

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

August 18 and 20, 2015

The Board of Directors of the State Compensation Insurance Fund met on August 18, 2015 at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA and on August 20, 2015 at the Omni Hotel, 500 California Street, San Francisco, CA.

August 18, 2015

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 11:30 a.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 (joined during Item 3); 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; General Counsel Margie R. Lariviere; 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 May 21-22, 2015 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Ratification of Appointment of General Counsel**
- 3d. Appointment of Corporate Secretary and Assistant Corporate Secretary**
- 3e. Ratification of Investment Policy Statement and Guidelines**
- 3f. Approval of Retirement Resolutions**
- 3g. Renewal of Expiring 4th Quarter Insurance Policies**

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

Abstain: 0

Motion carried.

Ms. Chalupa welcomed General Counsel Margie Lariviere to State Fund. Ms. Lariviere was named General Counsel in July 2015. Ms. Lariviere comes to State Fund with 20 years of experience as a trial attorney, advisor, regulatory counsel, executive, and law professor. Ms. Lariviere has been a Partner for Gordon & Rees, LLP based in San Francisco since 2012, where she served as a lead trial attorney in life, health, and disability litigation matters for insurance clients. Ms. Lariviere also brings a solid insurance background having served as an executive for AAA Insurance Exchange. Lastly, Ms. Chalupa noted that Ms. Lariviere has a passion for law and has been an adjunct professor for insurance at Hastings College of the Law for more than a decade. Ms. Lariviere serves as a committee member for the State Bar's Committee on Group Insurance programs, and has monitored settlement conferences as a judge pro tem in San Francisco Superior Court.

In addition, Ms. Chalupa thanked Ms. Padua for serving as Interim Corporate Secretary for over a year in the absence of the General Counsel. Ms. Chalupa noted that Ms. Padua will resume her position as Assistant Corporate Secretary.

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 2Q 2015 with 4,226 employees, 125 separations, 263 new hires, and 319 promotions. Of the 125 separations, 48 were retirements, 24 were resignations, 36 were transfers to other agencies, and 17 were others (death or dismissals). It is predicted that for 2015 the overall separation rate will be around 7.5% due to retirements.

Mr. Acker reported as of June 30, 2015 there was a 2.4% decrease in the number of hours over the 640 hour-cap and a 0.8% gain in the number of employees over the cap. Mr. Acker expects a further decrease in the number of hours for the 3Q 2015 as July and August are heavy vacation months. The leave cash out was a success with Supervisors and Managers cashing out 14,187.50 hours totaling \$558,897.69 attorneys cashing out 996 hours totaling \$52,899.56 and including other employees' cash out for 220 hours totaling \$6,062.60 for a grand total of 15,403.50 hours and cost of \$617,859.85.

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

AGENDA ITEM 5: FINANCIAL UPDATE – 2Q 2015

Chief Financial Officer Peter Guastamachio reported on the 2Q 2015 financial results. Mr. Guastamachio reported that net premium earned of \$787M was 8% more than last year, which is a \$60M increase over the prior year. This is due to moderate growth in premiums from renewal business. Mr. Guastamachio noted there is an overall increase in payroll across every industry sector including real estate and construction. It is predicted that the economy will remain strong the next few years.

State Fund combined Loss and Loss Adjustment Expense ratios totaled 106.6% through June 2015 which was 5 points lower than the same period in the prior year and slightly above budget. Mr. Guastamachio noted that last year there was a one-time increase in reserves of \$50M for Medical Cost Containment in the 1Q 2014 and a \$25M increase in reserves for State Fund's own Workers' Compensation self-insurance program in June 2014. This year, State Fund increased its reserves on its own Workers' Compensation self-insurance program in June 2015 by \$6M which accounts for the slight increase over budget of 0.6%.

The Underwriting Expense Ratio of 23% was 1 point higher than the same period in the prior year. This was attributed to higher variable expenses, primarily commissions and timing differences for group administrative fees. State Fund ended the 2Q 2015 with a Combined Ratio of 129.6% and an Underwriting Loss of \$234M which were 4 points and \$8M lower than the prior year. Offsetting the underwriting loss, the net investment income for 2Q 2015 was \$327M with realized capital gains of \$43M. This resulted in net income of \$132M for the quarter which is \$3M lower than the prior year. There was an increase in policyholders' surplus of \$55M since December 31, 2014.

In addition, Mr. Guastamachio noted by backing out all unplanned reserve changes for 2014 and 2015 plus any differences in the budget target for losses and LAE between 2014 and 2015, the combined ratio through June 30, 2014 would have been 123.2% versus 124.8% for the same period this year. This would have resulted in an Underwriting Loss of \$167M in 2014 versus \$196M in 2015.

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

AGENDA ITEM 7: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES (TAKEN OUT OF ORDER)

7a: GOVERNANCE COMMITTEE

7ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported on the following activities:

2015 California Whistleblower Protection Act Annual Notification – Annual notification has been emailed to all employees about the State Auditor's Whistleblower program and posters are displayed in areas where other employee notices are maintained. Whistleblower protection is extended to all reporters under California Law, regardless of venue reported.

Biennial Insurer Supplier Diversity Survey – The Supplier Diversity Survey was submitted to the Department of Insurance on June 30, 2015. There were 39 diverse suppliers used in 2014, a 21% increase in supplier volume since the 2013 report. Diverse Suppliers are minority- or women- or disabled veteran-owned businesses with headquarters in California.

Office of Foreign Assets Control (OFAC) Compliance – OFAC controls transactions and freezes assets of specifically designated nationals or other listed entities. State Fund is working to improve its OFAC related processes.

2015 Compliance Training Update – Further consolidation of ethics, conflicts of interest and privacy training into one module resulted in savings of 1-1/2 hours of employee time.

Preventing workplace harassment for employees was added and all compliance training must be completed by December 1, 2015.

Ethics and Privacy Reports – Human Resources and suspected privacy incidents continue as primary reports, with 31% of all concerns reported via State Fund's independent hotlines.

7b: AUDIT COMMITTEE

7bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits – At the May 2015 Closed Audit Committee session there were no new non-proprietary audits completed and reported for the 2Q 2015 so there is no update for the open session.

Whistleblower Hotline – All reports made through the Ethics Hotline are investigated. During 2Q 2015 there were 94 reports: 35 Ethics Hotline; 31 management referrals and 28 referrals from the Privacy Office. There were 94 new allegations received and 61 investigations completed. From the 61 completed investigations, there were 47 substantiated allegations and 14 unsubstantiated. Of the 47 substantiated allegations, 46 were referred to Manager Services for action and one involved an employee 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.

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 April 1, 2015 to June 30, 2015 were approved by the Investment Committee pursuant to its delegated authority, which included the purchase of 65 bonds totaling \$783.7M and sale of 18 bonds for \$134.9M. In the equity portfolio \$89.3M were purchased and \$75.4M were sold for rebalancing. The total net gain from the entire portfolio was \$42.8M. 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 Portfolio Performance results.

AGENDA ITEM 6: PRESIDENT'S REPORT (TAKEN OUT OF ORDER)

President and CEO Vern Steiner reported on the following activities:

Market Conditions:

Mr. Steiner reported that the market continues to show signs of softening. SB 863 savings are becoming more understood and overall carriers' combined ratios have been improving. There seems to be a general softening in prices especially for low risk, low loss business. State Fund submissions continue to be down this year compare to last year. This is due to increased competition and other dynamics. State Fund quoted a huge volume of California business since introducing its tiered rating in 2013 and has written a lot of new business in the past two years. The last rate filing was an increase that addressed specific needs in its pricing; and brokers are much more familiar with State Fund pricing.

Classification changes for 1000 State Fund workers:

Mr. Steiner reported that State Fund has limited control over classifications and pay ranges in the civil service system. State Fund has been examining pay issues in different parts of the organization and decided to move forward with a large position upgrade in core functions and specific insurance classifications. State Fund is upgrading positions in Claims and Policy functions where the work has increased in complexity, scope and responsibility over the years. This makes approximately 1,000 employees eligible for an upgrade to a senior level position subject to having passed the appropriate exam and received a supervisor's positive assessment of work performance. Mr. Steiner noted that this is an important step in assessing and aligning State Fund classifications with the level of work performed. Mr. Steiner further added that in the coming months State Fund will continue to evaluate positions to see if work has increased and to explore additional reclassifications.

Emerging Leader Program:

Mr. Steiner reported that State Fund established an Emerging Leader Program which is scheduled to launch the first two cohorts at the end of August 2015. The cohorts are a mix of new and current employees who have been identified as having high potential for leadership. In this program the participants will have the opportunity to attend industry-leading training in a blended curriculum of live courses and workshops; mentoring and coaching; on-the-job learning activities and assignments; online and eLearning modules; work on real-life business projects that make meaningful contributions; and demonstrate ability to achieve top results on a variety of business projects and assignments. Mr. Steiner noted that this is an important investment in creating a leadership pipeline to secure State Fund's future.

Strategy Videos and 1st All-Hands Quarterly Update:

Mr. Steiner noted that helping employees understand State Fund's vision for the future and its strategic plan has been a top priority this year. Throughout the year, a series of videos were produced providing a look into each of the strategies in the plan. Mr. Steiner reported that Chief Financial Officer Peter Guastamachio and his Finance team have also supported this effort with a series of roadshows that are designed to strengthen employees' understanding of how insurance financials work. The Finance team has managed to make these sessions fun and informative. In addition, Mr. Steiner reported that in July 2015 State Fund conducted its first ever All-Hands meeting via Webex to share results from the 1Q 2015 with employees. This was received positively and employees reported that it helped them better understand State Fund's strategic plan. Feedback was also received on how future sessions can be improved.

Lien Strategy:

Mr. Steiner reported that the Lien Defense Strategy that the State Fund Legal team has put together is having a significant reduction in lien settlement payments. In 2014, State Fund paid \$49,515,368 in lien settlements. For the 1st half of 2015, State Fund has paid \$11,713,071, and project \$23,426,141 by year's end. This represents an estimated 52% reduction in payments to lien claimants. The team working on these liens is very excited about the progress they are making. Each Friday they publish "Lien Wins of the Week", which in addition to motivating team members to get quality results, also serves as an information and education tool. Mr. Steiner shared some of the cases and employees who have had significant wins. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 8: CHAIRWOMAN'S REPORT

Ms. Chalupa noted that State Fund is a member of the American Association of State Compensation Insurance Funds (AASCIF), which is the trade association for state workers' compensation insurance companies from 26 different states and 8 Canadian workers' compensation boards. Each year AASCIF holds an annual conference for members to provide the opportunity for the executives and key personnel from various state funds to share best practices, discuss emerging issues, and learn new information to take back to their organizations. This year, California State Fund hosted the annual conference in July 2015. Several board members (Tom Rankin, Scott Reid, Larry Mulryan and Jack Neureuter) were able to attend. The conference was extremely well received and a big success. Ms. Chalupa congratulated and thanked Jennifer Vargen and Andreas Acker who were the executive sponsors of the event and also extended Board thanks and appreciation to everyone who worked to put the conference together.

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

AGENDA ITEM 9: BOARD MEMBER REPORTS

Ms. Chalupa requested any Board Member reports. Sen. Machado acknowledged the presence of Investment and Treasury department staff in the audience.

Ms. Robin Baker reported that she attended the Future of Occupational Health Symposium in June 2015. She noted discussion about issues that impact occupational health over the next 10-20 years in the areas of policy, practice and research. Ms. Baker noted that one major issue is the rapid growth in the usage of placement agencies and temporary workers in the workplace which affects the workers' compensation arena and has potential great impact to State Fund.

AGENDA ITEM 10: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 13-22

Ms. Chalupa requested public comment on the appropriateness of closed session for items 13-22 of which there was none.

AGENDA ITEM 11: PUBLIC COMMENT

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

Ms. Chalupa noted that the State Fund Board of Directors would now go into closed session for Board and Strategic retreat. Over the next couple of days, the Board and Executive Committee will be working on strategic planning. Ms. Chalupa highlighted the importance of strategic

planning which allows setting of priorities, focused energy and resources, strengthening operations, and ensuring employees and other stakeholders are working toward common goals. This is the time when the Board and Executive Committee establish agreement around intended outcomes/results, and assess and adjust the organization's direction in response to a changing environment.

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 11:55 a.m. to immediately reconvene in Closed Session.

August 20, 2015

AGENDA ITEM 23: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 10:40 a.m. at the Omni Hotel, 500 California Street, San Francisco, CA, following the conclusion of the Strategic Planning 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 by prior arrangement: 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; Counsel and Assistant Corporate Secretary Judith D. Sapper; and Randall Keen of Manatt, Phelps & Phillips, LLP.

AGENDA ITEM 24: PROPOSALS AND SUGGESTIONS FOR NOVEMBER 19-20, 2015 **AGENDA**

Ms. Chalupa noted that there has been a change to the November 2015 meeting dates due to conflict with some Board members. The meeting has been moved to December 10-11, 2015. Ms. Chalupa requested 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 December 10, 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 10:45 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary