

**STATE COMPENSATION INSURANCE FUND
INVESTMENT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

March 17, 2011

The Investment Committee met on March 17, 2011 at Milton Marks Conference Center, Benicia Room 3, 455 Golden Gate Avenue, 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: Chair Senator Michael J. Machado (Ret.); Donald E. Garcia; and Thomas E. Rankin. Francis E. Quinlan joined the meeting at agenda item 6.

There was a quorum.

Also present: President Tom Rowe; Chief Financial Officer Dan Sevilla; Chief Investment Officer Peter Guastamachio; General Counsel and Corporate Secretary Carol Newman; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie Chan; Treasury & Investments Manager Maria Quintanilla; Senior Vice President of Finance Ethel Wang; Staff Counsel David Freitas. Conning Asset Management Chief Investment Officer Rich Sega; Conning Asset Management Director, Head of Municipal Credit Research Paul Mansour; Standard and Poor's Managing Director Credit Market Services Steven Zimmermann; Standard and Poor's Director Credit Market Services Gabriel Petek

AGENDA ITEM 2: APPROVAL OF JANUARY 20, 2011 OPEN MEETING MINUTES

Sen. Machado requested a motion to approve the minutes of the January 20, 2011 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 January 20, 2011 Open meeting of the Investment Committee as presented.

YES: 3 NO: 0 Motion carried.

AGENDA ITEM 3: APPROVAL OF INVESTMENT TRANSACTIONS

Stephanie Chan, Treasury & Investments Program Manager, recommended that the Investment Committee approve investment transactions from December 1,

2010 to January 31, 2011. All investment transactions for this period were made in accordance with the Investment Policy at the time of purchase. During the months of December and January, State Fund purchased 44 securities totaling approximately \$404M. During this same time period, State Fund sold 5 bonds for a total of \$141M. Year-to-date through January 31, 2011, State Fund recognized a net capital gain of approximately \$184,000. The book value of State Fund's portfolio as of January 31, 2011 was approximately \$18.9B.

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 December 1, 2010 through January 31, 2011.

YES: 3 NO: 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 are two items on the report. The two out-of-compliance bonds are Rancho Cucamonga and the State of Oregon bonds. At the end of January 2011, the total amount of the bonds listed on the report is \$39M, which represents 0.2% 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 December 1, 2010 through January 31, 2011.

YES: 3 NO: 0 Motion carried.

AGENDA ITEM 4: MUNICIPAL BONDS MARKET OUTLOOK

Steven Zimmermann, Managing Director of Credit Market Services at Standards and Poor's (S&P), provided an introduction regarding the municipal bond market. He compared the rating distribution of U.S. municipal bonds with corporate bonds. He stated that over time, municipal ratings have been more stable than corporate ratings. S&P rates 40% of the securities sold in the municipal market.

Gabriel Petek, S&P's Director of Credit Market Services, stated the municipal market is broad and diverse; however, recently the municipal market is being impacted by a difficult economy, fiscal strain, budgetary issues, more strenuous regulatory requirements, and underperforming state and local revenues. Problems with financial liquidity could lead to cash flow problems and some credit ratings may be downgraded due to pension and long term health benefits underfunding. S&P anticipates additional near term rating downgrades but does not expect widespread default in this sector.

The Board asked S&P about the 2008 financial crisis and the effect on transparency requirements. S&P pointed out it is more forward looking with financial institutions; however, the overall rating criteria for Corporate Bonds and Municipal Bonds have not changed much after the crisis. Municipal bonds have different revenue streams and must be reviewed individually to determine their capacity to pay existing debt. Therefore, S&P continues to look at institutions on a case by case basis.

AGENDA ITEM 5: MARKET OUTLOOK /ECONOMIC UPDATE

Rich Sega, Conning Asset Management Chief Investment Officer, presented the U.S. Market Outlook and Economic Update. Mr. Sega discussed the effects the earthquake and tsunami disaster in Japan may have on the world economy. Some of the impact can be measured (for example the impact to Toyota or Honda Motors) but the impact of Japan's nuclear problems cannot be measured until contamination levels can be assessed. The yen remains strong and the cost of this disaster will be substantial for reinsurers. Long-term effects of this crisis may bring a flight to quality but it is difficult to predict how this will affect long-term rates. Japan's losses have been estimated at \$350B but this is a conservative estimate and will likely grow. Insured losses are estimated at \$15-\$35B. Countries will begin buying Japanese bonds and Japan will be buying less U.S. Treasuries.

The U.S. GDP growth was expected to average about 3.9% over the next two years but it is now lower. The unemployment rate remains high at over 9% and the number of people employed is still low. Housing prices have fallen and the weakness in housing is not completely over yet. Political unrest in Libya continues to put stress on oil prices which are still rising. Mr. Sega emphasized that Conning is still recommending an overweight position in corporate bonds.

Paul Mansour, Conning Asset Management Director of Municipal Credit Research, stated that most of the negative news in the municipal sector is related to General Obligation debt. Revenue bonds have not been adversely affected and are more stable credits. During the later part of 2010, there were large outflows of capital from municipal bond funds which caused bond prices to drop but prices have rallied in 2011 and the municipal market is more stable.

Mr. Francis (Frank) E. Quinlan joined the meeting.

AGENDA ITEM 6: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 9 THROUGH 11

Senator Machado requested public comment of which there was none.

The Investment Committee immediately convened into Closed Session.

AGENDA ITEM 12: 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: President Tom Rowe; Chief Financial Officer Dan Sevilla; 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; Staff Counsel David Freitas Conning Asset Management Chief Investment Officer Rich Sega and Conning Asset Management Director, Head of Municipal Credit Research Paul Mansour;

AGENDA ITEM 13: COMMITTEE MEMBER PRESENTATIONS

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

AGENDA ITEM 14: PROPOSALS AND SUGGESTIONS FOR MAY 12, 2011 AGENDA

Senator Machado asked if there were any additional recommendations from the committee for the May 12, 2011 agenda, of which there were none.

ADJOURNMENT

There being no further business before the Investment Committee, the meeting adjourned at 2:16 pm.

Respectfully submitted,

Stephanie Chan
Assistant Corporate Secretary