

**STATE COMPENSATION INSURANCE FUND
INVESTMENT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

FEBRUARY 16, 2012

The Investment Committee met on February 16, 2012 at the State Compensation Insurance Fund Headquarters, Board Room, 333 Bush Street, San Francisco, California.

AGENDA ITEM 1: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 12:15 p.m. and the following members were present: Chair Senator Michael J. Machado (Ret.); Donald E. Garcia; Scott K. Reid; and Francis E. Quinlan (Alternate).

There was a quorum.

Also present: President Tom Rowe; Chief Financial Officer Dan Sevilla; Chief Investment Officer Peter Guastamachio; Deputy Chief Counsel and Assistant Corporate Secretary Judith Sapper; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie Chan and Board Liaison and Assistant Corporate Secretary Hilda Padua.

AGENDA ITEM 2: APPROVAL OF NOVEMBER 17, 2011 OPEN MEETING MINUTES

MOTION: Mr. Garcia SECOND: Mr. Reid

To approve the minutes of the November 17, 2011 Open meeting of the Investment Committee as presented.

Sen. Machado requested public comment of which there was none. Sen. Machado called for the vote.

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 October 1, 2011 to December 31, 2011. All investment transactions for this period were made in accordance with the Investment Policy at the time of purchase. From October to December 2011, State Fund purchased 66 bonds totaling approximately \$669M. During this same time period, State Fund sold 2 bonds for a total of \$8M. Year-to-date through December 31, 2011, State Fund recognized a net capital gain of approximately \$13.7M. The book value of State Fund's portfolio as of December 31, 2011 was approximately \$18.9B.

MOTION: Mr. Garcia SECOND: Mr. Reid

To approve the Bond Transactions for the period October 1, 2011 through December 31, 2011.

Sen. Machado requested public comment of which there was none. Sen. Machado called for the vote.

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 a total of four out-of-compliance bonds. The Amgen and Mercantile Bankshares bonds were added to the out-of-compliance report, but will no longer appear in the next report, since they were sold at a gain in January 2012. At the end of December 2011, the total amount of the bonds listed on the report is \$66M, which represents approximately 0.3% of State Fund's investment portfolio.

MOTION: Mr. Garcia SECOND: Mr. Reid

To approve the Compliance Report for the period October 1, 2011 through December 31, 2011.

Sen. Machado requested public comment of which there was none. Sen. Machado called for the vote.

YES: 3 NO: 0 Motion carried.

AGENDA ITEM 4: APPROVAL OF INVESTMENT GUIDELINES

Sen. Machado called upon Chief Investment Officer Peter Guastamachio to present proposed revisions to the Investment Policy Statement & Guidelines Resolution. The Investment Resolution has been revised to expand the issuer limits based on credit quality. Single corporate issuer rated double A or better may not exceed 1.5% of the book value of the portfolio. Single corporate issuer rated below double A may not exceed 1.0% of the book value of the portfolio. The minimum credit quality of bond purchases has been changed from A2/A to A3/A-. The investment portfolio remains conservative with high credit-quality bonds. This modification is recommended because the corporate earnings (adjusted earnings per share) have increased four times from December 31, 2008 to September 30, 2011 and current debt leverage is the lowest in 25 years. The U.S. market is more stable than it was two years ago.

MOTION: Mr. Garcia SECOND: Mr. Reid

To recommend to the Board of Directors approval of the new Investment Resolution as presented.

Sen. Machado requested public comment of which there was none. Sen. Machado called for the vote.

YES: 3 NO: 0 Motion carried.

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 February 16, 2012 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.
- 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, or of the Dominion of Canada, or of any province of the Dominion of Canada which are payable in US dollars, 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 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 A3/A- by any NRSRO.
5. Single corporate issuer rated Aa3/AA- or better may not exceed 1.5% of the book value of the portfolio. Single corporate issuer rated below Aa3/AA- may not exceed 1.0% of the book value of the total portfolio.
6. Corporate securities in aggregate shall not exceed 45% of the total portfolio, including the Cash Management Holdings.
7. The investment manager shall not purchase municipal securities rated below A3/A- by any NRSRO.
8. 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.
9. Municipals in aggregate shall not exceed 20% of the total portfolio, including the Cash Management Holdings.
10. The aggregate total of corporates and municipals shall not exceed 55% of the total portfolio, including the Cash Management Holdings.
11. 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% of the total portfolio. MBS will include all Agency MBS, CMOs and CMBS for the aforementioned limits.
12. Securities issued and/or guaranteed by the Government of Canada and political subdivisions must be rated Aa3/AA- or better by a NRSRO. No single Canadian political subdivision may exceed 1.5% of the book value of the portfolio. Canadian political subdivisions in aggregate shall not exceed 5% of the total portfolio.
13. Securities issued and/or guaranteed by the US Government, US Agencies, and GSEs that have not been rated by a NRSRO will apply the rating assigned by the NRSRO to the issuer or the guarantor of the security.
14. Each of the Investment Managers will calculate the sector limits based on the book value of their respective portfolio. However, when calculating the sector limits at month-end, the Treasury & Investments staff will include both the book value of the total portfolio and the Cash Management Holdings.
15. 15% or more of the portfolio shall be maintained in securities maturing in five years or less.

16. 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.
17. 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.
18. Purchases of Commercial Paper must be rated A1/P1 by two NRSRO's 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.
19. 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.
20. 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, whichever is less. 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 NRSRO's.
21. Balances maintained in the PMIF will be monitored regularly by the Treasury and Investments staff, and reported to the Treasury and Investments Committee on a monthly basis.
22. 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.

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: 12.5%, Barclay's U.S. Agency Intermediate Index: 15%, Barclay's Taxable Municipal Index: 12.5%, Barclay's U.S. Corporate A or better Intermediate Index: 25%, and Barclay's Fixed Rate MBS Index: 35%.

RESOLVED, that this Resolution No. 1024 shall replace Investment Resolution No. 967 effective February 16, 2012.

AGENDA ITEM 5: ECONOMIC AND INVESTMENT OUTLOOK

Sen. Machado called upon Chief Investment Office Peter Guastamachio to introduce Rich Sega, Chief Investment Officer of Conning Asset Management, and Sean Hughes, Portfolio Management Director of Conning Asset Management. Mr. Sega reported on the current economic outlook and capital markets. While the Federal Reserve is keeping its target short-term

Federal Funds rate low until 2014, Mr. Sega shared his views on global recession, inflation, and regulatory uncertainty, which continue to put pressure on long-term interest rates as well. Mr. Hughes discussed how to mitigate the risk of rising interest rates by investing in select corporate bonds and high-dividend equity.

AGENDA ITEM 6: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 9 THROUGH 16

Sen. Machado requested public comment on the appropriateness of closed session agenda items 9-16, of which there was none.

AGENDA ITEM 7: PUBLIC COMMENT

Sen. Machado requested further public comment of which there was none. The Investment Committee immediately convened into Closed Session at 1:00 p.m.

AGENDA ITEM 17: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:05 p.m. following the conclusion of the Closed Session and the following members were present: Sen. Michael Machado (Ret.) Chair; Donald E. Garcia; Scott K. Reid; and Francis E. Quinlan.(Alternate).

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; Deputy Chief Counsel and Assistant Corporate Secretary Judith Sapper; and Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie Chan.

AGENDA ITEM 18: COMMITTEE MEMBER PRESENTATIONS

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

AGENDA ITEM 19: PROPOSALS AND SUGGESTIONS FOR MAY 17, 2012 AGENDA

Sen. Machado requested suggestions for agenda items for the May 17, 2012 Investment Committee meeting other than the standing agenda items, of which there were none.

ADJOURNMENT

There being no further business before the Investment Committee, the meeting adjourned at 2:10 p.m.

Respectfully submitted,

Stephanie Chan
Assistant Corporate Secretary