

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

August 29 and 31, 2017

The Board of Directors of the State Compensation Insurance Fund met on August 29 and 31, 2017 at the Napa Valley Marriott Hotel, 3425 Solano Avenue (Carneros Room), Napa, California.

August 29, 2017

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at noon.

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; Jack L. Neureuter; Thomas E. Rankin; Scott K. Reid; and William M. Zachry.

Absent by prior arrangement: Daniel M. Curtin; Steven L. Rank; 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.

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 18 and 19, 2017 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Approval of Investment Policy Statement and Guidelines**
- 3d. Approval of Banking Resolution**
- 3e. 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: Sen. Machado

SECOND: Ms. Robin Baker

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 the second quarter of 2017 with 4,303 employees, 117 separations, 120 new hires, and 203 promotions. Of the 117 separations, 51 were retirements, 26 were resignations, 23 were transfers, and 17 were others (death or dismissal). The overall separation rate for the second quarter of 2017 was 5.4% and the primary driver was retirements. Retirements in 2Q 2017 are lower than the past 2 years in the same period due to pay raises in July 1, 2017. Overall separation rate by the end of the year is expected to be 7%.

Mr. Acker reported as of June 30, 2017 there was a 13.6% decline in the number of hours over the 640 hour cap and a 15.7% decrease in the number of employees over the cap. The number of leave hours over the 640 cap went down dramatically due to the employees using their leave over the summer months and many employees with leave over the 640 cap accepted the option to cash-out their leave credits. Mr. Acker noted he will report out at the November 2017 meeting on the number of employees who cashed out leave credits.

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

AGENDA ITEM 5: FINANCIAL UPDATE – 2nd Quarter 2017

Chief Financial Officer Peter Guastamachio reported on the 2Q 2017 financial results.

The overall forecast for California and the U.S. Economy continues to be slow growth of 2% nationwide and 2.5% in California. The economy is in the third longest economic expansion since World War II. According to 2 newsletters published by UCLA, it is also predicted that mid-2019 will be the beginning of a recession. Growth will slow globally as the Federal Reserve is expected to continue raising interest rates.

State Fund continues to see declines in renewal business and new business. Net premiums earned of \$692M were 10.8% lower than the prior year (\$777M) which is attributed to a soft market and a filed rate decrease of 9.5% effective September 2016. The combined loss and loss adjustment expenses (LAE) ratio of 100.6% was 5.7 points lower than the prior year. The loss ratio remained flat at 74%; however, the LAE ratio of 26.6% was 5.7 points lower than last year.

The underwriting expense ratio of 32% was 9.7 points higher than the same period last year. State Fund adopted a new methodology of allocating expenses at the beginning of the year. The new method more accurately reflects how expenses are allocated between the different insurance functions, and resulted in shifting expenses from LAE to Underwriting. Overall the expenses were down \$33M from last year, but the expense ratio's increase is due to the lower premiums. Premiums are declining faster than expenses resulting in a higher combined ratio. The \$33M reduction was primarily attributed to 3 categories: employee expenses or headcount was down by about 140 people; and less money spent both on IT consultants and computer equipment than was forecasted for the year.

The combined ratio was 132.1%, and underwriting loss of \$223M. The combined ratio and underwriting loss for the same period last year were 129.4% and \$234M. Offsetting the

underwriting loss, net investment income was \$318M plus realized gains of \$94M due to liquidation of equity holdings in March 2017 when one of the equity managers was replaced.

Overall this resulted in net income of \$167M, which was \$59M higher than the same period last year. The policyholders' surplus was increased by \$99M since year-end 2016.

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 following:

Market Condition

There was little change with the California workers' compensation market since the May 2017 Board meeting. The market continues to be soft with carriers actively competing for market share. Brokers continue to share with State Fund that under the current market climate, competition requires them to shop accounts annually.

Rates

While State Fund filed a 7.3% reduction to its pure premium rate on September 1, 2017, decreasing the average base rates by 8.0%, carriers that have chosen to file mid-year rate changes are reducing rates between 1% and 10% and may follow with single and double digit reductions to their January 1, 2017 rates (5% - 20.5%). Brokers shared that carriers are applying significant schedule credits to obtain new business. In addition, where State Fund has routinely served as the primary carrier to provide a market for companies who have had a lapse of coverage, State Fund is seeing other carriers expand that appetite to take on this segment of the market. In addition, some carriers are becoming more open to write contractors despite the size of the business and employers' experience in the industry.

New Business and Retention

Through July 2017 new business submissions match 2016 levels. However, bind rates have dropped due to aggressive pricing and expanded appetite. This trend is most noticeable in middle-market accounts (\$25k - \$250k). Although State Fund wants to serve California employers directly, it is critical that State Fund maintain appropriate pricing discipline. The California market has a long track record of overheating and carriers underpricing to gain market share. State Fund can best use this time to continue its work to strengthen its operations and make it easy to do business with State Fund.

EASE OF DOING BUSINESS

Customer Service Center's (CSC) New Billing Services Unit

Half of all calls to the CSC are billing related. State Fund launched a new Billing Services Unit (BSU) that will only handle billing issues. The unit's goal is to provide one-call-resolution. This unit has the potential to profoundly impact the quality of service State Fund provides to its customers.

New Audit Forms

State Fund is streamlining the audit experience for low-risk policyholders (<\$13k in EAP). State Fund is rolling out a simplified audit form at the end of the month to approximately 3,000

policyholders. This new form will deliver three key benefits: 1) reduce servicing costs, which in turn helps State Fund keep rates down for employers; 2) deliver a simplified process and better customer experience; and 3) improve the timeliness of audits.

The new Mail-In Audit form is a result of feedback from brokers and policyholders. The intent is to streamline the audit process from a one-size-fits-all approach to one that fits the business being audited.

New Claims Videos

Good communication with claimants is critical to achieving optimal outcomes. State Fund launched a series of videos, in both English and Spanish, to support an injured worker's understanding of the claims process. The videos contain straightforward information to educate claimants on the following topics: 1) understanding Workers Compensation; 2) understanding the Utilization Review and Independent Medical Review Process; 3) delayed claims; 4) beginning or resuming Permanent Disability Benefits; and 5) beginning Temporary Disability Benefits.

Everyone Drives Great Experiences (EDGE)

Mr. Steiner noted that at the May 2017 meeting, he reported on the roll out of the customer service workshop for all employees called EDGE, which stands for Everyone Drives Great Experiences, and is designed to help employees change how they work in order to create a more customer-centric culture. The EDGE concepts work for all employees, whether customers are external or internal. EDGE was created to help support our ongoing efforts to improve the culture at State Fund and make State Fund a customer-focused organization. To date, the entire organization has attended the EDGE training. It has been incorporated into onboarding for new employees. Mr. Steiner continues to follow up regularly with employees about the training and was pleased to find that overwhelmingly employees have embraced it and that it is having a positive impact on how to solve problems.

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:

Regulatory Compliance and Reporting

The Corporate Governance Annual Disclosure (CGAD) was submitted to the California Department of Insurance (CDI) on May 17, 2017 and the 2017 Biennial Insurer Supplier Diversity Survey was submitted on June 30, 2017. State Fund's diverse spend was 9.5% during the reporting period, spread amongst 44 unique suppliers.

The annual Whistleblower communication and brochure about the State Auditor's Whistleblower Program was sent by email to all employees on July 5, 2017 and posters displayed in State Fund locations. Attestation of distribution was sent to the State Auditor on July 6, 2017.

Ethics and Privacy Reported Issues

In April 2017, a message about State Fund's hotline as a safe zone was published to the organization along with a brief four question survey. A total of 769 employees responded (18%) which is above the expected response of 10%. All four questions were rated higher than 70% for Strongly Agree or Agree in the areas of reporting Code of Conduct violations, experience no retaliations from reporting, lost opportunities, and discipline for violators.

Hotline and internal reporting remained steady at 119 in 1Q and 123 in 2Q 2017. There were 39 hotline reports for the first half of the year. Human Resources related issues continue to be the most reported category nationwide in the first half of 2017, with time and behavior representing 81% in this category.

Revisions to Policy Supporting the Code of Conduct - Privacy and Confidentiality Corporate Policy EC&F 2.0

Material revisions include State Fund's workforce must protect personal information to prevent unauthorized disclosure and restrict data access; use personal or confidential information only for business purposes; and report suspected privacy breaches. The personal information definition and notice triggering disclosures aligned with recent changes in the Civil Code.

Ms. Chalupa called for a Motion.

MOTION: Mr. Kropke

SECOND: Mr. Neureuter

To approve the proposed changes to the Privacy and Confidentiality Corporate Policy EC&F 2.0 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.

2017 Code of Conduct Content Review Cycle

Mr. Mulryan reported that State Fund's maturity level for the Code of Conduct and policy functions now exceeds the Corporate Executive Board's (CEB) peer benchmarking report. The CEB recommends Code content review bi-annually for organizational and regulatory purposes. The Governance Committee agreed with the staff recommendation of moving from annual to biennial review to align with current best practices.

Ms. Chalupa called for a Motion.

MOTION: Mr. Kropke

SECOND: Mr. Neureuter

To approve the proposed changes to the Code of Conduct Content Review cycle 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.

7b: AUDIT COMMITTEE

7bi: UPDATE ON COMPLETED CLOSED AUDITS

Mr. Reid reported on the following activities:

Completed Closed Audits

Mr. Reid reported that four projects were reported in the first quarter of 2017 in the Closed Session in May 2017. There are no non-proprietary projects to report in Open Session.

Whistleblower Hotline

Mr. Reid reported all Ethics Hotline reports are investigated. There were 121 ethics allegations reported in the period of April 1st through June 30th. Of the 121 new allegations, 83 did not require investigation and were referred to Manager Services and 38 were referred to the Internal Investigations Unit. Of the 38 investigations, 19 of these investigations are currently still in progress and 19 investigations have been completed.

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 April 1, 2017 to June 30, 2017 were approved by the Investment Committee pursuant to its delegated authority. Sen. Machado also reported the Investment Committee heard a report on the environmental, social and governance (ESG) investing. The Committee directed the staff to conduct a Request for Proposal (RFP) for investment consulting firms who will assist in adopting an ESG policy.

AGENDA ITEM 8: CHAIRWOMAN'S REPORT

Ms. Chalupa reported that she had an opportunity to attend the Riverside and Bakersfield Town Hall meetings. She found them enlivening and insightful. There were some common themes throughout the sessions.

State Fund's North Star – There was a high degree of employee awareness regarding State Fund's North Star, which is "Driven to help others and do the right thing."

EDGE – Ms. Chalupa noted there were discussions on opportunities and challenges regarding the EDGE customer service training at the Town Hall meetings.

State Fund's Technology – Ms. Chalupa reported that employees discussed State Fund's technology systems initiatives and the timeframes for rollouts, bug fixes and enhancements. Employees readily aired their challenges adapting to the current state and acknowledged their progress adopting new system procedures.

One Process – Ms. Chalupa reported that employees and supervisors shared feedback about the new claims structure.

Healthy Environment – Ms. Chalupa shared an exchange that took place at the Town Hall, which displayed work environment and culture are shifting in positive directions. An employee did not hesitate to jump in and correct the President respectfully. This was a very healthy sign about how comfortable and safe employees feel.

Mr. Neureuter concurred with Ms. Chalupa's 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 through 19

Ms. Chalupa requested public comment on the appropriateness of Closed Session for agenda items 13 through 19, of which there was none.

AGENDA ITEM 11: PUBLIC COMMENT

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

ADJOURNMENT

Ms. Chalupa noted that the Board will now go into Board Closed Session and a strategic planning retreat meeting. Over the next couple of days, the Board and Executive Committee will be working on strategic planning. This is the time when the Board and Executive Committee establish agreement around intended outcomes/results, and assess and adjust the organization's direction.

There being no further business, Ms. Chalupa adjourned the meeting at 12:20 p.m. to immediately reconvene in Closed Session.

August 31, 2017

AGENDA ITEM 20: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:35 a.m. at the Napa Valley Marriott Hotel, 3425 Solano Avenue (Mt. Veeder and Howell Rooms), Napa, California following the conclusion of the Board Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Robin L. Baker; 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: Daniel M. Curtin; 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.

AGENDA ITEM 21: PROPOSALS AND SUGGESTIONS FOR NOVEMBER 16-17, 2017

AGENDA

Ms. Chalupa requested suggestions for agenda items for the November 16, 2017 Board meeting. Ms. Padua noted that the proposed agenda items are for Closed Session.

Ms. Chalupa requested public comment, of which there was none, and she noted that the next Board meeting is scheduled for November 16, 2017 at the State Compensation Insurance Fund Office, Pleasanton, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting at 11:40 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary