

**STATE COMPENSATION INSURANCE FUND
INVESTMENT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

AUGUST 16, 2012

The Investment Committee met on August 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: Chief Investment Officer Peter Guastamachio; Assistant Chief Counsel and Assistant Corporate Secretary Vera C. De Martini; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie K. Chan; and Senior Vice President Government and Business Affairs Brian Watson.

AGENDA ITEM 2: ANTITRUST ADMONITION

Senator Machado called attention to and requested acknowledgment that the Investment Committee members read State Fund's Antitrust Admonition included in each Committee member's meeting materials.

AGENDA ITEM 3: APPROVAL OF FEBRUARY 16, 2012 OPEN MEETING MINUTES

MOTION: Mr. Garcia

SECOND: Mr. Reid

To approve the minutes of the May 17, 2012 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 4: APPROVAL OF INVESTMENT TRANSACTIONS

Stephanie Chan, Treasury & Investments Program Manager, recommended that the Investment Committee approve investment transactions from April 1, 2012 to June 30, 2012. All investment transactions for this period were made in accordance with the Investment Policy at the time of purchase. From January to March 2012 State Fund purchased 126 bonds totaling approximately \$1.1B. During this same time period, State Fund sold 9 bonds

for a total of \$103.7M par value. State Fund recognized a net capital gain of approximately \$28M. The book value of the entire portfolio as of June 30th was approximately \$18.8B.

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 two out-of-compliance bonds. At the end of June 2012, the total amount of out-of-compliance bonds was approximately \$40M in book value, or 0.2% of State Fund's entire investment portfolio.

MOTION: Mr. Garcia

SECOND: Mr. Reid

To approve the Bond Transactions for the period April 1, 2012 through June 30, 2012.

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

YES: 3

NO: 0

Motion carried.

MOTION: Mr. Garcia

SECOND: Mr. Reid

To approve the Compliance Report for the period April 1, 2012 through June 30, 2012.

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

YES: 3

NO: 0

Motion carried.

AGENDA ITEM 5: REPORT ON BANK ACCOUNTS AND CASH MANAGEMENT HOLDINGS

Sen. Machado called upon Treasury & Investments Program Manager Stephanie Chan to report on the bank accounts and cash management holdings. Ms. Chan reported on Agenda Items 5 and 6, advising that KPMG, State Fund's independent auditors, completed the 2011 audit and issued the statutory financial statement for State Fund as of December 31, 2011. KPMG confirmed that no internal control deficiencies were identified during the audit and there were no corrected or uncorrected audit differences impacting cash or investments as of or for the year ended December 31, 2011, in amounts that exceeded KPMG's audit difference posting threshold.

AGENDA ITEM 6: REPORT ON LONG-TERM INVESTMENT HOLDINGS HELD BY THE STATE TREASURER'S OFFICE

This agenda items was included in Ms. Chan's report on Agenda Item 5, regarding bank accounts and cash management holdings.

AGENDA ITEM 7: UPDATE ON LEGISLATION AFFECTING THE PORTFOLIO

Sen. Machado called upon Senior Vice President Government and Business Affairs Brian Watson to report on the legislative update affecting the portfolio. Mr. Watson reported that Senate Bill 1513, which expands State Fund's ability to invest and reinvest in the same manner as private carriers, including certain equities, specified mortgage-related investment instruments and in the stock of the Federal Home Loan Bank, passed out of the Assembly and will soon go to the Governor for signature. The bill also restricts such investment and reinvestment to 20% of the excess of admitted assets over liabilities and required reserves, and requires the California Department of Insurance to submit a report by January 31, 2019 assessing the benefit and risk of the equity investment history. The amended statute will sunset on January 1, 2025.

AGENDA ITEM 8: ECONOMIC AND INVESTMENT OUTLOOK

At Sen. Machado's invitation Deutsche Asset Management, one of State Fund's asset managers, provided an overview of the global financial challenges in the post-bubble world, including the United States, Europe and emerging economies. Mr. Josh Feinman, Deutsche's Chief Economist, observed that the U.S. recovery is fitful and subpar with slowing growth hampered by the housing bubble implosion. The slow economic recovery may be further adversely impacted by the ongoing Euro-zone financial crisis unless there is reform of underlying problems. Additionally, the "fiscal cliff" facing the United States could adversely impact the economic recovery if the expiring tax cuts are permitted to lapse. In the Euro-zone, Deutsche believes that the crisis may be averted if structural reforms are implemented. Mr. Feinman noted that emerging markets, including rapid growth in China, are decelerating. Overall, Deutsche concludes that it will take time to repair the damage done and foresees continuing volatility in the financial markets and low interest rates for the next 2-3 years.

Mr. Gregory Staples, Manager Director of Deutsche, observed the impact of geo-political issues in Israel, the Middle East and Syria affecting market volatility and low interest and zero/negative yields in bond valuation, as well as capital flows moving from stocks and mutual funds to bonds. However, the cost of equities is low compared to bonds and the dividend yield on blue chip stock is higher than the yield on blue chip bonds.

AGENDA ITEM 9: PUBLIC COMMENT ON APPROPRIATENESS OF CLOSED SESSION FOR ITEMS 12 THROUGH 14

Sen. Machado requested public comment on the appropriateness of closed session agenda items 12-14, of which there was none.

AGENDA ITEM 10: PUBLIC COMMENT

Sen. Machado requested further public comment of which there was none. The Investment Committee immediately convened into Closed Session at 12:40 p.m.

AGENDA ITEM 15: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 2:20 p.m. and the following members were present: Sen. Michael J. Machado (Ret.) Chair; Donald E. Garcia; Scott K. Reid; and Francis E. Quinlan. (Alternate).

There was a quorum.

Also present: President Tom E. Rowe; Chief Financial Officer Dan Sevilla; Chief Investment Officer Peter Guastamachio; General Counsel and Corporate Secretary Carol R. Newman; Assistant Chief Counsel and Assistant Corporate Secretary Vera C. De Martini; Treasury & Investments Program Manager and Assistant Corporate Secretary Stephanie K. Chan; and Board Liaison and Assistant Corporate Secretary Hilda B. Padua.

AGENDA ITEM 16: COMMITTEE MEMBER PRESENTATIONS

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

AGENDA ITEM 17: PROPOSALS AND SUGGESTIONS FOR NOVEMBER 15, 2012 AGENDA

Sen. Machado requested suggestions for agenda items for the November 15, 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 2:25 p.m.

Respectfully submitted,

Vera De Martini
Assistant Chief Counsel and Assistant Corporate Secretary