the May 21-22, 2015 Board meeting. Mr. Rank requested a report on the Special Investigation Unit (SIU) staffing and areas of specialty to be presented to the entire Board. Ms. Chalupa asked Board Liaison Ms. Padua if there were other agenda items identified. Ms. Padua reported that a couple of closed agenda items were noted and will be part of the agenda for the August 2015 Strategy meeting. Ms. Chalupa requested other agenda items 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 May 21, 2015 at the State Fund Corporate Office, 333 Bush Street, San Francisco, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting at 9:55 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Interim Corporate Secretary



Resolution No. 2049

BOARD OF DIRECTORS

**APPROVAL OF 2014 AT-RISK COMPENSATION DIFFERENTIAL AND
2015 COMPENSATION FOR EXECUTIVES**

WHEREAS, the Board has approved a Performance Awards program for State Fund staff, managers, supervisors, CEAs and Program Managers, with the total size of the award pool subject to the Board's discretion, based on enterprise performance; and

WHEREAS, the Board has considered State Fund's enterprise performance for 2014, and now seeks to establish and approve the total size of the 2014 performance award pool for State Fund staff, managers, supervisors, CEAs and Program Managers; and

WHEREAS, the annual compensation package for State Fund's president, chief financial officer, chief operating officer, chief information officer, chief investment officer, chief risk officer, chief claims operations officer, chief of internal affairs, chief actuarial officer, chief medical officer, and general counsel ("Exempt Executives") includes an annual base salary, retention differentials and an at-risk differential based upon an annual performance evaluation conducted by the Board of Directors ("Board"); and

WHEREAS, the Board has completed its performance evaluations for each of the Exempt Executives and Non-Exempt Executive Committee Members for calendar year 2014; and the Board seeks to increase the base salary and retention differentials for 2015 and approve some of the at-risk compensation for certain of the Exempt Executives for 2014 as identified in the attached Schedule of Executive Committee At-Risk 2014 Compensation Differential and Salary Adjustments Based on Performance Evaluations.

NOW, THEREFORE,

IT IS RESOLVED that the Board hereby finds that State Fund's enterprise performance for 2014 continued to demonstrate significant progress in its multi-year business transformation to become a more efficient and agile insurance carrier; that 2014 performance specifically strengthened financial stability and State Fund's enterprise risk management position; and hereby approves a 2014 performance award pool not to exceed \$7 million for State Fund staff, managers, supervisors, and CEAs, Program Managers and Executives; and

BE IT FURTHER RESOLVED that the Board hereby adopts and approves the increases in 2015 base salaries and retention differentials and the 2014 at-risk component of 2014 compensation as identified in the attached Schedule of Executive Committee 2014 At-Risk Compensation Differential and Salary Adjustments Based on Performance Evaluations.

PASSED AND ADOPTED at the meeting of the Board of Directors of the State Compensation Insurance Fund held on this 20th day of February, 2015 by the following vote:

State Compensation Insurance Fund
Board of Directors – May 21, 2015

Open Agenda Item 3a – Consent Calendar: Approval of February 19-20, 2015 Open Meeting Minutes
Resolution: Approval of Performance Awards and Approval of President and Executive Leadership 2014
Performance Against Plan and 2015 Executive Compensation



Resolution No. 2049

<u>MEMBER</u>	<u>VOTE</u>
Sheryl A. Chalupa	Yes
Robin L. Baker	Yes
Daniel M. Curtin	Yes
Marvin P. Kropke	Yes
Sen. Michael J. Machado (Ret.)	Yes
Lawrence E. Mulryan	Yes
Jack L. Neureuter	Yes
Steven L. Rank	Yes
Thomas E. Rankin	Yes
Scott K. Reid	Yes
William M. Zachry	Yes

BOARD of DIRECTORS of the STATE COMPENSATION INSURANCE FUND

I, Hilda B. Padua, Acting Corporate Secretary for the State Compensation Insurance Fund Board of Directors, hereby certify that the foregoing resolution was adopted by the Board of Directors at their meeting held February 20, 2015.

Hilda B. Padua
Acting Corporate Secretary

Date



BOARD OF DIRECTORS

Resolution No. 2049

SCHEDULE OF EXECUTIVE COMMITTEE 2014 AT-RISK COMPENSATION DIFFERENTIAL AND SALARY ADJUSTMENTS BASED ON PERFORMANCE EVALUATIONS

Position	2014 Annual Base Salary	Recommended 2015 Base Salary*	Recommended Annual Retention for 2015*	Recommended At-Risk Compensation Differential for 2014
President & CEO (Vern Steiner) (Eff. 6/9/14)	\$450,000	\$450,000	\$18,000	\$75,158.49
Chief Information Officer (Marj Hutchings)	\$327,600	\$343,980	\$61,646	\$46,683
Chief Financial Officer (Peter Guastamachio)	\$312,131	\$320,000	\$32,472	\$79,593.48
Chief Risk Officer (Ken Van Laar)	\$308,506	\$308,506	\$29,491	\$31,467.61
Chief of Internal Affairs (Dante W. Robinson)	\$250,000	\$265,000	Not applicable	\$47,500
Chief Claims Operations Officer (Beatriz Sanchez)	\$180,000	\$180,000	\$27,000	\$9,000
EVP & Chief Administrative Officer (Andreas Acker)	\$124,074	State Guidelines	Not applicable	\$14,888.88
EVP Field Operations (Darlyn Regan)	\$131,334	State Guidelines	Not applicable	\$13,133.40
EVP of Public Affairs (Jennifer Vargen)	\$124,344	State Guidelines	Not applicable	\$14,921.28
Chief Medical Officer (Dinesh Govindarao)	\$350,000	\$350,000	Not applicable	\$52,500
Chief Actuary Kate Smith (Eff. 3/17/14)	\$220,000	\$250,000	Not applicable	\$26,190
Chief Operations Officer Richard Law (Eff. 1/1/15)	Not applicable	\$373,750	Not applicable	Not applicable

**2015 Annual Base Salary and Annual Retention is effective January 1, 2015.*