

**STATE COMPENSATION INSURANCE FUND
BOARD OF DIRECTORS**

MINUTES OF OPEN SESSION MEETING

November 20 and 21, 2014

The Board of Directors of the State Compensation Insurance Fund met on November 20 and 21, 2014 at the State Fund Corporate Office, 333 Bush Street, San Francisco, CA.

November 20, 2014

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order on November 20, 2014 at 2:05 p.m.

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

Absent by prior arrangement: Christine Baker (non-voting member).

There was a quorum.

Also present: President and 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 September 23 and 26, 2014 Open Meeting Minutes**
- 3b. Board Member Educational Opportunities and Approval of Planned Board Member Education and Expense Reimbursement**
- 3c. Authorization to Secure a Renewal Workers' Compensation Program effective January 1, 2015**
- 3d. Approval of 2015 Board and Committee Meeting Schedule**
- 3e. Approval of 2015 Board and Committee Agenda Items**
- 3f. Approval of Board Committee Assignments for 2015**
- 3g. Approval of Retirement Resolutions**
- 3h. Legislative Update**

Ms. Chalupa noted that there is no approval of an action for item 3h, "Legislative Update."

Ms. Chalupa asked whether any Board member had any comments on the items on the Consent Calendar. Mr. Rankin noted that he would like to add under agenda item 3b, "Board Member Educational Opportunities" National Academy of Social Insurance – Medicare and Medicaid: The Next 50 Years. Mr. Rankin noted he would like to add the training scheduled for January 2015.

MOTION: Mr. Kropke

SECOND: Mr. Zachry

To approve the Consent Calendar as presented.

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

YES: 11

NO: 0

Motion carried.

AGENDA ITEM 4: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 6-12

Ms. Chalupa requested public comment on the appropriateness of closed session for items 6-12, of which there was none.

AGENDA ITEM 5: PUBLIC COMMENT

Ms. Chalupa requested public comment.

1. President and CEO of the North State Building Industry Association (NSBIA) Michael Strech noted his association, which includes over 5000 employers who work mainly in residential construction, had an opportunity to meet with State Fund senior management three weeks ago in Pleasanton. The NSBIA advances risk management by partnering with employers to provide safety training and distribute safety information which benefits employers, workers and State Fund. This function has been embraced by both the industry and the policyholders. Mr. Strech noted the construction association coalition funded an actuarial study by Bickmore Risk Services which was completed in three weeks. The results were issued in a report which was distributed to the Board of Directors. The report showed that the construction book of business outperformed the State Fund book of business, with a loss ratio of 87%, which Marc Connerly of the Roofing Contractors Association of California will discuss during his public comment. By having this study done it shows how serious the association is on finding good long term opportunities to work with State Fund. Mr. Strech requested to continue the conversations about group programs and maintain an ongoing partnership so that they can be part of the solution for good pricing.
2. Aubyn Jo Dean deferred her public comment time to Executive Director of the Roofing Contractors Association of California Marc Connerly.
3. Executive Director of Roofing Contractors Association of California Marc Connerly stated that there is clear data showing the need for improvement in loss expense from State Fund's perspective. Mr. Connerly recently attended an insurance committee meeting which involved discussions regarding safety policies and training. He noted that the majority of the training provided now is in the form of video and written materials which have the lowest retention rates. He proposes the group program take on a different structure, which includes removing the 6% group discount rate and using a performance based group program instead. They would charge an administrative fee to market services to members. The proposal also includes construction groups be combined into

one super group with a qualification for dividend, credit, or refund evaluated on an individual basis.

4. Executive Director of Bay Area Builders Exchange Scott Leary expressed his appreciation to the Board's consideration given to the Group program. Mr. Leary noted that State Fund's Group program is a good choice for his employers. Mr. Leary would like to continue to leverage the association's strengths and relationships for mutual benefit.
5. SEIU Local and 1000 Vice President Margarita Maldonado discussed four issues. First, is the Performance Award structure and its implementation in the past. There have been many conversations concerning unequal application with an unfair percentage applied to two different tiers. Ms. Maldonado provided examples and requested a uniform process of administering the performance awards to employees. She is concerned the impact it has on employee morale. Second, is the outsourcing problem which Ms. Maldonado will discuss with State Fund's HR team on December 2, 2014. Third, is the communication to employees when the new Oracle Time and Labor System was rolled out. Ms. Maldonado noted the need for an active communication plan attached to the application for recording time and how to stay in compliance. There needs to be consistency in how lower and mid-level management instruct employees on how to record their time. Ms. Maldonado encourages a communication plan at every level for launching new programs. Fourth, is a letter written by Syretta Peoples, a Workers Compensation Technician in the Fresno CPC thanking the Board of Directors for offering tuition reimbursement. Ms. Peoples was able to obtain a Master's Degree from Fresno State University.

ADJOURNMENT

There being no further business, Ms. Chalupa adjourned the meeting at 2:40 p.m. to immediately reconvene in Closed Session.

November 21, 2014

AGENDA ITEM 13: CALL TO ORDER AND ROLL CALL

The meeting reconvened at 10:20 a.m. following the conclusion of the Closed Session and the following Members were present: Sheryl A. Chalupa (Chair); Robin Baker; Daniel M. Curtin; Marvin Kropke; Lawrence E. Mulryan; Jack Neureuter; Steven L. Rank; Thomas E. Rankin; Scott Reid; and William M. Zachry.

Absent by prior arrangement: Sen. Michael Machado and Christine Baker (non-voting member).

There was a quorum.

Also present: President and 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 14: RATIFICATION OF APPOINTMENT OF CHIEF OPERATING OFFICER

Ms. Chalupa noted there is nothing to report at this time.

AGENDA ITEM 15: STAFFING UPDATE

Executive Vice President of Human Resources and Chief Administrative Officer Andreas Acker presented an update on staffing. Mr. Acker reported that State Fund permanent staffing levels continue to decline with 4,130 permanent employees at the end of September 2014. There were 245 employees that separated through September, which represented a 7.6% annualized separation rate. There were 120 retirements and 71 transfers to other agencies which accounted for over 78% of the separations. The projection for the end the year is a separation rate of between 8% and 8.5%, in line with 2013 with the separation rate of 8.1%.

As of September 30th there was an 8.6% reduction in hours over the 640 cap and 7.5% reduction in the number of employees over the cap. The downward trend is expected to continue into the 4th quarter.

AGENDA ITEM 16: UPDATE ON AB 2720

Counsel and Assistant Corporate Secretary Judith D. Sapper noted that AB 2720 (Ting) will require all entities that are subject to the Bagley-Keene Open Meeting Act to report the votes of individual Board members on open session votes. The new legislation also requires reporting the vote or abstention on each action of each member present for the action. The new law will take effect on January 1, 2015. Beginning in January, staff will record each member's votes on actions taken in open session.

Ms. Sapper asked for preference of the Board on how to note each members vote. It was decided that each member with a "NO" or "Abstain" vote will be noted, which will be a more efficient way of capturing the votes. This method was adopted.

AGENDA ITEM 17: WORKPLACE SAFETY AND LOSS PREVENTION UPDATE

Program Manager of Safety and Health Lauren Mayfield presented on the history of loss prevention services, State Fund's current strategy and future envisioned services. Ms. Mayfield noted workplace safety has been a core value of State Fund since its inception. Loss Prevention staff have an average experience of 15-20+ years and are technically very well trained.

In the past, loss prevention services were focused on providing services to all employers by premium level not by risk. The frequency of service was dependent on the needs of the policyholder and the determination made by the loss prevention professional. Services were provided but the progress was not always tracked or documented well. Loss prevention efforts didn't reach all policyholders in need of safety advice or training due to premium thresholds. Public outreach was primarily offered via the State Fund website, social media and seminars.

Currently, the new strategy encompasses identifying employers at high risk for occupational injuries and illness which include industries such as construction and agriculture. There is a new methodology to identify those policyholders most in need of loss prevention services, which includes follow up visits at prescribed intervals to monitor progress. iPads have been implemented to aid in field work allowing Loss Prevention personnel to be able to document their work efficiently as they conduct their visits. In addition, safety materials are now digitalized with updated information on regulatory trends, streaming videos, social media, and increased seminar offerings. With this new framework there is the ability to collect data for analysis which

shows if interventions were successful, tailor services to the business, and to look at the impact of interventions over a period of time.

The future of Loss Prevention Services includes improved collaboration between State Fund and outside entities such as the Commission on Health and Safety and Workers Compensation and Cal OSHA to provide additional resources for policyholders through safety seminars and training resources. The State Fund website will also include industry specific safety information by industry and risk, with increased streaming videos, social media presence and expanded safety seminars.

AGENDA ITEM 18: FINANCIAL UPDATE – 3rd QUARTER 2014

Chief Financial Officer Peter Guastamachio reported on the 3rd quarter financial results for 2014. State Fund's financial results are significantly impacted by economic conditions, including unemployment and market pricing. State Fund continues to maintain disciplined pricing and wrote approximately 107,000 policies, which were 4% more than budget and 7% more than the same period in the prior year. Estimated annual premiums were 6% less than budget and 27% more than the same period in the prior year. The strong growth in premiums in 2014 is due to a hardened market and the impact of tiered pricing. The loss and loss adjustment expenses (LAE) ratio of 111.8% was 10 points higher than budget and 14 points higher than the same period in the prior year. There are several reasons for this increase. State Fund has seen a higher frequency of large losses in accident year 2014. This resulted in a 79% loss ratio, 4 points higher than budget and prior year. During this nine month period, State Fund also strengthened LAE reserves by \$50M for Medical Cost Containment and \$16M for the company's self-insurance program.

The combined ratio of 134% was 5 points higher than budget and 6 points higher than the same period in the prior year. The increase in the combined ratio is primarily attributed to the increases in loss and LAE. The related underwriting loss for the quarter was \$382M. The net investment income of \$494M was 3% higher than budget. The net income of \$182M was \$3M more than budget. Policyholders' surplus grew by \$142M since December 31, 2013. Ms. Chalupa requested public comment of which there was none.

AGENDA ITEM 19: PRESIDENT'S REPORT

President and CEO Vern Steiner reported that he completed his first round of employee visits. In total he met with 800 staff members and several hundred managers and supervisors. It was a beneficial experience that allowed him to understand the underlying dynamics of the organization. Mr. Steiner will work on the communication out to the organization regarding his insights and takeaways and plans to plot the course forward.

Ms. Steiner reported that he met with the attorney union, CASE, to introduce himself and establish a relationship. The meeting was productive where issues that are important to State Fund attorneys were discussed.

Mr. Steiner also reported that State Fund staff continued to meet with larger associations as part of the group insurance assessment. He met with the Farm Bureau leadership earlier in the month to advise them on the status of State Fund's assessment and to keep the lines of communication open.

In addition, Mr. Steiner noted that market conditions in California's workers' compensation seem to be softening.

AGENDA ITEM 20: REPORTS BY THE CHAIRS OF COMMITTEE ACTIVITIES

20a: GOVERNANCE COMMITTEE

20ai: GOVERNANCE, COMPLIANCE AND PRIVACY UPDATE

Mr. Mulryan reported that the third quarter compliance reporting includes 2014 annual anti-fraud training, code of conduct targeted training and acknowledgement results, reported ethics and privacy related issues, and new legislation AB 1710.

2014 Annual Anti-Fraud Training – As of September 1, 2014, 99.3% of employees identified as anti-fraud personnel have completed the training.

2014 Code of Conduct Training and Certification – As of September 1, 2014, 100% of consultants have completed the Code of Conduct training; 10 consultants had their access temporarily disabled until they completed their training. This is the highest rate that has been achieved since annual Code of Conduct training began.

Ethics and Policy Hotline Reported Issues – Human Resources reporting volume for 3Q 2014 remained constant compared to the same period in 2013. The 3Q reports by category included 35% suspected conflict of interest/discrimination; 9% suspected retaliation, 19% suspected misconduct; and 21% suspected misuse/theft of time or funds. Suspected privacy/security incident report volume declined 23% compared to 3Q of 2013. This is attributed to a decrease in volume of transmissions of private information for non-business purposes.

Policies and Procedures – New legislation AB 1710 (Dickinson) is effective January 1, 2015, amending the California Civil Code relating to unauthorized disclosure of California residents' personal information. The law requires companies to offer free credit monitoring services when a disclosure includes an affected person's social security number and/or driver's license number or California identification card number. State Fund's current practice extends beyond the law's requirements by offering free credit monitoring services to affected persons if their birthdate or financial account information has been disclosed.

20b: AUDIT COMMITTEE

20bi: UPDATE ON COMPLETED CLOSED AUDITS

Ms. Chalupa reported on the following activities:

Completed Closed Audits – The completed audits reported out in the September 2014 closed session were proprietary and are not subject to discussion in the Board of Directors open session.

Whistleblower Hotline – All reports made through the Ethics Hotline are investigated.

During 3Q 2014 there were 95 reports from all sources (Ethics Hotline – 42; Management referral – 24; Privacy – 29). There were 39 substantiated allegations; 30 involved employees transmitting their own personal identifying information (PII) or that of their family members, relatives, policyholders, and claimants to a non-State Fund e-mail account. None of the 30 substantiated privacy allegations were material to State Fund's financial statements. State Fund continues to educate its employees on the importance

of protecting PII and proprietary information. This education is completed through various training courses including annual Code of Conduct training.

20c: INVESTMENT COMMITTEE

20ci: BOND TRANSACTIONS AND COMPLIANCE REPORT

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

The investment transactions and compliance reports for the period of July 1, 2014 to September 30, 2014 were approved by the Investment Committee pursuant to its delegated authority, which included the purchase of 46 bonds totaling \$570.4M and sale of 7 bonds for \$67.2M. In the equity portfolio \$41.2M were purchased and \$44.5M were sold for rebalancing. The total net gain from the entire portfolio was \$49.7M as of September 30, 2014. The aggregate book value of all the investments was \$18.9B. There were two bonds no longer in compliance with State Fund's Investment Policy.

AGENDA ITEM 21: CHAIRWOMAN'S REPORT

Ms. Chalupa reported on the following activities:

National Association of Corporate Directors (NACD) Board Leadership Conference:

Ms. Chalupa reported that in October a number of Board Members (Scott Reid, Lawrence Mulryan, Michael Machado, Jack Neureuter, and Sheryl Chalupa) attended the NACD's Board Leadership Conference. The conference was comprehensive, covering important topics that were crafted to deepen attendees' understanding of both the challenges and opportunities Board members face in today's world. The conference was also an excellent opportunity to talk to other Directors from large and small businesses. Some of the highlights were as follows:

- Board Committee Forums (Audit, Nominating and Governance, Strategy and Risk) – A series of workshops that dove into the current issues, best practices and associated challenges that each various Board Committees face. These forums were designed to be highly practical and they provided good opportunity for peer-exchange discussions.
 - Audit Committee Hot Topics (changing regulatory environment, changes in revenue reporting requirements, cyber risk, etc.)
- The Board's Role in Strategy – In this session the NACD convened a Blue Ribbon Commission of directors, governance experts, and business leaders that shared how the Board and management need to prepare for and respond to the events that require a shift in strategic direction-such as mergers and acquisitions, disruptive technologies, natural disasters, or competitors.
- Cybersecurity and the Boardroom – This session drew on insights from NACD's Cyber Security Summit, and experts shared leading practices on how to prevent, detect, respond to, and mitigate these risks.
- The Internet of Everything – This session discussed the internet's omnipresent role in business and the enormous potential for disruption – that creates both risk and opportunity.

- Generations in the Boardroom – This session focused on preparing for generational changes and changing dynamics in the boardroom and at the management level.
- The Board's Role in Innovation – The NACD explored what activities corporate directors should engage in to ensure that the company's approach to innovation is sound, that the proper metrics are being used to analyze the success of the innovation strategy, and that the strategy aligns with long-term business goals.

Year-End Message:

Ms. Chalupa thanked Board members for their service and leadership in 2014. She also thanked the Executives and staff for their hard work in 2014. The organization managed a CEO transition and has made significant progress in improving customer service throughout the organization, but most especially in the Customer Service Center and in Underwriting. The first two phases of Next Generation Policy and Billing Systems initiatives were launched which included i) a redesigned website that provides easier navigation; ii) a customer portal that makes it easier for policyholders to manage their policies online; iii) PriceNowDirect - a new submission engine for employers who are not represented by a broker; and iv) a pilot program for the new quote management system.

In addition, Ms. Chalupa noted that on the Claims front staff continues to put in a lot of time and effort into the development of business requirements and a road map for the new claims management system, CARE. There is also progress managing opioid usage in the treatment of injured workers. Through peer to peer counseling and early intervention with pharmacy partners, 2014 marked the third year in a row for State Fund that opioids have declined both as the number of overall prescriptions and as a percentage of pharmaceutical expense. This is important work on behalf of injured workers and employers.

AGENDA ITEM 22: BOARD MEMBER REPORTS

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

AGENDA ITEM 23: PROPOSALS AND SUGGESTIONS FOR FEBRUARY 19-20, 2015 AGENDA

Ms. Chalupa requested additional items for the February 19-20, 2015 Board meeting. Mr. Rank requested a report on the expansion rate of the Special Investigation Unit (SIU) and areas of specialty and how SIU interacts with Underwriting, Premium Audit and other business units. He also requested a report on the number of investigators being hired and their background and expertise. 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 January 7, 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 Interim Corporate Secretary