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Date: May 4, 2009

AGENDA ITEM 7

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. 842 effective May 15, 2009**
- IV. ANALYSIS:**
A proposed Investment Policy Statement and Guidelines Resolution is attached with the recommendation that it replace Investment Resolution No. 842 effective May 15, 2009.

PETER GUASTAMACHIO, Chief
Investment Officer

Attachment

INVESTMENT COMMITTEE MEETING (OPEN)

AGENDA ITEM 7

ATTACHMENT 7-I

INVESTMENT POLICY STATEMENT and GUIDELINES RESOLUTION

PRESENTED BY: Peter Guastamachio

May 14, 2009

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 15, 2009 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 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, and E 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.

State Compensation Insurance Fund
Investment Policy Statement & Guidelines Resolution
Page 2 of 5

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 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 United States or any State thereof are not permitted.
6. Bonds or other obligations of a State or political subdivision.

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. 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. There is no per issuer limit of US Treasuries, US Agencies, and Agency MBS.
2. 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.

3. New purchases of municipals shall be rated no lower than A2/A by two nationally recognized rating services. 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.
4. 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.
5. 15% or more of the total portfolio shall be maintained in securities maturing in five years or less.
6. 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.
7. Securities issued and/or guaranteed by the Government of Canada and political subdivisions must be rated Aa3/AA- or better by two nationally recognized rating services. 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.
8. The credit rating of the fixed income portfolio shall average at least Aa2/AA at all times. When calculating the overall credit quality of the portfolio, the lower of the credit ratings will be used.
9. Securities issued and/or guaranteed by a State or political subdivision must be rated A3/A- or better by a nationally recognized rating service.
10. Securities issued by a qualifying corporation and purchased prior to May 9, 2008 must be rated A3/A- or better by a nationally recognized rating service.
11. If a security subsequently is rated below the thresholds established in E (9) and E (10), 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.
12. 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.
13. 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.
14. The performance of the portfolio will be compared to the return of the benchmark noted in Appendix A. 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.

**State Compensation Insurance Fund
Investment Policy Statement & Guidelines Resolution
Page 4 of 5**

15. 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.
16. 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.
17. 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.

RESOLVED, that this Resolution No. 871 shall replace Investment Resolution No. 842 effective May 15, 2009.

BOARD OF DIRECTORS of the STATE COMPENSATION INSURANCE FUND

Appendix A: Benchmarks

The following benchmarks are established for individual mandates and the overall portfolio.

1. Fixed Income: Barclay's U.S. Treasury Intermediate Index: 10%, Barclay's U.S. Treasury Short Term Index: 5%, Barclay's U.S. Agency Intermediate Index 10%, Barclay's U.S. Corporate A or better Intermediate Index 30%, Barclay's U.S. Corporate A or better Long Index: 5% and Barclays Fixed Rate MBS Index 40%.

Notes:

Previous labeled Lehman benchmarks have been renamed following the acquisition by Barclays of the Lehman's North American investment banking business.

Taxable municipals are a proxy for investment-grade corporates.