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Date: May 10, 2010

**AGENDA ITEM 10**

**TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT: INVESTMENT POLICY**
- II. PROGRAM: EXECUTIVE - CHIEF INVESTMENT OFFICER**
- III. RECOMMENDATION: To adopt new Resolution replacing Investment Resolution No. 871 effective May 21, 2010.**

- IV. ANALYSIS:**  
A proposed Investment Policy Statement and Guidelines Resolution No. 919 is attached with the recommendation that it replace Investment Resolution No. 871 effective May 21, 2010.

The Investment Charter was reviewed and there are currently no recommendations for changes.

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PETER GUASTAMACHIO,  
Chief Investment Officer

Attachments

INVESTMENT COMMITTEE MEETING (OPEN)

AGENDA ITEM 10

ATTACHMENT 10-I

APPROVAL of INVESTMENT GUIDELINES and CHARTER

PRESENTED BY: Michael J. Machado, Peter Guastamachio

May 20, 2010

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 Compensation Insurance Fund in regular meeting assembled at San Francisco on May 21, 2010 that:

- A. All purchases must meet the following criteria and any further detailed criteria for the specific mandate.
  1. The preservation of State Compensation Insurance 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 performance benchmarks.
- B. The President or Chief Investment Officer, and in their absence, either the Executive Vice President or Chief Financial 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 full faith and credit of the United States of America (US) 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 U.S. 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 mortgage derivatives such 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 US or any State thereof including securities issued under Rule 144(a) that are held in the portfolio and were purchased prior to May 9, 2008. Effective May 9, 2008, new purchases of bonds, notes, and other interest bearing obligations issued by a corporation organized under the laws of the US or any State thereof are not permitted.
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 but excluding obligations issued by public universities effective March 2, 2010. Public university bonds that are held in the portfolio and were purchased prior to March 2, 2010 are permitted to be held.

**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 US are pledged.
2. Securities of US Government Agencies and GSEs.
3. 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.
4. Mutual Fund(s) that reflect similar criteria to those listed in D.1. through D.3.
5. State Treasurer's Pooled Money Investment Fund (PMIF).
6. Interest-bearing bank accounts.

**E. Credit Rating Standards and Limitations:**

1. The 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.

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2. The investment manager will assign a credit rating to each security using the following logic: a) When considering the credit rating of the municipal securities, the higher of the financial guarantor or the underlying credit will be used. b) If one nationally recognized statistical rating organization (NRSRO) rates the security, the rating will apply; c) If two NRSRO rate the security, the lower rating will apply; d) If all three NRSRO rate the security, the second lowest will apply.
3. There is no per issuer limit of US Treasuries, US Agencies, and Agency MBS.
4. No single corporate issuer may exceed 0.75% of the book value of the portfolio. 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.
5. New purchases of municipals shall be rated no lower than A2/A/A or better, using the methodology described in E (2). No single municipal issuer may exceed 0.50% of the book value of the portfolio. 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. Municipals in aggregate shall not exceed 15% of the portfolio.
6. MBS issued by the US Government Agencies and GSEs shall comprise no more than 45% of the total portfolio. No single MBS pool may exceed 1.00% of the book value of the portfolio. MBS will include all Agency MBS, CMOs and CMBS for the aforementioned limits.
7. 15% or more of the total portfolio shall be maintained in securities maturing in five years or less.
8. Securities issued and/or guaranteed by the US Government, US Agencies, and GSEs are recognized as Aaa/AAA/AAA entities if they have not been otherwise rated by the NRSRO.
9. Securities issued and/or guaranteed by the Government of Canada and political subdivisions must be rated Aa3/AA-/AA- or better, using the methodology described in E (2). 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 portfolio.
10. Securities issued and/or guaranteed by a State or political subdivision must be rated A3/A-/A- or better, using the methodology described in E (2).
11. Securities issued by a qualifying corporation and purchased prior to May 9, 2008 must be rated A3/A-/A- or better, using the methodology described in E (2).
12. If a security subsequently is rated below the thresholds established in E (9) through E (11), the security may continue to be held. The Investment Manager will conduct a credit analysis and present the analysis with a recommendation to the Chief Investment Officer.
13. When calculating the per issuer and sector limits, the Pooled Money Investment Fund will be included. This number shall be provided to the Investment Manager on a monthly basis.
14. The duration of the portfolio will be managed within a range based upon analyses and projections developed with management. At present, the duration of the total portfolio is not to exceed 5.0, and will be reviewed and approved by the Board annually.

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15. The performance of the portfolio will be compared to the return of the benchmark noted in section F. This composition of the index will change as the corporate bond allocation is lowered through sales and/or maturities. At a minimum, the benchmark will be reviewed and reauthorized by the Board on an annual basis.
16. 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.
17. 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. 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.
18. Balances maintained in the PMIF will be monitored regularly by the Cash Management Unit of Financial and Investment Services, and reported to the Cash Management and Investment Committee on a monthly basis.

**F. Benchmarks:**

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 Barclays Fixed Rate MBS Index 40%.

RESOLVED, that this Resolution No. 919 shall replace Investment Resolution No. 871 effective May 21, 2010.

AYES: \_\_\_\_\_

NOES: \_\_\_\_\_

RESOLUTION: \_\_\_\_\_

**STATE COMPENSATION INSURANCE FUND**  
**Investment Committee Charter**  
**(Adopted May 14, 2009)**

**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 the 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 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 that 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 or Chief Investment Officer, the authority to direct investment transactions on behalf of State Fund and, in their absence, to delegate to either the Executive Vice President or Chief Financial Officer that authority to the extent deemed appropriate by the Committee and subject to the limitations set forth in the Investment Policy.