

**STATE COMPENSATION INSURANCE FUND
INVESTMENT COMMITTEE**

MINUTES OF OPEN SESSION MEETING

January 15, 2009

The Investment Committee met on January 15, 2009 in the Milton Marks Conference Center, State Building, 455 Golden Gate Ave, San Francisco, California.

AGENDA ITEM 1: ROLL CALL

The meeting was called to order at 3:05 p.m. and the following Members were present: Vincent E. Mudd, Chair; Francis (Frank) E. Quinlan.

Also present: Chief Financial Officer Jay Stewart; Fiscal and Investment Services Manager Leslie Dawe; Treasury Services Manager Stephanie Chan; President Janet Frank; General Counsel and Corporate Secretary Carol R. Newman; Assistant Chief Counsel and Assistant Secretary Judith D. Sapper; and Randall Keen, Esq. of Manatt Phelps & Phillips.

AGENDA ITEM 2: PUBLIC COMMENT ON THE APPROPRIATENESS OF CLOSED SESSION ITEMS 4 THROUGH 6

Mr. Mudd requested public comment of which there was none.

The Investment Committee immediately convened into Closed Session.

AGENDA ITEM 3: APPROVAL OF NOVEMBER 20, 2008 CLOSED MEETING MINUTES Closed Session.

AGENDA ITEM 4: INVESTMENT PORTFOLIO RISK AND COMPETITIVE STRATEGY Closed Session.

AGENDA ITEM 5: INVESTMENT MANAGER SELECTION Closed Session.

AGENDA ITEM 6: SELECTION OF CHIEF INVESTMENT OFFICER Closed Session.

AGENDA ITEM 7: CALL TO ORDER AND ROLL CALL

The meeting was called to order at 3:55 p.m. following the conclusion of the Closed Session and the following Members were present: Vincent E. Mudd, Chair; Francis (Frank) E. Quinlan.

Also present: Chief Financial Officer Jay Stewart; Fiscal and Investment Services Manager Leslie Dawe; Treasury Services Manager Stephanie Chan; President Janet Frank; General Counsel and Corporate Secretary Carol R. Newman; Assistant Chief

Counsel and Assistant Secretary Judith D. Sapper; and Randall Keen, Esq. of Manatt Phelps & Phillips.

AGENDA ITEM 8: INTRODUCTIONS

Mr. Mudd introduced the Investment Committee members.

AGENDA ITEM 9: APPROVAL OF NOVEMBER 20, 2008 OPEN MEETING MINUTES

MOTION: Mr. Quinlan Second: Mr. Mudd

To approve the minutes of the November 20, 2008 Open meeting of the Investment Committee as presented.

AYES: 2 NOES: 0 Motion carried.

AGENDA ITEM 10: APPROVAL OF INVESTMENT TRANSACTIONS AND COMPLIANCE REPORT

Fiscal and Investment Services Manager Leslie Dawe discussed the selection and retention of investments and the composition of State Fund's \$19B portfolio as of December 31, 2008. Ms. Dawe presented the bond transactions for October 1, 2008 through November 30, 2008, noting 42 long term securities consisting of 3 Governments securities, 1 Agency security, 35 Mortgage Backed Securities and 3 Municipal securities were purchased at \$1,209,184,373. She also reported on the sale of 26 bonds consisting of 23 Agency securities and 3 Corporate securities which were sold for \$885M. After presentation of the bond transactions the following action was taken:

MOTION: Mr. Quinlan Second: Mr. Mudd

To approve, and recommend the Board of Directors ratify, the bond transactions for the period of October 1, 2008 through November 30, 2008.

AYES: 2 NOES: 0 Motion carried.

Ms. Dawe reported there were no short term investment transactions during the months of October and November 2008 and the following action was taken:

MOTION: Mr. Quinlan Second: Mr. Mudd

To approve that there were no short term transactions during the months of October and November 2008.

AYES: 2 NOES: 0 Motion carried.

Ms. Dawe presented the compliance report for investments owned as of November 30, 2008. All of the investments were in compliance with State Fund's Investment Policy at

the time of purchase and met the required credit standards based upon the credit analysis of an independent nationally recognized rating service. State Fund's Investment Policy allows an investment to be retained even if it is out of compliance. The process requires the outside Investment Manager to review the non-compliant investment and make a recommendation with supporting rationale to hold or sell the non-compliant investment. There were 14 bonds at \$220M whose credit ratings fell below the minimum single A credit rating, an increase of \$10M from the prior compliance report and representing 1.16% of State Fund's portfolio of approximately \$19B. State Fund sold \$30M of noncompliant MBIA bonds in December 2008. The Investment Manager recommended holding the other bonds that have compliance issues and State Fund's Executive Management concurs with the recommendations. State Fund's Investment Policy also establishes a limit of 0.75% of the value of the long term investment portfolio for ownership in any single corporate or municipal issuer. As of November 30, 2008 there were 3 companies whose holdings exceeded the 0.75% limit by less than \$3M per company. State Fund sold off a small portion of each of these 3 holdings and the investments are now in compliance with the guidelines. After presentation of the compliance report the following action was taken:

MOTION: Mr. Quinlan Second: Mr. Mudd

To recommend the Board of Directors accept the compliance status of the securities on the compliance report for the period of October 1, 2008 through November 30, 2008.

AYES: 2 NOES: 0 Motion carried.

AGENDA ITEM 11: MARKET OUTLOOK AND ECONOMIC UPDATE

Mr. Stewart presented an economic update and market outlook. According to investment manager Conning the outlook for the U.S. and global economies continues to deteriorate with a slight recovery forecast for 2010. He noted the U.S. and its major trading partners are in a recession. There is a future risk of inflation from the expansion in monetary growth resulting from the government's attempt to rekindle the economy. The nation's unemployment rate is the highest since 1993, with 2.6M jobs lost in 2008. The UCLA Anderson forecast indicates California will have increasing unemployment in 2009. The equity and credit markets have not yet signaled a turn around according to Conning. One U.S. economist predicts the yield on the 10 year Treasury note will be about 3% by the end of 2009 but could fall below 2% during the year. No one knows what effect the proposed stimulus package will have on California but the economy will have a dramatic impact on workers' compensation.

Mr. Stewart reported State Fund's preliminary investment results show net investment income before gains, losses and impairments is projected to be approximately \$990M, slightly more than budgeted. Total investment income, including capital gains, losses, and impairments is projected to be approximately \$900M, lower than the \$978M budgeted by the amount of the impairment write-downs. Net gains, losses and impairments improved from the Third Quarter are expected to be a loss of

approximately \$91M, less than 0.5% of State Fund's total portfolio. Mr. Stewart noted the overall average credit quality of the portfolio remains at Aa1/AA+, the current duration is 3 years, liquidity is strong, and less than 10% of the portfolio rolls over in each of the next 3 years. He expects income to be stable with replacement yields at or near maturing book yields.

AGENDA ITEM 12: PROPOSALS AND SUGGESTIONS FOR MARCH 2009 AGENDA

The Investment Committee again requested the Market Outlook and Economic Update remain as a standing agenda item and proposed Mr. Stewart present information about the potential impact of a stimulus package on California and State Fund, a briefing on the state's finances and budget situation, and a description of the statutory restrictions on State Fund's investments.

AGENDA ITEM 13: PUBLIC COMMENT

Mr. Mudd requested public comment of which there was none.

The next Investment Committee meeting is scheduled for March 12, 2009 at 3:00 p.m. in San Francisco, California.

ADJOURNMENT

There being no further business before the Investment Committee, the meeting adjourned at 4:25 p.m.