

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

May 21-22, 2015

The Board of Directors of the State Compensation Insurance Fund met on May 21-22, 2015 at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA.

May 21, 2015

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:05 p.m.

Ms. Chalupa requested Ms. Padua to call roll. The following were present: Sheryl A. Chalupa (Chair); Robin L. Baker; Daniel M. Curtin; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Jack L. Neureuter; Steven L. Rank; Thomas E. Rankin (joined during Item 3); Scott K. Reid; William M. Zachry; and Christine Baker (non-voting member).

Absent by prior arrangement: Marvin P. Kropke.

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 February 19-20, 2015 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Renewal of Expiring 3rd Quarter Insurance Policies**
- 3d. Annual Review and Approval of State Fund By-Laws**
- 3e. Annual Review and Approval of Committee Charters**
- 3f. 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. Zachry

SECOND: Mr. Curtin

To approve the Consent Calendar as presented.

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

YES: 10

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 the 1Q 2015 with 4,111 employees, 53 separations, 129 new hires, and 83 promotions. Of the 53 separations, 19 were retirements, 13 were resignations, 17 were transfers to other agencies, and 4 were others (death or dismissals). There was a net gain of employees due to an increased number of new hires.

Mr. Acker reported as of March 31, 2015 there was a 1.3% gain in the hours over the cap and a 3.8% gain in the number of employees over the cap. Mr. Acker noted that this was normal for the 1Q and he expects a decrease in hours for the remaining three quarters. Supervisors, attorneys, and managers have the option to cash out up to 40 hours of leave in June which will result in an additional reduction of hours in the 2Q.

Mr. Acker also reported on the Age and Years of Service of State Fund Employees. Mr. Acker noted that 14.8% of the overall staff, 20% of line supervisors and above are within the retirement range with 20 years of service and at/over the age of 55 and 12% of claims adjusters are vested with 10 years at/over the age of 55. He estimates that there will be a steady stream of 200-250 employees retiring annually for the next five years. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 5: FINANCIAL UPDATE – 1Q 2015

Chief Financial Officer Peter Guastamachio reported on the 1Q 2015 financial results. Mr. Guastamachio reported that with the introduction of tiered pricing in March of 2013 combined with a hardening market, State Fund saw its premium grow by 81% over the past two years. Specifically, premium grew by 27% in 2013 and 54% in 2014. This rapid growth was led primarily by an influx of new business. Mr. Guastamachio noted that now State Fund's pricing model is more seasoned and the market has softened a bit. State Fund Net Premiums Written (NPW) and Net Premiums Earned (NPE) of \$386M and \$391M through March were up 11% and 14% over the same period in 2014. This was a \$49M increase in NPE over the prior year. The modest growth in premium this year is coming primarily from payroll growth on renewal business rather than from new business.

State Fund's combined Loss and Loss Adjustment Expense Ratios totaled 106% which was 11 points lower than the same period in the prior year and is on target with budget. The Underwriting Expense Ratio of 23.1% was 1 point lower than the same period in the prior year and is almost 5 points lower than budgeted. This improvement was attributable to improved operating efficiencies in variable expenses plus the slight growth in premiums. State Fund ended the 1Q with a Combined Ratio of 129% and an Underwriting Loss of \$113M. Compared to last year, the Combined Ratio and Underwriting Loss were 11 points and \$26M lower. Mr. Guastamachio further reported offsetting the Underwriting Loss, net investment income through March was \$164M with realized capital gains of \$22M. This resulted in net income of \$75M for the quarter which is up \$27M from the 1Q last year. Lastly, there was an increase in policyholders' surplus of \$35M since year end.

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

AGENDA ITEM 6: STATEMENT OF ACTUARIAL OPINION

Mr. Guy Avagliano of Milliman reported State Fund's gross carried reserves were \$12.5B versus Milliman estimated reserves of \$12.4B, resulting in a 1% difference. There was no difference in the Loss Portfolio Transfer carried and estimated reserves. Mr. Avagliano presented a comparison of State Fund's carried reserves with Milliman's selected estimates at successive year-ends, noting that in prior years State Fund's carried reserves exceeded Milliman's estimates but in 2013 were slightly below. He noted the ultimate loss components and ultimate loss ratios as of December 31, 2014 and the California workers' compensation loss ratio summary. The ultimate loss ratio range as indicated by Milliman projection methods was 75% at the midpoint and 79% as selected. Milliman provided a clean Actuarial opinion, noting the reserves set were consistent with California State standards; consistent with Actuarial standards; and reasonable. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 7: PRESIDENT'S REPORT

President and CEO Vern Steiner reported on the following activities:

First Quarter Business Results

Mr. Steiner reported that policy and premium growth have continued to slow. Premium growth in the 1Q 2015 was just under 10%, driven by strong renewal premium. The actual submissions for quotes were down, indicating that there is a market available and it is priced competitively. The brokered channel continues to be the source of State Fund premium growth. Direct channel premium was down slightly, but the loss trend has flattened out in the past quarter. In the 1Q 2015, quote volume (number of quotes issued) was highest in construction (24%), followed by service (18%), and agriculture (16%). Of the quotes produced, the most bound were in construction (34%) and service (21%).

Senate Hearing

Mr. Steiner reported that on March 11, 2015, he had the opportunity to testify before the Senate Insurance Committee about the progress State Fund has made in improving operations, corporate governance, and internal controls. Mr. Steiner shared some of the highlights of his testimony. Mr. Steiner reminded the committee of State Fund's purpose and importance to the state's economy. He reviewed the history of the California workers' compensation market collapse 15 years ago and State Fund's response when it wrote more than half of the market. Mr. Steiner also shared the significant challenges the organization faced that included being subject to statewide hiring freezes and other resource constraints that made it difficult to provide service to the influx of new business. Following the private market's return to California, State Fund shed business as quickly as it had written it, creating yet more challenges as the organization faced downsizing. Mr. Steiner communicated his intent to strengthen the organization so it can respond with more agility in the future and insulate employees as much as possible from these growth cycles. Senator Roth was very supportive and inquired what the legislature could do to help State Fund. Mr. Steiner agreed to return to Senator Roth with proposals for creating greater flexibility within the structure.

In addition, Mr. Steiner testified about State Fund's response to the 2007 and 2008 California Department of Insurance audits and the significant progress State Fund has made in resolving outstanding audit results. Importantly, this work has been part of a larger overhaul of State Fund operations to reduce fixed operating costs, increase transparency, and strengthen corporate governance and internal controls. While State Fund has made significant progress since 2007, it

still has work to do and has developed strategies to evolve, adapt, and innovate in order to best serve California's employers and workers.

Mr. Steiner noted that the legislative hearing also provided the opportunity to hear from the Senate Insurance Committee about things that are important to them.

Anti- Fraud Successes

State Fund investigations resulted in a few notable cases resulting from our anti-fraud efforts:

Garment Manufacturers – Premium Fraud

Two sewing contractors, Meriko, Inc. and SF Apparel, Inc., which manufacture jeans for a well-known high-end retailer, allegedly conspired with their CPA to hide tens of millions in payroll to avoid paying workers' compensation premiums and payroll taxes. Their conspiracy led to premium fraud losses totaling more than \$11.5 million for several workers' compensation insurers, including State Fund (\$2.7M). The initial fraud tip was made by a claims adjuster who became suspicious and alerted the Special Investigation Unit (SIU) when the employer attempted to file two claims on an expired State Fund policy. The SIU lead investigator launched an investigation and noticed behaviors that led her to suspect the employer was misrepresenting the size of the operation. State Fund's SIU notified California Department of Insurance (CDI) of the suspected fraud.

Medical Clinics – Provider Fraud

State Fund successfully pursued medical provider fraud by filing a civil Qui Tam whistleblower lawsuit against Paul Randall and Christina Hernandez, the owners of Platinum Medical of Hawaiian Gardens, California, under the False Claims Act for a variety of fraudulent activity including billing for medical examinations that were not rendered, upcoding, and unbundling of toxicology charges. State Fund was awarded a \$10.2M judgment.

AGENDA ITEM 8: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

8a: GOVERNANCE COMMITTEE

8ai: 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 following activities:

2015 Conflict of Interest Code

State Fund amended its Conflict of Interest Code for new positions that are now considered designated filers, and changes to the organization's structure. The changes were filed with the Fair Political Practices Commission (FPPC) on May 15, 2015 for their review and approval. The final approval and effective date is anticipated within the next 120 days.

2015 Code of Conduct

The 2015 Code of Conduct was published on April 24, 2015 and was available internally and externally to the public through www.statefundca.com. Acknowledgement and

training has been delayed until July to account for contract completion with the training vendor.

Statement of Economic Interest (Form 700) Annual Filing Compliance

State Fund achieved 100% compliance by active designated filers. FPPC filing was completed for Board members, the CEO, CIO, and CFO as required by the Government Code. For inactive or separated employees who have not yet filed, Human Resources sends them two reminder notices before referring them to the FPPC.

Compliance Training

For 2015, training has been consolidated where possible for efficiency, including merging privacy and cyber security training, use of the Conflicts of Interest module to satisfy Code of Conduct requirements, and one of the ethics modules for Statement of Economic Interest filers. Upcoming training includes: "Preventing Workplace Harassment" for Managers and Supervisors; "Ethics Orientation for State Officials, Employees, and Consultants" for all designated filers; "Code of Conduct" and "Privacy and Cyber Security" for the entire State Fund workforce; and "Anti-Fraud" for integral anti-fraud personnel.

National Data Privacy

This is State Fund's third year of participation in National Privacy Day. This year, Video Consultant Chris Terry of Communications worked with the Governance Office to produce a new video titled "*We All Have a Choice to Make*," which highlights the role of each workforce member in safeguarding private information. The video was shown to the Board members and to the public. Ms. Simmons and the Committee members acknowledged the work of Mr. Terry.

Ethics and Privacy Reports

Human Resources issues and suspected privacy incidents continue as the primary subjects of the reports. Forty-three percent of all concerns were reported via State Fund's independent hotlines, which is consistent with hotline reporting in 3Q 2014. The majority of suspected privacy incidents reported was internal and preventable.

8a:ii: BOARD DELEGATED AUTHORITY AND APPROVAL LEVELS

Mr. Mulryan reported that in November of 2009 the Board approved a Resolution of Delegated Authority to the President affirming delegation of certain powers, functions, and duties and outlining the topics requiring the President to obtain the advice and ratification of the Board. The Board also set approval levels for the exercise of the President's powers, functions, and duties. The delegation of authority and approval levels is reviewed annually and recommendations are presented and approved at the May Governance Committee Open meeting and recommended to the full Board for adoption. Mr. Mulryan reported that there are no recommended changes for Board adoption this year.

8b: AUDIT COMMITTEE

8bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits – There were six completed closed audits: Claims Operations Site visit and File Review Audit – Fresno; Real Estate Management; Active Directory; Corporate Secretary Board; Enterprise Risk Management and Claims Operations Site Visit and File Review Audit – Santa Ana.

All of the closed audits are correctible 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 1Q 2015 there were 31 reports; 14 management referrals and 26 referrals from the Privacy Office. There were 71 new allegations received and 61 investigations completed. From the 61 completed investigations, there were 26 substantiated allegations and 35 unsubstantiated. Of the 26 substantiated allegations, 24 were referred to Manager Services for action and two involved employees who separated or retired from State Fund.

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

8c: INVESTMENT COMMITTEE

8ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

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

The investment transactions and compliance reports for the period of January 1, 2015 to March 31, 2015 were approved by the Investment Committee pursuant to its delegated authority, which included the purchase of 55 bonds totaling \$631.4M and sale of 6 bonds for \$44.5M. In the equity portfolio \$108.1M were purchased and \$145.2M were sold for rebalancing. The total net gain from the entire portfolio was \$22.3M. The aggregate book value of all the investments was \$19.1B. 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 9: CHAIRWOMAN'S REPORT

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

Senate Hearing

Ms. Chalupa thanked the team who helped Mr. Steiner prepare for the Senate Insurance Committee Oversight Hearing held on March 11, 2015. Ms. Chalupa conveyed the Board's appreciation of everyone who spent the significant amount of time required in pulling together information the Insurance Committee requested. The Board was pleased to hear the positive testimony from Insurance Commissioner Dave Jones about State Fund's progress and ability to fulfill its purpose in the California market. Ms. Chalupa noted that there is still a lot of work ahead but this was a moment to acknowledge all that State Fund has achieved in since 2008.

California Workers' Compensation Institute Annual Meeting (CWCI)

Ms. Chalupa noted that the 51st Annual Meeting of the CWCI was held on March 19, 2015. The theme was "The High Cost of Low Quality Care." Alex Swedlow, the President of CWCI, gave an update on claims trends inside workers' compensation and the impact of SB 863 in the areas of liens, fee schedules, surgical hardware, medical provider network administration and the reengineered dispute resolution process. Mr. Swedlow's colleague, Rena David, presented information on how the Independent Medical Review process is working. Much of this information was also shared during the March 25th Senate Oversight Hearing on SB 863. Dr. Gary Franklin from the University of Washington and Dr. David Deitz, National Medical Director for Liberty Mutual Insurance, both gave talks on the challenges associated with delivery of quality care and outcomes inside the workers' compensation system.

The keynote address by Insurance Commissioner Dave Jones highlighted the Department's role in providing oversight to workers' compensation insurance. Ms. Chalupa noted there were about 15 State Fund attendees to the meeting, including Board members Larry Mulryan, Mike Machado, Jack Neureuter, Tom Rankin, and William Zachry, as well as Mr. Steiner and nine staff members. Ms. Chalupa congratulated Mr. Steiner on his re-election as Chairman of the Board of CWCI.

National Advisory Committee on Occupational Safety and Health

Ms. Chalupa reported that Board member Robin Baker was appointed to serve as a member of the National Advisory Committee on Occupational Safety and Health (NACOSH) by Secretary of Labor Thomas E. Perez.

Ms. Baker noted she was very happy with the appointment. NACOSH advises the Secretaries of Labor and Health and Human Services on occupational safety and health programs and policies.

Celebrating Women Leaders in California

Ms. Chalupa reported that she had the pleasure of attending an event hosted by Governor Brown for women appointees, called "Celebrating Women Leaders in California." It was held at the California State Railroad Museum and over 600 women attended, including Robin Baker, Christine Baker and herself from the Board. Ms. Chalupa thanked the Governor for hosting the event, as well as California Women Lead, the California Legislative Women's Caucus, and the California Commission on the Status of Women for co-hosting.

Business Review Meetings

Ms. Chalupa reported that the 1Q 2015 Business Review Meetings (BRMs) were held on April 22-23, 2015 at State Fund's Pleasanton campus. Ms. Chalupa attended the first day, which included presentations by Claims and Legal. Ms. Chalupa reported that with the Claims report, she was impressed with the dialogue that took place about various strategies leaders throughout Claims are using to inspire a culture shift, including: 1) how to deal with competing priorities, how to better engage employees, and communication and information overload; 2) the role of Assistant Claims Managers and the importance of giving tools, training, and permission; and 3) the discussions around P.I.E. – Proactive, Independent, Empowered.

Ms. Chalupa noted there was a robust discussion about the Lien Defense report and strategy. Ms. Chalupa noted that representatives from Legal provided a good overview of Legal goals

and major areas of focus. There was discussion about the turnover (retirement) projection for Legal versus the rest of the organization; culture issues and steps to improve. Ms. Chalupa thanked Ms. Robin Baker for attending the BRM and encouraged Board members to try to attend the 4Q BRM scheduled in October 2015 in Santa Ana.

Doug Stewart

Ms. Chalupa regretfully announced the passing of Doug Stewart on April 20, 2015 following a battle with cancer. Mr. Stewart joined State Fund in 2008 as first Chief Risk Officer and later served as interim President and CEO in 2009. As Chief Risk Officer, Mr. Stewart introduced an enterprise-wide risk management practice that identified and addressed important risks to the organization. Mr. Stewart also implemented the first phase of business analytics in underwriting practice which established the foundation for future pricing strategies. Mr. Stewart provided important stewardship to State Fund in his role as interim President and inspired the entire organization with his deep passion for State Fund's purpose and values. Ms. Chalupa noted that on behalf of the Board, she extended her deepest condolences to Mr. Stewart's wife, Kathy and their children, Anne and Jeff.

AGENDA ITEM 10: BOARD MEMBER REPORTS

Ms. Chalupa requested any Board Member reports. Ms. Robin Baker noted that she found the Business Review Meetings valuable as a Board member. It was an opportunity to hear what is going on and meet staff.

Mr. Jack Neureuter noted that he was glad he had the opportunity to attend the town hall meetings in Riverside and Santa Ana on April 2-3, 2015. He heard questions and comments from staff including thanks for hiring Mr. Steiner.

AGENDA ITEM 11: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 14-24

Ms. Chalupa requested public comment on the appropriateness of closed session for items 14-24 of which there was none.

AGENDA ITEM 12: PUBLIC COMMENT

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

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:55 p.m. to immediately reconvene in Closed Session.

May 22, 2015

AGENDA ITEM 25: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:05 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; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Thomas E. Rankin; and Scott K. Reid.

Absent by prior arrangement: Christine Baker; Marvin P. Kropke; Jack L. Neureuter; Steven L. Rank; and William Zachry.

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 congratulated Mr. Steiner on the approaching one year anniversary of his appointment as President and CEO.

AGENDA ITEM 26: PROPOSALS AND SUGGESTIONS FOR AUGUST 18-20, 2015 AGENDA

Ms. Chalupa asked Board Liaison Ms. Padua if there were other agenda items identified. Ms. Padua reported that some 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 August 18, 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 11:10 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Interim Corporate Secretary