

I. INTRODUCTION

A. BACKGROUND

California Governor Pete Wilson's report on Competitive Government in April of 1996, proposes many changes as part of his three year plan for streamlining state government.

The Competitive Government report suggests that many functions now performed by the State of California can be done better and at a lower cost by private and non-profit organizations. The report suggests that the State currently operates entities that are fully self-supporting and require no state oversight.

The Governor's first course of action was to direct all State agencies and departments to divest appropriate functions to the private and non-profit sector, particularly those that are self-supporting or can be run more efficiently through private or non-profit management.

Governor Wilson's action plan for the State Compensation Insurance Fund (State Fund) calls for the State Fund's Board of Directors and the Department of Industrial Relations (DIR) to conduct a comprehensive feasibility study on privatization of the State Fund to be completed in six months.

B. PURPOSE OF THIS STUDY

In response to that directive, Milliman & Robertson, Inc. (M&R) has been engaged to conduct a study examining the feasibility of privatizing the State Fund. Privatizing has many different meanings, and this study will review several major options. The study focuses on identifying the pros and cons of the options and to a limited extent on the implementation costs. Before a specific option could be adopted it will undoubtedly be necessary to develop more extensive cost and benefit information and to identify who will bear the costs and receive the benefits of implementation.

In examining the feasibility of privatization, this study addresses the following subjects:

- the history, characteristics, and status of the State Fund
- objectives of privatization in California
- guaranteed available market issues
- national models for guaranteed available markets
- legal issues

- privatization options for the State Fund
- evaluation criteria for options
- the evaluation of options

C. LIMITATIONS

We have relied on the accuracy of documents, data and information provided by the State Fund and by others. We have not audited or independently verified these data or information. If any portion of the underlying data or information are inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

Our various estimates, judgments, opinions, and recommendations involve future contingencies such as economic conditions, court decisions, legislative actions and the like. These conditions are subject to substantial uncertainty and actual results will vary from our estimates.

D. USE OF THIS STUDY

This study was prepared by Milliman & Robertson, Inc. for the State Fund Board of Directors and for the Director of the Department of Industrial Relations for presentation to the Governor's office for use in reviewing State Fund privatization options. Also contributing to this study are the State Fund staff, DIR staff, and tax experts from LeBoeuf, Lamb, Green & MacRae LLP. Throughout the study, matters of law, tax, personnel, legislation, accounting, and constituency interests are addressed. These portions of the report are contributions from the participants to the study other than Milliman & Robertson, Inc.

This feasibility study was prepared for the use of and only to be relied upon by the State Fund, the Department of Industrial Relations, and the Governor's Office. M&R is not responsible for any other use of the study. The data, assumptions, methodology, and conclusions in the study may not be appropriate for any other use. If provided to others, the study must be provided in its entirety. Any such party should have its own experts review this study to evaluate its relevance to that party and to ensure that the party understands the assumptions and uncertainties inherent in our study. This study may not be filed with the SEC or other securities regulatory bodies.