

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

March 2-3, 2017

The Board of Directors of the State Compensation Insurance Fund met on March 2-3, 2017 at the State Fund Vacaville Office, 1010 Vaquero Circle (Learning Center), Vacaville, California.

March 2, 2017

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 1:35 p.m.

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

Absent: Daniel M. Curtin; Jack L. Neureuter; and Christine Baker (non-voting member).

There was a quorum.

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

Ms. Chalupa acknowledged the presence of selected individuals from the Emerging Leader Program in the audience. Ms. Chalupa noted that the Emerging Leader Program was created to recruit and develop future leaders in order to build up State Fund's leadership talent pool. Ms. Chalupa also noted that the Board had an opportunity to interact with the selected participants in between Committee sessions.

Ms. Chalupa also acknowledged the individuals who coordinated and assisted with the campus tour of main operations (CSC, CPC, Data Center, and Mailroom Operations) in Vacaville.

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 17 and 18, 2016 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Review and Approval of Audit and Governance Committee Charters**

3d. Approval of Retirement Resolutions

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. Rankin

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: 9

NO: 0

Abstain: 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 2016 with 4,299 employees, 334 separations, 266 new hires, and 593 promotions. Of the 334 separations, 182 were retirements, 73 were resignations, 46 were transfers to other agencies, and 33 were others (death or dismissal). With the closure of Chatsworth in the summer, 50 temporary employees remain as of December 31, 2016. The overall separation rate for 2016 was 7.7% with the primary driver being retirements.

Mr. Acker reported as of December 31, 2016 there was a 4.2% overall decrease in the number of hours over the 640 hour cap. CalHR is now requesting all State Agencies to have a firm plan to decrease the vacation hours over the 640 cap by 10%. State Fund began addressing this issue 10 years ago. There will be better progress in 2017 due to a possibility for exempt employees to cash out hours into a tax deferred account such as the 401K or 457.

At the end of 2016, 15.86% or 682 employees were over 55 years old and had 20 or more years of service; 29.7% or 1,277 employees were over 55 years old and had 10 or more years of service. Some employees have put off retirement due to the change in classification to a senior level and bargaining increase of 5%. It is anticipated that it will take 2 years to reach the wage cap so retirement numbers will increase in 2018 and 2019.

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

AGENDA ITEM 5: FINANCIAL UPDATE – 4th Quarter 2016

Chief Financial Officer Peter Guastamachio reported on the 4Q 2016 financial results.

State Fund continues to see a decline in new business and in renewals. The overall forecast for the California and U.S. economy is positive with GDP growth at 2% and slightly higher growth in California. Overall payroll and wages continue to increase and the real estate and construction markets are robust. The net premiums earned of \$1.5B was 4.8% less than the prior year. The loss and loss adjustment expenses (LAE) ratio of 106.3% was comparable to the same period last year. The combined ratio of 130.2% was 0.4 point higher than the same period in the prior year which resulted in an underwriting loss of \$478M. Net investment income of \$627M was \$15M lower than in 2015 and realized capital gains of \$69M was \$20M lower than the same period in 2015. Net income of \$192M was lower than the same period in the prior year due to lower net premiums earned, investment income, and realized capital gains along with higher charge-offs of uncollected premiums. There was an increase in policyholders' surplus of \$156M since year-end 2015.

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

AGENDA ITEM 6: PRESIDENT'S REPORT

President and CEO Vern Steiner provided an update on the completion of the RICO lawsuits including Drobot and Pacific Hospital. The doctors involved in the fraud scheme no longer treat State Fund injured workers. They will no longer accept new State Fund injured workers and will transfer care to doctors in the State Fund MPN. They waived \$40M in outstanding liens. These cases have made important progress in creating awareness of medical fraud and in decreasing the abuse in the system. The six individuals involved pled guilty to the charges and the increased attention in fraud in the media is positive. The Special Investigation Unit (SIU) and Fraud Assessment Commission have gotten increased interest from the local district attorneys in taking on fraud cases which reflects the lack of tolerance for fraud in the current environment.

State Fund's strategy remains firm at not paying a lien if we don't owe it. In 2015, 17.4% of overall liens were resolved. In 2016, 15.5% of liens achieved a pay nothing ruling.

The overall California Workers' Compensation Market is a soft market. Carriers are competing for business by using aggressive tactics, undercutting State Fund insurance quotes, and looking to their broker partners for opportunities to acquire State Fund business. State Fund must fulfill its purpose to be available to California employers, and aims to provide the fairest price in the first instance. In January 2017 State Fund wrote the same amount of business as in 2015. State Fund is preparing financially and operationally to handle the market cycle. State Fund is working on improving customer service so customers will stay with State Fund. For example, as of May 1st, payment terms and payroll reporting frequency will become more flexible and initial deposit requirements will be reduced.

AGENDA ITEM 7: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

7a: GOVERNANCE COMMITTEE

7ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported on the following activities:

New Travel Restriction Law Effective January 1, 2017

- AB 18870 – The bill supports California's position on fairness, equality and non-discrimination, which prohibits agencies from requiring employees to travel to states passing laws after June 26, 2015 that discriminate based on gender identity, orientation, or expression; and requiring approval for travel to the same states.

Own Risk and Solvency Assessment (ORSA) Report

State Fund filed its ORSA report with the Department of Insurance on December 16, 2016. The ORSA report will be referenced in the "Oversight to Critical Risk Areas" section of the 2017 Corporate Governance Annual Disclosure.

2016 Compliance Training

The workforce goal for compliance training was achieved at 99.3% compliance rate for 2016 courses (Code of Conduct, Anti-Fraud, and Security Awareness). The contingent worker compliance rate was at 97%. Physical and logical access was disabled for 14 contingent workers, after which 11 accounts have been re-activated following training completion.

2016 versus 2015 Hotline Analysis

The Hotline volume from 2015 to 2016 has declined by 25% and management referrals increased by 72%. The same trend occurred in 3Q and 4Q 2016; with hotline reports declining by 16% and management reports increasing by 17%.

Mr. Mulryan noted that the hotline report volume is influenced in part by the reduced number of suspected privacy incident reports: 23 in 2015 versus 13 in 2016. The Privacy Office observed a 50% decline (118 in 2015 to 59 in 2016) in preventable internal privacy incident reports. The reduction in suspected or reported privacy incident reports can be attributed to privacy awareness messaging and quality assurance programs implemented by Claims and Workers' Compensation Legal Department.

Human Resources (HR) related issues continue to be the most reported category at 78% (624 out of 801) in 2016, with 80% of HR reports related to performance, inappropriate/offensive behavior, and attendance issues. This trend aligns with other industries as reported in the 2015 Navex Global Ethics and Compliance Hotline Benchmark report.

7b: AUDIT COMMITTEE

7bi: UPDATE ON COMPLETED CLOSED AUDITS

Mr. Reid reported on the following activities:

Completed Closed Audits

There were 6 projects reported in November 2016 and only 1 was non-proprietary. In the 2016 Delayed-Denied Liability Claims audit there were 4 issues identified. Management has developed action plans to address these 4 issues with anticipated implementation beginning June 30.

Whistleblower Hotline

Mr. Acker reported all Ethics Hotline reports are investigated. During 4Q 2016 there were 131 reports received from the Ethics Hotline, California Whistleblower Hotline, Human Resources CMS, and the Privacy Office.

Of the 131 allegations received, 48 investigations were completed. From the 48 completed investigations, 28 were substantiated allegations and referred to Manager Services for possible disciplinary action; 18 were unsubstantiated; and 2 were inconclusive. There were a total of 9 privacy breaches reported with 2 currently under investigation; 2 were unsubstantiated; and 5 were found to be in violation of the Privacy and Confidentiality Corporate Policy.

Human Resources and the Privacy Office will work with management on identifying and implementing risk mitigation measures, implementing corrective actions, and taking disciplinary measures where necessary; and will continue to work with programs on training and counseling to address identified issues.

Lastly, the Audit Committee heard a report from staff on Cyber Security Risk, which will be on the full Board agenda for the August Strategic meeting; Model Audit Rule; Pension and OPEB update; and a report from the External Auditor during Closed Session.

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 periods of October 1, 2016 to December 31, 2016 were approved by the Investment Committee pursuant to its delegated authority. Sen. Machado also reported the Investment Committee heard a report from Wellington Management on the market and economic outlook and State Fund's portfolio performance results.

AGENDA ITEM 8: CHAIRWOMAN'S REPORT

Ms. Chalupa thanked Andrea Bailey and the staff of the Learning Center for putting together the Vacaville campus tours and for hosting the Board and Committee meetings. Ms. Chalupa is impressed with the operations and thanked the managers and staff of the CPC, CSC, Mailroom Operations, and Information Technology, who took the time to show the Board members the operations of their departments and units.

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 through 23

Ms. Chalupa requested public comment on the appropriateness of Closed Session for agenda items 13 through 23, 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 2:15 p.m. to immediately reconvene in Closed Session.

March 3, 2017

AGENDA ITEM 24: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 10:40 a.m. at the State Fund Vacaville Office, 1010 Vaquero Circle (Learning Center), Vacaville, California following the conclusion of the Board 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 Zachry.

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

There was a quorum.

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

AGENDA ITEM 25: APPROVAL OF 2016 PERFORMANCE AWARDS

Ms. Chalupa reported that the Board has approved Performance Awards for 2016. Ms. Chalupa noted that State Fund is working to become a more efficient and agile insurance organization and building a performance based culture that can support and sustain State Fund's unique role in California's workers' compensation market. To fulfill its role, State Fund must have the tools necessary to successfully compete with the market for talent, including the ability to recognize and reward performance. In 2013 the Board introduced performance awards to ensure State Fund has the ability to attract and retain talent in the marketplace. Performance awards are tied to enterprise results as well as individual performance/contribution and are an appropriate investment in building and sustaining a performance culture that delivers value to its customers. Highlights for 2016 results include:

- State Fund wrote \$1.5 billion in premiums for 128,000 policyholders.
- Investment income was \$627 million.
- Net income was \$192 million.
- State Fund's policyholders' surplus grew by \$156 million since December 31, 2015.
- The combined ratio was 130.2 percent.
- Loss and Loss Adjustment Expense reserves continued to be within targeted adequacy levels.

Although the organization was not able to achieve every goal set out in the plan, the Board has funded \$13.2 million in Performance Awards, which represents a funding level of 90%.

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. Mulryan

SECOND: Mr. Zachry

To approve the 2016 Performance Awards Resolution as presented.

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

YES: 11

NO: 0

Abstain: 0

Resolution carried.

The certified Resolution No. 2107 is attached hereto.

AGENDA ITEM 26: APPROVAL OF PRESIDENT AND EXECUTIVE LEADERSHIP 2016 PERFORMANCE AGAINST PLAN AND 2017 EXECUTIVE COMPENSATION

Ms. Chalupa reported that the Board of Directors has evaluated the performance of each executive for 2016. 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. Zachry

SECOND: Mr. Rankin

To approve the 2016 At-Risk Compensation Differential and 2017 Compensation for President and Exempt positions as presented.

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

YES: 11

NO: 0

Abstain: 0

Resolution carried.

The certified Resolution No. 2108 is attached hereto.

AGENDA ITEM 27: PROPOSALS AND SUGGESTIONS FOR MAY 18-19, 2017 AGENDA

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 18, 2017 at State Compensation Insurance Fund, 333 Bush Street, San Francisco, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting at 10:50 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary



BOARD OF DIRECTORS

APPROVAL OF PERFORMANCE AWARDS

WHEREAS, the Board has approved a Performance Awards program for State Fund staff, supervisors and managers, senior leaders, and Exempt and Non-Exempt Executives, with the total size of the award pool subject to the Board's discretion, based on enterprise performance and individual performance; and

WHEREAS, the Board approved a 2016 potential award pool of approximately 5% of annual salary spend (\$14.6 million at 100% of target); and

WHEREAS, the Board has considered State Fund's enterprise performance for 2016, and now seeks to establish and approve the total size of the 2016 performance award pool for State Fund staff, supervisors and managers, senior leaders, and non-exempt executives; and

NOW, THEREFORE,

IT IS RESOLVED that the Board hereby finds that State Fund's enterprise performance for 2016 continued to demonstrate significant progress in its multi-year business transformation to become a more efficient and agile insurance carrier; that 2016 performance specifically strengthened financial stability and State Fund's enterprise risk management position; that 2016 performance demonstrated improvement in customer service; that overall State Fund met or exceeded most enterprise objectives; and hereby approves a 2016 performance award pool to be administered by management not to exceed \$13.2 million (funded at 90% of target) for State Fund staff, supervisors and managers, senior leaders, and non-exempt executives.


PASSED AND ADOPTED at the meeting of the Board of Directors of the State Compensation Insurance Fund held on this 3rd day of March, 2017 by the following vote:



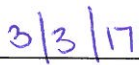
<u>MEMBER</u>	<u>VOTE</u>
Sheryl A. Chalupa	Yes
Robin L. Baker	Yes
Daniel M. Curtin	Yes
Marvin P. Kropke	Yes
Sen. Michael J. Machado (Ret.)	Yes
Lawrence E. Mulryan	Yes
Jack L. Neureuter	Yes
Steven L. Rank	Yes
Thomas E. Rankin	Yes
Scott K. Reid	Yes
William M. Zachry	Yes

BOARD of DIRECTORS of the STATE COMPENSATION INSURANCE FUND

I, Hilda B. Padua, Assistant 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 March 3, 2017.



Hilda B. Padua
Assistant Corporate Secretary



Date



BOARD OF DIRECTORS

APPROVAL OF PRESIDENT AND EXEMPT EXECUTIVE LEADERSHIP 2016 AT-RISK COMPENSATION DIFFERENTIAL AND 2017 EXEMPT EXECUTIVE COMPENSATION

WHEREAS, the Board has approved a Performance Awards program for State Fund staff, supervisors and managers, senior leaders, and Executives, with the total size of the award pool subject to the Board's discretion, based on enterprise performance and individual performance; 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 considered State Fund's enterprise performance for 2016 and has completed its performance evaluations for each of the Exempt Executives and Non-Exempt Executive Committee Members for calendar year 2016; and the Board seeks to increase the base salary and retention differentials for the Exempt Executives for 2017 and approve the at-risk compensation for the Exempt Executives for 2016 as identified in the attached Schedule of Exempt Executive Committee At-Risk 2016 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 2016 continued to demonstrate significant progress in its multi-year business transformation to become a more efficient and agile insurance carrier; that 2016 performance specifically strengthened financial stability and State Fund's enterprise risk management position; that 2016 performance demonstrated improvement in customer service; that overall State Fund met or exceeded most enterprise objectives; and the Board hereby adopts and approves the increases in 2017 base salaries and retention differentials and the 2016 at-risk component of 2016 compensation as identified in the attached Schedule of Executive Committee 2016 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 3rd day of March, 2017 by the following vote:



<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, Assistant 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 March 3, 2017.

H B Padua

Hilda B. Padua
Assistant Corporate Secretary

3/3/17

Date



BOARD OF DIRECTORS

Resolution No. 2108

SCHEDULE OF EXECUTIVE LEADERSHIP 2016 AT-RISK COMPENSATION DIFFERENTIAL AND 2017 EXECUTIVE COMPENSATION

Position	2016 Annual Base Salary	Recommended 2017 Base Salary*	Recommended Annual Retention for 2017*	Recommended At-Risk Compensation Differential for 2016
President & CEO (Vern Steiner)	\$475,000	\$475,000	\$30,000	\$141,075
Chief Financial Officer (Peter Guastamachio)	\$320,000	\$320,000	\$55,000	\$86,400
Chief Operating Officer (Richard Law)	\$373,750	\$392,437	Not applicable	\$100,913
Chief Claims Operations Officer (Steve Hunckler)	\$375,000	\$375,000	Not applicable	\$101,250
General Counsel (Margie Lariviere)	\$375,000	\$375,000	Not applicable	\$92,813
Chief of Internal Affairs (Dante W. Robinson)	\$290,000	\$310,300	Not applicable	\$57,420
Chief Information Officer (Marj Hutchings)	\$343,980	\$357,739	\$61,646	\$61,916
Chief Risk Officer (Ken Van Laar)	\$310,000	\$310,000	\$40,000	\$55,800
Chief Medical Officer (Dinesh Govindarao)	\$367,500	\$367,500	Not applicable	\$66,150
Chief Actuary (Kate Smith)	\$265,000	\$280,000	Not applicable	\$47,700

**2017 Annual Base Salary and Annual Retention is effective January 1, 2017.*