

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

May 26-27, 2016

The Board of Directors of the State Compensation Insurance Fund met on May 26-27, 2016 at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA.

May 26, 2016

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:00 p.m.

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

Absent: Robin L. Baker; Jack L. Neureuter; William M. Zachry; and Christine Baker (non-voting member).

There was a quorum.

Also present: President & 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 Michael Franklin and Sandy Lyons of The River Group who are attending the Board and Committee meetings as observers as part of the Board Evaluation process.

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 18 and 19, 2016 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Annual Review and Approval of State Fund By-Laws**
- 3d. Annual Review and Approval of Board Delegated Authority and Approval Levels**
- 3e. Board Member Education and Travel Expense Reimbursement Policy**
- 3f. Annual Review and Approval of Committee Charters**
- 3g. 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. Padua noted that "Approval of the Investment Charter" under item 3f needed to be pulled from the consent calendar. The Investment Committee due to lack of quorum deferred the approval to the July 2016 meeting.

Ms. Chalupa called for a Motion.

MOTION: Mr. Kropke

SECOND: Mr. Mulryan

To approve the Consent Calendar as revised.

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

YES: 8

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 the first quarter of 2016 with 4,419 employees, 50 separations, 104 new hires, and 50 promotions. Of the 50 separations, 20 were retirements, 13 were resignations, 11 were transfers to other agencies, and 6 were others (death or dismissal). The overall separation rate for the first quarter of 2016 was 4.6% and the primary driver was retirements.

Mr. Acker reported as of March 31, 2016 there was a 7% increase in the number of hours over the 640 hour cap and a 15.8% increase in the number of employees over the cap. Mr. Acker noted that employees typically do not take much vacation in the winter months and the use of leave will increase during the summer and fall months. State Fund approved a leave cash-out option for 80 hours at the supervisory and management level. State Fund is currently negotiating the SEIU contract and will discuss a leave cash-out option for rank and file employees.

Mr. Acker also reported on the Age and Years of Service of State Fund Employees. Mr. Acker noted that 647 employees, which equates to 15% of the overall staff, are within the retirement range with 20 years of service and at/over the age of 55. In 2008, there were 620 employees, which equates to 7% of the overall staff, within that retirement range. The average retirement age is 61. In comparison to prior years, the staffing has remained fairly stable the past 8 years. Mr. Acker estimates that there will be a steady stream of 200-250 employees retiring annually for the next 5 years but State Fund will be able to absorb this in the normal course of business.

AGENDA ITEM 5: FINANCIAL UPDATE – 1st QUARTER 2016

Chief Financial Officer Peter Guastamachio reported on the 1st Quarter 2016 financial results. Mr. Guastamachio reported that net premium earned of \$368M through March was down 6% from last year, which is a \$24M decrease over the prior year. Mr. Guastamachio noted that there is an increase in payroll from renewal business but a decline in new business. The policy count for the year is down by 9% while average premium per policy is up by 1%. The overall forecast for the California and U.S. economy is still positive and projects GDP growth at 2.7% instead of the previous forecast of 3.3%. The overall forecast for California and the U.S. economy continues to be slow growth with steady gains in employment of about 2% in 2016. Payrolls are expected to grow at the same rate and we continue to see growth in the real estate and construction markets as well as in retail sales and technology.

State Fund combined Loss and Loss Adjustment Expense ratios of 106.3% was 0.3% higher than the same period in the prior year. The loss ratio improved by 4 points but was offset by higher salaries and benefits expense resulting from additional staffing coupled with lower premiums. The Underwriting Expense Ratio of 22.3% was 0.8 points lower than the same period in the prior year mainly due to lower variable expenses in commissions and group administrative fees.

State Fund Combined Ratio for the 1Q 2016 was 128.6% and an Underwriting Loss of \$111M which were 0.5 points and \$2M lower than the prior year. Offsetting the underwriting loss, the net investment income through March was \$162M with realized capital gains of \$21M. This resulted in net income of \$67M through March which is \$7M less than the same period in the prior year. There was an increase in policyholders' surplus of \$44M since year-end 2015.

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

AGENDA ITEM 6: STATEMENT OF ACTUARIAL OPINION

Mr. Guy Avagliano of Milliman, State Fund's Appointed Actuary, reviewed the Loss and Loss Adjustment Expense reserves as of December 31, 2015. He reported State Fund's booked loss reserves for Statutory Claim and Claim Adjustment Expense Reserves were: unpaid losses at \$10.9B, unpaid loss adjustment expense at \$1.74B, unpaid losses – direct and assumed at \$11B, and unpaid loss adjustment expense – direct and assumed at \$1.74B. Milliman provided a clean Actuarial opinion, noting the reserves set were consistent with California State standards; consistent with Actuarial standards; and reasonable provisions were made for unpaid claims. This opinion was filed with the California Department of Insurance in February 2016.

AGENDA ITEM 7: PRESIDENT'S REPORT

President and CEO Vern Steiner reported on the following activities:

Market Update

Mr. Steiner reported that State Fund recently received the California's workers' compensation market share report from the California Department of Insurance for the 2015 market. Mr. Steiner reported that the total premium in 2015 grew to \$12.3B compared to 2014 which was \$11.4B. State Fund continued to have the largest market share and remained relatively flat at 13.29% vs. 13.38% in 2014. In April the Workers' Compensation Insurance Rating Bureau (WCIRB) submitted a pure premium rate filing for accounts that renew on or after July 1, 2016 for 5% reduction over the average for January 1, 2016. The Bureau cited improvements related to reduced medical costs, although the cost of adjusting claims has been increasing. Mr. Steiner noted that the market is very competitive and State Fund has seen a significant drop in new business which is driving the reduction in in-force premium referenced in the CFO report. The estimated annual premium has declined in the first quarter approximately 8% compared to last year driven largely by a 44% reduction in new business. Mr. Steiner reported that the trend in new business will continue as submissions have decreased this year by 16%. This trend began last year and State Fund has seen it pick up in the first quarter. Brokers are using the PriceNow tool to get estimated prices but the consistent feedback is they have many options for their business.

Small Commercial Process Improvement

Mr. Steiner reported that State Fund's small commercial underwriting team has recently implemented some significant process redesigns to improve the efficiency and timelines of quoting. An educational campaign started with contracted brokers around the need for complete and accurate applications. Historically, incomplete submissions have created a significant delay on quote turnaround times. In addition, State Fund revised quote terms to be clear that quotes are "subject to" the information on the

application being correct, and implemented a back-end review process to focus resources to those accounts that bind with State Fund. Since implementation, the quote turnaround time was reduced from six to three days. Mr. Steiner noted this initiative was a project in which change management was well thought out and executed internally and externally and involved frontline staff in building solutions. This redesign puts State Fund on a stronger path for quoting efficiency, policy accuracy, pricing and customer service.

Roofing Incentive Program

Mr. Steiner reported that during the first quarter 258 employers were eligible, of which 130 accepted representing \$5,655,447 in premium. State Fund Loss Control conducted 382 separate inspections and generated 514 recommendations for the 130 participating businesses. In 1Q 2016, State Fund made incentive payments totaling \$71,897. Mr. Steiner noted that it is too early to measure long term success but State Fund has been told several employers are using the incentives to pay for new safety equipment such as fall protection harnesses. Employers turned down the program due to having a small number of employees or employees who are very experienced; and too much time to implement. State Fund has received positive feedback on the quality of the training of the independent trainers.

Curbing Opioid Addiction/Restoring Injured Workers

Mr. Steiner reported that State Fund has been working to curb the use of opioids by injured workers. State Fund has taken several steps to address this issue with doctors including: 1. injured worker education - mailers to injured workers prescribed with schedule II opioids describing the risks of opioids; 2. Provider education – card stock mailer to Medical Provider Network (MPN) physicians on Opioid Management and free continuing medical education (CME) developed at State Fund for training physicians on the management of acute pain and chronic pain; 3. Pharmacy – better tracking of injured worker medicine levels, establishment of a preferred drug list, reduced office dispensing through MPN agreements, tighter control on opioid dispensing, and closing the network; and 4. Peer to Peer counseling – performance management program for high offenders and a chronic pain program for complex cases.

Mr. Steiner reported that since implementation, the number of injured workers receiving over 80 and 120 medicines dropped by 38% and 47% between April 2014 to April 2015 and another 43% and 41% between April 2015 to April 2016. In November 2015, State Fund closed its pharmacy network and will continue to improve the quality of medical care for State Fund injured workers.

Lien Defense Strategy

Mr. Steiner noted that State Fund implemented a more assertive policy around handling of liens. Today, State Fund is focused on paying what State Fund owes timely and defending against what it does not owe. Mr. Steiner reported that in 2015, State Fund paid approximately \$27.5M in vendor liens, which was over \$22M less than in 2014. Included in this number were 2,472 wins which resulted in disallowed \$12,333,257 liens. After the 1Q 2016, it is reported 306 wins resulting in \$4,287,284 in disallowed liens. The 2016 year end projections are 1,236 wins, resulting in \$17,149,137 in liens disallowed. The drop off in the number of wins projected from 2015 to 2016 can be explained by the effects of SB 863. Specifically liens dismissed for failure to pay the lien activation fee by December 31, 2015 are now dismissed by operation of law. Although the number of wins is projected to decline by 50%, the dollar amount is expected to increase, likely due to the increase in hospital lien claimants with large lien balances that are challenging State Fund's Blue Cross/Anthem contract or that claim to be exempt from the Official Medical Fee Schedule. Mr. Steiner highlighted some cases.

AGENDA ITEM 8: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

8a: GOVERNANCE COMMITTEE

8ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported on the following activities:

2016 Code of Conduct

Mr. Mulryan reported that the 2016 Code of Conduct focused on State Fund's values and drivers, including "Doing the Right Thing." The 2016 Code of Conduct defined State Fund values; expanded the gift section to clarify alignment with the Fair Political Practices Commission and role-based restrictions; included material on copyright, ethics and accountability, and added a monetary loan subsection to the Incompatible Activities. The Code of Conduct training schedule has been published for employees to complete.

Mr. Mulryan noted that the Governance Committee approved the 2016 Code of Conduct and recommended the Board approve the 2016 Code of Conduct as presented. Ms. Chalupa called for a Motion.

MOTION: Mr. Kropke

SECOND: Mr. Rankin

To approve the 2016 Code of Conduct as presented.

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

YES: 8

NO: 0

Abstain: 0

Motion carried.

Statement of Economic Interest Compliance (Form 700)

State Fund achieved 100% compliance by active designated filers. The annual 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 notices before referring them to the FPPC.

Compliance Training

For 2016, compliance training includes regulatory-based training on Anti-Fraud, Privacy and Cyber Security (includes annual Proprietary System Notice); and Code of Conduct Acknowledgement.

National Data Privacy Day

This is State Fund's fourth year of participation in National Privacy Day. This year, Governance re-released the video titled "*We All Have a Choice to Make*," which highlights the role of each workforce member in safeguarding private information. The video received 850 views since its release.

State Fund is embarking on a Copyright Awareness program.

Ethics and Privacy Reports

Human Resources issues and suspected privacy incidents continue as the primary subjects of the reports. Eighty-three percent of referrals were internal and seventeen percent of the allegations were reported via State Fund's independent hotlines. Seventy-two percent of the referrals were HR diversity and workplace respect issues; and fifteen percent of the referrals were privacy-related matters.

8b: AUDIT COMMITTEE

8bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits

There were three closed audits: 2015 Talent Acquisition Audit; 2015 Claims Operations Site Visit and File Review – Stockton; and 2015 Accounts Payable Confirmations Project. In the 2015 Talent Acquisition Audit one issue was identified related to improving formal written policies and procedures to be followed by staff. In the 2015 Claims Operation Site Visit and File Review – Stockton two issues were identified related to improving controls over sending timely benefit notices, and the posting of case plans. In the 2015 Accounts Payable Confirmations Project the Internal Audit Department developed a process to validate vendor invoice payments, and verify vendor refund payments received by State Fund.

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 2016 there were 120 reports from the following sources: 6 from Ethics Hotline, 35 from Direct Reports, 52 from Human Resources and 27 referrals from the Privacy Office. Of the 120 allegations received, 57 investigations were completed. From the 57 completed investigations, there were 35 substantiated allegations referred to Manager Services for possible disciplinary action, 21 were unsubstantiated and 1 was inconclusive.

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.

8c: INVESTMENT COMMITTEE

8ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

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

Due to the lack of a quorum, items 3, 9 and 15 of the Investment agenda were deferred for approval at the July 2016 Investment Committee meeting.

Sen. Machado also reported the Investment Committee heard a report from Investment Manager BlackRock on the economic outlook and State Fund's portfolio performance results.

AGENDA ITEM 9: CHAIRWOMAN'S REPORT

Ms. Chalupa congratulated those employees with students who are graduating this year. Ms. Chalupa noted the importance of education and continues to encourage higher education for employees. She wishes employees a happy and safe summer for those with vacation plans.

AGENDA ITEM 10: BOARD MEMBER REPORTS

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

AGENDA ITEM 11: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 14 through 27

Ms. Chalupa requested public comment on the appropriateness of Closed Session for items 14 through 27, of which there was none.

AGENDA ITEM 12: PUBLIC COMMENT

Ms. Chalupa requested public comment. Ms. Chris Armenta, a defense attorney from Los Angeles involved in the *State Compensation Insurance Fund vs. Michael D. Drobot, Sr., et al.* case stated that the existing litigation process for this case has direct and serious personal, financial and emotional impacts on her clients and there is no evidence they were involved in defrauding State Fund. Lastly, Ms. Armenta recommended that State Fund file to get a return of fees from State Fund's counsel who was recently disqualified due to a conflict of interest for the sake of its stakeholders.

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

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:25 p.m. to immediately reconvene in Closed Session.

May 27, 2016

AGENDA ITEM 28: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:25 am at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA, following the conclusion of the Board Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Daniel M. Curtin; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; and William Zachry.

Absent: Robin L. Baker; Marvin P. Kropke; Jack L. Neureuter; and Christine Baker (non-voting member).

There was a quorum.

Also present: President & 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 29: PROPOSALS AND SUGGESTIONS FOR JULY 27-29, 2016 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 July 27, 2016 at The Renaissance Lodge in Sonoma.

Ms. Chalupa adjourned the meeting at 11:30 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary