

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

November 16 - 17, 2017

The Board of Directors of the State Compensation Insurance Fund met on November 16-17, 2017 at the State Fund Pleasanton Office, 5890 Owens Drive (Pacific and Atlantic rooms), Pleasanton, California.

November 16, 2017

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2 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; 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 and CEO Vernon L. Steiner; General Counsel and Corporate Secretary Margie R. Lariviere; 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 August 29 and 31, 2017 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Review and Approval of 2018 Board and Committee Meeting Schedule and Location**
- 3d. Review and Approval of 2018 Board and Committee Agenda Items**
- 3e. Authorization to Secure a Renewal Workers' Compensation Program effective January 1, 2018**
- 3f. Approval of Retirement Resolutions**

Ms. Chalupa noted that “Approval of Investment Agenda Items” under agenda “item d” needed to be pulled out from the Consent Calendar. After further discussions with the Governance and Investment Committees, the annual agenda will be revised.

Ms. Chalupa asked whether any Board member had any other comments on the items on the Consent Calendar of which there were none. Ms. Chalupa called for a Motion.

MOTION: Mr. Mulryan

SECOND: Mr. Rankin

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

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 third quarter of 2017 with 4,315 employees, 198 separations, 208 new hires, and 326 promotions. Of the 198 separations, 96 were retirements, 47 were resignations, 33 were transfers, and 22 were others (death or dismissal). The overall separation rate for the third quarter of 2017 was 6.1% and the primary driver was retirements.

Mr. Acker reported as of August 31, 2017 there was a 19.7% decline in the number of hours over the 640 hour cap and a 21.2% decrease in the number of employees over the cap. The number of leave hours over the 640 cap went down dramatically due to the use of leave over the summer months and many employees accepting the options to cash-out their leave credits or put them into their 401K plans. Mr. Acker reported a total of 883 employees (staff and management) accepted the 2017 leave and savings plus buy backs, which totaled to 67,142 hours, \$2,589,004 in gross pay.

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

AGENDA ITEM 5: FINANCIAL UPDATE – 3rd Quarter 2017

On behalf of Chief Financial Officer Peter Guastamachio, President and CEO Vernon Steiner reported on the 3Q 2017 financial results.

State Fund continues to see declines in renewal business and new business. Net premiums earned of \$1B were 12.9% lower than the prior year (\$1.2B) which is attributed to a soft market and a filed rate decrease of 9.5% effective September 2016 and 8% effective September 2017. 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 32.7% was 9.8 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 \$49M 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 \$49M reduction was primarily attributed to three categories: employee expenses or

headcount was down; and less money was spent both on IT consultants and computer equipment than was forecasted for the year.

The combined ratio was 133.3%, and underwriting loss was \$340M. The combined ratio and underwriting loss for the same period last year were 129.2% and \$350M. Offsetting the underwriting loss, net investment income was \$469M plus realized gains of \$115M due to liquidation of equity holdings in March 2017 when one of the equity managers was replaced.

Overall this resulted in net income of \$210M, which was \$55M higher than the same period last year. The policyholders' surplus was increased by \$138M since year-end 2016.

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

AGENDA ITEM 6: PRESIDENT'S REPORT

President and CEO Vernon Steiner provided an update on the following:

Employee Response to Wildfires

Mr. Steiner reported that California experienced devastating wildfires in October 2017 that impacted many of State Fund's customers, brokers and employees. State Fund activated services to try to help all those who were impacted.

Mr. Steiner highlighted the generosity and compassion of State Fund employees who also stepped up to help their co-workers: 1) Employees adjusted workloads and opened their homes to offer shelter to employees who were evacuated; 2) donated \$6,000 in gift cards to their colleagues to help meet their immediate needs; 3) donated \$6,275 to non-profit agencies for disaster relief; and 4) started a GoFundMe campaign for those employees who lost their homes. Mr. Steiner noted that State Fund employees' commitment and generosity to their co-workers made him extremely proud to work for State Fund.

Market

California's workers' compensation market continues to be very competitive. Rates continue to decrease reflecting the savings from reform and medical cost trends. State Fund's most recent 8% rate decrease went into effect September 1, 2017 and follows a 9.5% rate decrease last year, which brings our average filed rates down by almost 17% in the past year.

Overall 2017 new business submission levels continued to track 2016. Factoring in the rate decrease, the written premium performance in the Small Commercial segment is also in line with 2016 performance.

Overall premium, however, for the year was down 18% at the end of the third quarter primarily due to lower retention in the middle market-sized accounts (\$25K - \$250K premium) where the market is particularly competitive. Consequently, Mr. Steiner noted that there was a decrease in the rate of lost premium in August and September and the October results showed a marked improvement.

State Fund continues to focus on strengthening its customer service and making it easier to do business, and ensuring that underwriters price each risk with careful consideration and at the best, appropriate price. Mr. Steiner noted that during soft market cycles, such as this, it is critical that State Fund maintain pricing discipline.

Recognizing Excellence in Video Production

Mr. Steiner reported that State Fund's video Workers' Comp 101 recently won the Best Video award at DevLearn's Demofest event. DevLearn is an annual conference for training professionals organized by the eLearning Guild, with a concentration on instructional design.

Mr. Steiner congratulated Tianna Mitchell and Carol Kim of Human Resources Department for their excellent work.

The winning video was shown to the Board.

Ms. Chalupa on behalf of the Board congratulated again the staff and requested that the video becomes part of the New Board Member On-Boarding training.

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 Legislation – SB 272 (Mendoza)

This legislation expanded State Fund's exempt positions from 11 to 16 positions and requires Board development and execution of salary setting criteria and salary survey processes. Starting in September 2018, State Fund is required to submit the report to the California Department of Human Resources (CalHR); make a biennial report to the Legislature; post the report on State Fund's website; and allow paper copies to be ordered by telephone.

State Fund's Charter and regulatory reporting documents have been revised accordingly.

National Association of Insurance Commissioners (NAIC) Model Data Security Rule

On October 24, 2017, the NAIC's Executive Committee and Plenary adopted Version 6 of the Model Law. The Model Law contains three required elements: 1) an Information Security Program; 2) Investigation of cybersecurity events; and 3) Notification to regulators and affected persons of cybersecurity events.

A Model Rule must be introduced and approved through the California legislative process to become law, which may take six months.

Ethics and Privacy Reported Issues

Hotline reporting remained steady at 16% of reported issues volume (27 of 173), which is in line with the national average for hotline reporting versus other sources.

The reporting volume increased by 38% quarter over quarter (173 versus 125), which can be attributed to the July 2017 organizational messaging and HR Performance

Management meeting outreach to managers and supervisors. Human Resources issues continue to be the most reported category for almost 70% of the reports (120 of 173).

7b: AUDIT COMMITTEE

7bi: UPDATE ON COMPLETED CLOSED AUDITS

Mr. Reid reported on the following activities:

Completed Closed Audits

Mr. Reid reported that seven projects were reported in the second quarter of 2017 in the Closed Session in August 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 151 ethics allegations reported in the period of July 1st through September 30th. Of the 151 new allegations, 106 did not require investigation and were referred to Manager Services and 45 were referred to the Internal Investigations Unit. Of the 45 investigations, 18 of these investigations are currently still in progress and 27 investigations have been completed.

Disaster Recovery Plan and GL Conversion Project

Mr. Reid reported that the Disaster Recovery Plan testing and the General Ledger conversion project were successfully implemented. Mr. Reid thanked the staff for their hard work and job well done.

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 July 1, 2017 to September 30, 2017 were approved by the Investment Committee pursuant to its delegated authority. Sen. Machado also reported the Investment Committee heard a report from Deutsche Asset Management on the market outlook; a report from staff on portfolio performance; and the Committee approved the Short-Term Investment Policy Statement and Guidelines Resolution Number 2126 and the Investment Policy Statement and Guidelines Resolution Number 2127.

7d: AD HOC SAFETY AND LOSS PREVENTION COMMITTEE

Ms. Robin Baker reported that the Ad Hoc Safety and Loss Prevention Committee has met three times and is working on the initiatives to be presented to the full Board for approval at the August 2018 Strategic Planning meeting.

AGENDA ITEM 8: CHAIRWOMAN'S REPORT

Ms. Chalupa reported on the following:

California Wildfires

Ms. Chalupa noted that the thoughts of the Board were with those who have been impacted by the California wildfires and the Board appreciated all that State Fund and its employees have done to help meet the needs of those in crisis. Ms. Chalupa acknowledged the State Fund team with Mr. Acker's leadership that mobilized immediately to support impacted employees; broadened the services of the Employee Assistance Program; and coordinated employee efforts to support colleagues.

In addition, as a result of these fires, State Fund's business continuity plans were activated. Ms. Chalupa recognized and thanked all of the employees that stepped up to ensure that State Fund's core functions – particularly claims benefit payment, new case make-up, and Customer Service Center – continued without interruption for customers and the injured workers.

End of Year

Ms. Chalupa reported that in addition to receiving business updates at the Board meetings, many Board members also attended town halls, business review meetings and other employee gatherings. The Board was able to see first-hand employees' enthusiasm for State Fund's purpose as well as their hard work and commitment to making State Fund even better. Ms. Chalupa thanked all employees for their hard work and on behalf of the Board wished all employees a very Happy Holiday season.

AGENDA ITEM 9: BOARD MEMBER REPORTS

Ms. Chalupa requested any Board member reports. Ms. Robin Baker reported that she attended the Workers' Compensation 101 training and was impressed with the quality of training. Ms. Baker congratulated the staff on the excellent on-boarding program. Ms. Baker also reported that she recently attended the American Public Health Associates Conference (APHA) and part of the agenda was readiness for Climate Change and the importance of each company's readiness to respond.

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

AGENDA ITEM 10: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 13 through 21

Ms. Chalupa requested public comment on the appropriateness of Closed Session for agenda items 13 through 21, 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 2:45 p.m. to immediately reconvene in Closed Session.

November 17, 2017

AGENDA ITEM 22: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 11:20 a.m. at the State Fund Pleasanton Office, 5890 Owens Drive (Pacific and Atlantic Rooms), Pleasanton, 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; Sen. Michael J. Machado (Ret.); Lawrence E. Mulryan (joined during item 23); Jack L. Neureuter; Steven L. Rank; Thomas E. Rankin; Scott K. Reid; and William Zachry.

Absent by prior arrangement: Marvin P. Kropke 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; Board Liaison and Assistant Corporate Secretary Hilda B. Padua; and Counsel and Assistant Corporate Secretary Judith D. Sapper.

AGENDA ITEM 23: APPROVAL OF BOARD COMMITTEE ASSIGNMENTS FOR 2018

Ms. Chalupa requested Ms. Padua to display the proposed Board Committee Assignments for 2018. Ms. Chalupa noted that the assignments include the expanded Investment and Risk Committee and that the Investment and Risk Committee Charter will be approved at the February 2018 meeting.

MOTION: Mr. Mulryan

SECOND: Mr. Curtin

To approve the Board Committee Assignments for 2018 as presented.

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

YES: 10

NO: 0

Abstain: 0

Motion carried.

AGENDA ITEM 24: PROPOSALS AND SUGGESTIONS FOR February 22-23, 2018 AGENDA

Ms. Chalupa requested suggestions for agenda items for the February 22-23, 2018 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 February 22, 2018 at the State Compensation Insurance Fund Office, Pleasanton, California unless noticed for a new date and time.

Ms. Chalupa adjourned the meeting at 11:25 a.m.

Respectfully submitted,

Hilda B. Padua
Board Liaison and Assistant Corporate Secretary