

**STATE COMPENSATION INSURANCE FUND
INVESTMENT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

November 18, 2010

The Investment Committee met on November 18, 2010 at the Milton Marks Conference Center, State Building, Benicia Room, 455 Golden Gate Ave, San Francisco, California.

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting came to order at 12:05 p.m. and the following members were present: Sen. Michael J. Machado (Ret.), Chair; Donald E. Garcia; Thomas E. Rankin; and Francis (Frank) E. Quinlan (Alternate).

There was a quorum.

Also present: Chief Investment Officer Peter Guastamachio; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie Chan; Treasury & Investments Manager Maria Quintanilla; Senior Vice President of Finance Ethel Wang; and Staff Counsel David Freitas.

AGENDA ITEM 2: APPROVAL OF SEPTEMBER 9, 2010 OPEN MEETING MINUTES

Sen. Machado requested a motion to approve the minutes of the September 9, 2010 Open meeting of the Investment Committee as presented.

Sen. Machado requested public comment of which there was none.

MOTION: Mr. Rankin SECOND: Mr. Garcia

To approve the minutes of the September 9, 2010 Open meeting of the Investment Committee as presented.

YESSES: 3 NOES: 0 Motion carried.

AGENDA ITEM 3: INVESTMENT CHARTER & INVESTMENT POLICY STATEMENT & GUIDELINES RESOLUTION REVIEW

Peter Guastamachio, Chief Investment Officer, highlighted the changes made to the revised Investment Charter and Investment Policy Statement & Guidelines Resolution. The Investment Charter has been updated to reflect that in the

absence of the President and Chief Investment Officer, the authority to direct investment transactions will be delegated to either the Chief Financial Officer or Chief Risk Officer. The Chief Risk Officer was added due to the recent retirement of the Executive Vice President of State Fund.

President Tom Rowe and Acting Chief Financial Officer Dan Sevilla joined the meeting at 12:15 pm.

Several changes were made to the Investment Policy Statement & Guidelines Resolution to reflect the passage of SB1407 which allows State Fund to diversify, strengthen its investment portfolio, and invest in corporate bonds effective January 1, 2011. For example, maximum allocation limits have been revised to allow no more than 45% of the total portfolio in corporate bonds, 20% in municipal bonds, and 55% in the aggregate total of corporate and municipal bonds. The minimum credit ratings for corporate and municipal purchases have been updated. Also, investment criteria for Commercial Paper and Certificates of Deposit issued by corporations were updated.

Sen. Machado requested a motion to recommend that the Board adopt the new Investment Charter and Investment Policy Statement and Guidelines Resolution as presented. A copy of the new Investment Charter and Investment Policy Statement and Guideline Resolution No 951 are attached to these minutes.

Sen. Machado requested public comment of which there was none.

MOTION: Mr. Rankin SECOND: Mr. Garcia

To recommend that the Board adopt the new Investment Charter and Investment Policy Statement and Guidelines Resolution No. 951 as presented.

YESSES: 3 NOES: 0 Motion carried.

AGENDA ITEM 4: APPROVAL OF INVESTMENT TRANSACTIONS

Stephanie Chan, Treasury & Investments Program Manager, recommended that the Investment Committee approve investment transactions from August 1 to September 30, 2010. All investment transactions for this period were made in accordance with the Investment Policy at the time of purchase. During the months of August and September, State Fund purchased 18 securities totaling approximately \$335.7M. During this same time period, State Fund sold nine securities totaling approximately \$37.5M. Year-to-date through September 30, 2010, State Fund booked a net capital gain of approximately \$5.5M. The book value of State Fund's portfolio as of September 30, 2010 was approximately \$19.2B.

Sen. Machado requested public comment of which there was none.

After presentation of the Bond Transactions report, the following actions were taken:

MOTION: Mr. Rankin SECOND: Mr. Garcia

To approve and recommend that the Board of Directors ratify the Bond Transactions for the period of August 1 through September 30, 2010.

YESSES: 3 NOES: 0 Motion carried.

Ms. Chan presented the Compliance Report indicating that all of State Fund's investments were in compliance with the Investment Policy and met certain minimum credit rating standards at the time of purchase. There were no changes to the Report since the July 2010 meeting. The three out-of-compliance bonds are Southern California Public Power Authority, Rancho Cucamonga, and the State of Oregon, totaling \$139M, or less than 1% of State Fund's investment portfolio.

Sen. Machado requested public comment of which there was none.

After presentation of the Compliance Report, the following actions were taken:

MOTION: Mr. Rankin SECOND: Mr. Garcia

To approve and recommend the Board of Directors ratify the Compliance Report for the period of August 1 through September 30, 2010.

YESSES: 3 NOES: 0 Motion carried.

AGENDA ITEM 5: MARKET OUTLOOK /ECONOMIC UPDATE

Peter Guastamachio, Chief Investment Officer, presented the U.S. Market Outlook and Economic Update. Mr. Guastamachio discussed the second round of quantitative easing policy, known as QE2. Aimed at stimulating the U.S. Economy, the Central Bank plans to purchase \$600B of Treasuries and reinvest all mortgage principal payments in Treasuries. As a result, the Central Bank hopes to lower the interest rates faced by companies and households. The ultimate goal is to stimulate the U.S. economy by encouraging consumer buying, increasing corporate profits, boosting the stock market, and increasing employment. However, QE2 does not appear to be working as effectively as planned due to the lack of support from countries like China. China is purchasing

less U.S. debt because they feel that a weaker dollar may hurt their exports and may increase inflation in their country.

Mr. Guastamachio presented an analysis of the current yield environment mapping the yield curves for Treasuries, Agencies, Mortgage-Backed Securities, Corporate Industrials, Corporate Finance, and Taxable Municipals. The corporate yields are much lower than nine months ago, which will make it difficult to improve the overall yield of this portfolio since reinvestment rates are so low.

The Committee had a discussion about the trend of unemployment rate and its impact on the economy.

AGENDA ITEM 6: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 8 THROUGH 10

Sen. Machado requested public comment of which there was none.

The Investment Committee immediately convened into Closed Session.

AGENDA ITEM 11: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:15 p.m. following the conclusion of the Closed Session and the following Members were present: Sen. Michael Machado (Ret.) Chair; Donald E. Garcia; Thomas E. Rankin; and Francis (Frank) E. Quinlan (Alternate).

There was a quorum.

Also present: Chief Investment Officer Peter Guastamachio; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie Chan; Treasury & Investments Manager Maria Quintanilla; Senior Vice President of Finance Ethel Wang; and Staff Counsel David Freitas.

AGENDA ITEM 12: COMMITTEE MEMBER PRESENTATIONS

Sen. Machado asked if there were any presentations from the Committee members, of which there were none.

AGENDA ITEM 13: PROPOSALS AND SUGGESTIONS FOR JANUARY 2011
AGENDA

Sen. Machado asked if there were any additional recommendations from the Committee for the November's agenda, of which there were none.

AGENDA ITEM 14: PUBLIC COMMENT

Sen. Machado requested if there were any speaker cards or public comment, of which there were none.

The next Investment Committee meeting is scheduled for January 20, 2011.

ADJOURNMENT

There being no further business before the Investment Committee, the meeting adjourned at 2:20 p.m.

Respectfully submitted,

Stephanie Chan
Assistant Corporate Secretary

STATE COMPENSATION INSURANCE FUND
Investment Committee Charter
(Adopted November 18, 2010)

Mission/Purpose

The Investment Committee (the "Committee") shall assist the Board of Directors ("Board") of State Compensation Insurance Fund ("State Fund") in fulfilling its investment oversight responsibilities by (1) overseeing State Fund's capital and financial resources; (2) advising the Board on issues related to State Fund's Investment Policy Statement and Guidelines ("Investment Policy") particularly in light of changing business, legislative, regulatory, legal or other conditions; (3) recommending, granting approval, making necessary decisions, and providing direction on items related to the investments of State Fund; and (4) monitoring, reviewing and evaluating the work of State Funds' Chief Investment Officer and outside Investment Managers relating to the investments of the company.

Organization

The Committee is a standing committee of the Board and shall be composed of no less than three (3) members. All Committee members must possess an understanding of the detailed responsibilities of the Committee membership and of State Fund's business, operating, financial, and investment environment. The Committee members shall maintain an effective working relationship with the Board, State Fund's Chief Investment Officer, State Fund's Chief Financial Officer, State Fund's management, outside Investment Managers, and financial consultants.

Meetings

The Committee shall hold regular meetings, in accordance with the provisions of the Bagley-Keene Open Meeting Act ("Bagley-Keene") and no less than four (4) times a year. The Committee shall hold regular meetings on the same day as, or within one day of, the regular meetings of the Board. The Committee may hold additional meetings at the request of any Committee member in compliance with the provisions of Bagley-Keene and State Fund's By-laws.

- a. The Committee may, at its discretion, invite members of management and/or other directors to attend the Committee's meetings where necessary to further the business of the Committee. Notwithstanding the foregoing, the total number of members of the Board (including Committee members) attending the Committee's meeting at any one time shall not equal or exceed a majority of the number of members of the Board.

- b. State Fund's Chief Investment Officer and Chief Financial Officer shall be present or available by phone during all regularly scheduled Committee meetings. The outside Investment Managers shall be present at Committee meetings as deemed appropriate by the Committee.
- c. A majority of the Committee shall constitute a quorum. Each member of the Committee will have one vote and actions at the meeting shall be approved by a majority of the members present.
- d. Minutes shall be prepared at each meeting and filed with the minutes of State Fund's Board.
- e. The Committee Chairperson or the Chairperson's designee shall give a full report of the Committee's actions at the earliest scheduled Board meeting.

Duties and Responsibilities

- 1. **Oversee**
 - a. Oversee that State Fund operates in a legal, ethical, and socially responsible manner and complies with all applicable laws in the execution of State Fund's Investment Policy.
 - b. Oversee all transactions as required by the Investment Policy and in compliance with the Insurance Code and approve all investment transactions, as appropriate within the parameters established by the Investment Policy and set forth in State Fund's Statutory Annual Statement to the Insurance Commissioner of the State of California.
- 2. **Recommend**
 - a. Work with State Fund's Chief Investment Officer to develop criteria for the selection and recommendation of an Investment Manager(s) to the Board based on those criteria.
 - b. Recommend the discharge of an Investment Manager, if necessary.
 - c. Recommend and approve updates and/or changes to the Investment Policy.
- 3. **Advise**
 - a. Advise the Board on matters related to State Fund's Investment Policy.
 - b. Advise the Board of changing business, legislative, regulatory, legal or other conditions that may affect State Fund's investment strategy.

4. Evaluate

- a. Evaluate the Investment Managers' performance, fee structures, services and any other relevant factors on an annual basis.
- b. Evaluate the effectiveness of the system used for monitoring compliance with State Fund's Investment Policy.
- c. Evaluate peer company investments on an annual basis.
- d. Evaluate the current investment strategy to determine if it is consistent with meeting State Fund's strategic goals.
- e. Evaluate the investment portfolio managed by outside Investment Managers and make recommendations based on that evaluation.

Powers

The Committee shall have the following powers:

- a. To meet with senior management and other appropriate parties to receive information and discuss investment strategies, including but not limited to strategic allocations, strategic duration and/or a method of determining an appropriate duration, and benchmarks, as necessary, to measure relevant manager performance and overall company performance.
- b. To oversee and consult with State Fund's Chief Investment Officer on matters related to investment strategies in accordance with State Fund's Investment Policy.
- c. To hire appropriate experts and authorize management to hire appropriate experts to execute investment and oversight functions.
- d. To perform other investment functions as requested by the full Board of Directors.
- e. To form and delegate certain authority to subcommittees.
- f. To amend or repeal the Charter or any provisions of the Charter as appropriate due to new laws or regulations and recommend any changes to the Board.
- g. To execute other powers as may be necessary and appropriate in order to fulfill the Committee's responsibility under this charter.
- h. To perform such other functions as assigned by State Fund's charter, bylaws, or the Board.
- i. To evaluate the Committee's performance on an annual basis, either separately or in conjunction with an annual evaluation of the full Board.
- j. To delegate to the President and Chief Investment Officer, the authority to direct investment transactions on behalf of State Fund and, in their absence, to delegate to either the Chief Financial Officer or Chief Risk Officer that authority to the extent deemed appropriate by the Committee and subject to the limitations set forth in the Investment Policy.

BOARD OF DIRECTORS

STATE COMPENSATION INSURANCE FUND

INVESTMENT POLICY STATEMENT & GUIDELINES RESOLUTION

WHEREAS, the Board of Directors of the State Compensation Insurance Fund (State Fund) is required to invest and reinvest the moneys of the State Fund which are in excess of current requirements in securities authorized by law for the investment of funds of private insurance carriers, in accordance with Sections 11787 and 11797 of the Insurance Code; and

WHEREAS, the State Fund is a non-tax paying entity; and

WHEREAS, the opportunities to acquire or dispose of such securities are such that it is impracticable to obtain the advice and determination of the Board in advance of each separate transaction; and

WHEREAS, the Board deems it to be prudent policy to establish standards which can be applied administratively to the selection and purchase of securities; and

RESOLVED, by the Board of Directors of the State Fund in regular meeting assembled at San Francisco on November 18, 2010 that:

- A. All purchases must meet the following criteria and any further detailed criteria for the specific mandate.
 - 1. The preservation of State Fund's principal and surplus, while maximizing income, will be the primary and underlying criteria for the selection and retention of securities.
 - 2. State Fund assets will be managed and controlled in a manner consistent with prudent business practices.
 - 3. The long-term objective is to exceed established benchmarks.

- B. The President or Chief Investment Officer, and in their absence, either the Chief Financial Officer or Chief Risk Officer, are hereby authorized to purchase or sell, exchange, or otherwise dispose of at the market, securities which are authorized by law for the investment of the funds of private insurance carriers provided the type of security to be acquired is described hereafter in this section and meets the conditions and standards set forth in Sections C, D, E and F as approved by the Board of Directors. Any Investment Manager approved by the Board of Directors and under contract with State Fund may purchase and sell securities on behalf of State Fund per the terms, limitations and guidelines set forth in this INVESTMENT POLICY STATEMENT & GUIDELINES RESOLUTION under the primary direction of the Chief Investment Officer and, in his/her absence, the direction of the aforementioned officers in this section.

- C. Long Term Fixed Income Investments

Allowable securities include the following assets and with Board approval can include other asset classes as allowed under applicable regulations.

 - 1. Bonds, notes, certificates of indebtedness, or other obligations for which the faith and credit of the United States of America are pledged.

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2. Obligations of US Government Agencies and Government Sponsored Entities (GSEs).
3. Obligations of the Dominion of Canada, or of any province of the Dominion of Canada, or obligations for which are pledged the faith and credit of the Dominion of Canada, or of any province or city of the dominion which are payable in US dollars.
4. Mortgage-backed securities (MBS) issued by the US Government Agencies and GSEs, including pass-throughs, PAC CMOs (Planned Amortization Class Collateralized Mortgage Obligations), TAC CMOs (Targeted Amortization Class Collateralized Mortgage Obligations), VADM CMOs (Very Accurately Defined Maturity Collateralized Mortgage Obligations) and Sequential pay CMOs, but excluding such mortgage derivatives as inverse floaters, interest only strips, principal only strips, and "support bonds." No direct sub-prime or Alt-A MBS are allowed.
5. Publicly traded fixed income securities issued by a corporation organized under the laws of the United States or any State thereof including securities issued under Rule 144(a).
6. General obligations of any State for which the faith and credit of the State are pledged for the payment of principal and interest.
7. Obligations issued under authority of law by any county, municipality, or school district in any State, or in any province of the Dominion of Canada or in any political subdivision of the Commonwealth of Puerto Rico, including bonds of any county water district.

D Cash and Cash Equivalents

Maintain short-term funds to obtain a reasonable level of earnings by participating in the following:

1. Bonds, notes, certificates or indebtedness, or other interest bearing obligations for which the full faith and credit of the United States of America are pledged.
2. Obligations of US Government Agencies and GSEs.
3. Commercial Paper issued by a corporation organized under the laws of the United States or any State.
4. Certificates of Deposit (CDs) issued by domestically chartered banks and savings and loans. The institution's charter is acceptable if granted by a state or national regulatory body. This includes domestically chartered branches of foreign banks, commonly referred to as Yankees.
5. Mutual Fund(s) that reflect similar criteria to those listed in D.1. through D.4.
6. State Treasurer's Pooled Money Investment Fund (PMIF).
7. Interest-bearing bank accounts.

E. Credit Rating Standards and Limitations

1. To monitor compliance, the investment manager will assign a credit rating to each security using the following logic: a) If one nationally recognized statistical rating

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organizations (NRSRO) rates the security, the rating will apply; b) If two NRSRO rate the security, the lower rating will apply; c) If all three NRSRO rate the security, the second lowest will apply; d) When considering the credit rating of the municipal securities, the higher of the financial guarantor or the underlying credit will be used.

2. The weighted credit rating of the fixed income portfolio shall average at least Aa2/AA/AA, at Moody's, S&P and Fitch, respectively, at all times.
3. There is no per issuer limit of US Treasuries and US Agencies.
4. The investment manager shall not purchase corporate securities rated below A2/A/A by two or more NRSRO without prior approval of the Chief Investment Officer.
5. The purchase of split-rated corporate securities where the lowest rating is A3 or A- is permitted only upon consent of the Chief Investment Officer before purchase (example: A3/A/A or A2/A/A-).
6. Single corporate issuer rated Aa3/AA- or better may not exceed 1.00% of the book value of the portfolio. Single corporate issuer rated below Aa3/AA- may not exceed 0.75% of the book value of the total portfolio, including the Cash Management Holdings. Only those holdings in each manager's positions exceeding the thresholds as of April 1, 2009 that resulted from the division of the portfolio are exempt from this limitation.
7. Corporate securities in aggregate shall not exceed 45% of the total portfolio, including the Cash Management Holdings.
8. The investment manager shall not purchase municipal securities rated below A2/A/A by two or more NRSRO without prior approval of the Chief Investment Officer.
9. The purchase of split-rated municipal securities where the lowest rating is A3 or A- is permitted only upon consent of the Chief Investment Officer before purchase (example: A3/A/A or A2/A/A-).
10. Single municipal issuer rated Aa3/AA- or better may not exceed 1.00% of the book value of the portfolio. Single municipal issuer rated below Aa3/AA- may not exceed 0.75% of the book value of the total portfolio, including the Cash Management Holdings. Only those holdings in each manager's positions exceeding this threshold as of April 1, 2009 that resulted from the division of the portfolio are exempt from this limitation. Ultimate credit obligor will be used to define a single municipal issuer.
11. Municipals in aggregate shall not exceed 20% of the total portfolio, including the Cash Management Holdings.
12. The aggregate total of corporates and municipals shall not exceed 55% of the total portfolio, including the Cash Management Holdings.
13. MBS issued by the US Government Agencies and GSEs shall comprise no more than 45% of the total portfolio, including the Cash Management Holdings. No single MBS pool may exceed 1.00% of the total portfolio, including the Cash Management Holdings. MBS will include all Agency MBS, CMOs and CMBS for the aforementioned limits.
14. No single Canadian political subdivision may exceed 0.75% of the book value of the portfolio. Canadian political subdivisions in aggregate shall not exceed 5% of the total portfolio, including the Cash Management Holdings.

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15. Securities issued and/or guaranteed by the US Government, US Agencies, and GSEs are recognized as Aaa/AAA entities if they have not been otherwise rated by the rating agencies.
16. Securities issued and/or guaranteed by the Government of Canada and political subdivisions must be rated Aa3/AA- or better by a NRSRO.
17. Securities issued and/or guaranteed by a State or political subdivision must be rated A3/A- or better by a NRSRO.
18. Securities issued by a qualifying corporation must be rated A3/A- or better by a NRSRO.
19. When calculating the sector limits, the Cash Management Holdings will be included. This number may be provided to the Investment Manager on a monthly basis.
20. 15% or more of the portfolio shall be maintained in securities maturing in five years or less.
21. The duration of the portfolio will be managed within a strategic range of 3.0 to 6.5, which is reviewed and approved by the Board annually. An operational target within the duration range will be established and reviewed by the Chief Investment Officer periodically.
22. The performance of the portfolio will be compared to the return of the benchmark noted in section F. At a minimum, the benchmark will be reviewed and reauthorized by the Board on an annual basis.
23. Purchases of Commercial Paper must be rated A1/P1 by two nationally recognized rating services and split rating is not allowed. Eligible Commercial Paper may not exceed 180 days' maturity, or represent more than 10 percent of the outstanding paper of an issuing corporation. No single Commercial Paper issuer may exceed 10% of the Total Cash Management Holdings. Eligible Commercial Paper is further limited to issuing corporations having shareholders' equity in excess of \$10 Billion. Commercial Paper holdings are limited to a maximum of 70% of the Total Cash Management Holdings.
24. Shares in any one mutual fund may not exceed 3% of State Fund's total assets, or 50% of the total Cash Management Holdings, whichever is less. Total investment in all mutual funds may not exceed 7% of State Fund's total assets.
25. The terms for any CDs should never exceed a year. CDs per issuer may not exceed \$50 million or 10% of the total Cash Management Holdings. CDs are further limited to issuing corporations having shareholders' equity in excess of \$10 Billion. CD holdings are limited to a maximum of 30% of the Total Cash Management Holdings. CD issuers must be rated A1/P1 by two nationally recognized rating services.
26. Balances maintained in the PMIF will be monitored regularly by the Cash Management Unit of Fiscal & Investment Services, and reported to the Cash Management and Investment Committee on a monthly basis.
27. If any of the above mentioned rules are breached, the Investment Manager will conduct an analysis and present it with a recommendation to the Chief Investment Officer.

State Compensation Insurance Fund

Investment Policy Statement & Guidelines Resolution

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F. Performance Benchmark

1. The benchmarks are for individual mandates and the overall portfolio for fixed income is Barclay's U.S. Treasury Intermediate Index: 15%, Barclay's U.S. Agency Intermediate Index: 15%, Barclay's Taxable Municipal Index: 10%, Barclay's U.S. Corporate A or better Intermediate Index: 20%, and Barclay's Fixed Rate MBS Index: 40%.

RESOLVED, that this Resolution No. 951 shall replace Investment Resolution No. 919 effective January 1, 2011.