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Date: February 11, 2025

**TO: MEMBERS, INVESTMENT AND RISK COMMITTEE**

<b>I. AGENDA ITEM # AND TITLE:</b>	Open Agenda Item 3c: Consent Calendar: Approval of Investment Policy Resolution
<b>II. NAME AND PROGRAM:</b>	Treasury and Investments
<b>III. ACTIVITY:</b>	<input type="checkbox"/> Informational <input type="checkbox"/> Request for Direction <input checked="" type="checkbox"/> Action Proposed <input type="checkbox"/> Exploratory
<b>IV. JUSTIFICATION:</b>	<input checked="" type="checkbox"/> Standard/Required Item <input type="checkbox"/> Board Request – New Item <input type="checkbox"/> New Topic from Staff

**V. EXECUTIVE SUMMARY:**

- Investment Policy Resolution No. 2566 will replace Investment Policy Resolution No. 2509. Investment Policy Resolution No. 2566 updates the overall equity portfolio benchmark to the Vanguard Dividend Appreciation Index Fund, as per the recommendation in Item 9 of the November 2024 Investment & Risk Committee meeting.

**DETAILS OF CHANGE:**

Section	Changes
Page 4, sections E.1 and E.2	Clarify the inclusion of LPs and Business trusts per Insurance code section 1196.1(f)(5)
Page 8, Section M.3	Replace the current equity portfolio benchmark with the new equity portfolio benchmark. <ul style="list-style-type: none"> <li>Current benchmark is 65% Russell 1000 Index and 35% MSCI USA IMI High Dividend Yield Index.</li> <li>New benchmark is Vanguard Dividend Appreciation Index Fund.</li> </ul>
Page 8, Section M.3.A (old)	Remove duplicated reference to benchmark.
Page 8, Section M.3.B	Remove specific reference to passive equity benchmark.
Page 8, Section M.3.A (new)	Add new clause which states that specific and appropriate benchmarks will be selected for each underlying investment manager.



**(DRAFT)**

**BOARD OF DIRECTORS**

**STATE COMPENSATION INSURANCE FUND**

**INVESTMENT POLICY RESOLUTION**

[Proposed] Revisions to Be Approved

Investment and Risk Committee: February 25, 2025

Board of Directors: February 26, 2025

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 11783 (c), 11787 and 11797 of the Insurance Code; and

WHEREAS, the State Fund is a public enterprise fund and is exempt under federal and California law from paying income taxes; 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 investment standards and benchmarks which can be applied administratively to the selection and purchase of securities; and

WHEREAS, the Board also deems it prudent to establish guidelines and procedures so that the selection, purchase, holding and sale of investments or securities is done in conformity with the State Fund's investment philosophy and risk tolerance and statutory investment authority; and

RESOLVED, by the Board of Directors of the State Fund in regular meeting on February 26, 2025 that the following investment policy is adopted for the management of the investments or securities purchased or owned by State Fund:

**A. Investment Philosophy and Strategy**

All Portfolios are structured and managed in a manner consistent with prudent and conservative investment practices. The objective is to enhance optimal investment return and extract long-term value creation from the entire investment portfolio. All investments must meet the criteria stated in the Investment Policy Statement Resolution and any additional detailed criteria for their specific investment portfolio, as stated in the corresponding Investment Guidelines and Procedures Resolution.

## **B. Environmental, Social, and Governance (ESG) Principles**

Consideration of Environmental, Social, and Governance (“ESG”) risks is a key component in the investment management process. To achieve the investment objectives set forth in the Investment Policy Statement, the portfolio investment decisions will be actively guided by an environmental focus and relevant ESG criteria.

ESG Incorporation: All portfolios shall be structured and managed in a manner consistent with prudent investment practices. The Investment Manager will have an ESG framework as part of its investment process that incorporates State Fund’s ESG goals. The framework shall be used in selection of investments decisions and more broadly across the portfolio management practices. The Investment Manager will use care and discretion as to how this framework will be applied in meeting State Fund’s primary investment objectives and ESG goals. All else equal, the Investment Manager shall prefer securities which, in his/her assessment, show superior environmental, social and governance practices. All investment managers must collaborate with State Fund on its ESG goals and criteria, as stated in State Fund’s Investment Guidelines and Procedures Resolution.

## **C. Delegation of Authority**

1. The Investment Manager may purchase and sell securities on behalf of State Fund per the terms, limitations and guidelines set forth in this Investment Policy Resolution and the Investment Guidelines And Procedures Resolution under the primary direction of the Chief Investment Officer and, in his/her absence, at the direction of the officers listed in Paragraph 2 of this Section.
2. In accordance with Sections 926.1, 11783(c), 11787 and 11797 of the Insurance Code, 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 through J as approved by the Board of Directors.
3. Whenever the President and the Chief Investment Officer, the Chief Financial Officer and the Chief Risk Officer are unavailable or absent, the State Fund Vice President of Investments and the State Fund Senior Investment Manager are hereby authorized to approve a written request made by an Investment Manager to sell equity securities at a price lower than the actual price originally paid for the equity security.

## **D. Core Fixed Income Portfolio**

The objective of the Core Fixed Income Portfolio is to preserve State Fund’s principal and surplus, while maximizing current income and exceeding established benchmarks over the long-term. Allowable securities include the following assets and with Board approval can include other asset classes as allowed under applicable regulations.

The weighted credit rating of the core fixed income portfolio shall average at least A1/A+/A+ at Moody’s, S&P and Fitch, respectively, at all times. The duration of the portfolio will be managed within a strategic range of 3.0 to 6.5 years, 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.

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. Pursuant to Insurance Code sections 926.1, 1192 and 1196.1(f)(5) publicly traded, interest bearing, fixed income securities issued by a corporation or business trust or limited partnership 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.
6. Pursuant to Insurance Code sections 926.1, 1192 and 1196.1(f)(5) non-registered, privately placed, interest bearing, fixed income securities issued by a corporation organized under the laws of the United States or any State thereof, or the Dominion of Canada or any province of the Dominion of Canada which are payable in US dollars and which securities can be purchased or sold pursuant to SEC Rule 144A.
7. General obligations of any State for which the faith and credit of the State are pledged for the payment of principal and interest.
8. 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.
9. Asset-backed securities (ABS) publicly traded and issued by a corporation organized under the laws of the United States or any State thereof and securitized by credit card receivables or auto loans are allowed. No other type of ABS is allowed. No privately placed ABS is allowed.
10. Commercial mortgage-backed securities (CMBS) issued by the US Government Agencies and GSEs and non-Agency CMBS.
11. Investments may be made in bonds, notes or other obligations issued, assumed or guaranteed by the following international financial institutions: the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the International Finance Corporation, or the African Development Bank.

## **E. Non-core Fixed Income Portfolio**

The objective of the Non-core Fixed Income Portfolio is to preserve State Fund’s principal and surplus via strategic allocation to the private corporate and infrastructure sectors of the fixed income market and to add value (net of management fees) relative to the return, while exceeding established benchmarks over the long-term.

1. Pursuant to Insurance Code sections 926.1, 1192 and 1196.1(f)(5) non-registered, privately placed, interest bearing, fixed income securities issued by a corporation (including Limited Partnerships and Business Trusts) organized under the laws of the United States or any State thereof, or the Dominion of Canada or any province of the Dominion of Canada which are payable in US dollars and which securities can be purchased or sold pursuant to SEC Rule 144A, Rule 4(a)(2), or Reg D.
2. Pursuant to Insurance Code sections 1192 and 1196.1(f)(5) non-registered, privately placed, interest bearing, fixed income securities issued by a corporation (including Limited Partnerships and Business Trusts) organized under the laws of the United States or any State thereof for the express purpose of financing an infrastructure project or projects located in the United States. For this investment guideline, “infrastructure projects” are transactions entered into by corporations to operate or maintain or rebuild utility networks, water, conventional power generation, renewable power generation, gas pipelines transport, LNG terminals or transactions providing essential services such as toll roads, bridges, tunnels, rail roads, seaports, airports, bus networks parking, storage, communications towers, waste management, public stadia, fiber or data centers.

## **F. Equity Portfolios**

The objective of the Equity Portfolios is to preserve State Fund’s principal and surplus by adding diversity to the portfolio and reducing volatility of the results over the long term. The Equity Portfolios are expected to exceed the performance of its established benchmark over the long term.

- A. The objective of the active equity portfolio is to seek long-term total return and current income by investing primarily in large cap, high quality dividend paying stocks of United States and Canada companies that show a consistent history of strong dividend growth and sustainability or are expected to produce sustainable growing dividends.
- B. The objective of the passive equity portfolio is to seek long-term total return by investing in growth-oriented stocks of United States and Canada companies.

The following types of equity securities are permissible:

1. Federal Home Loan Bank stock purchased directly by State Fund.
2. Pursuant to Insurance Code section 1191 common and preferred stock of corporations issued, domiciled and organized under the laws of the United States or any State thereof, or the Dominion of Canada or any province of the Dominion of Canada which are payable in US dollars. Stock and other equity securities issued by foreign domiciled companies shall not be purchased for the Equity Portfolio.

Investment Manager must obtain written approval from the Chief Investment Officer or State Fund Vice President of Investments, and in their absence, the State Fund Senior Investment Manager, prior to selling any equity securities at a price lower than the actual price originally paid for the equity security.

#### **G. Preferred Securities Portfolio**

The objective of the Preferred Securities Portfolio is to provide diversification and reduce volatility, while enhancing current income and long-term total return. The portfolio will be invested in preferred stocks, hybrid securities, and other subordinated instruments (and in cash and short term fixed income securities pending such investment). The Portfolio is expected to exceed the performance of its established benchmark over the long term.

#### **H. Federal Home Loan Bank Portfolio**

The objective of the Federal Home Loan Bank (FHLB) Portfolio is to preserve State Fund's principal and surplus and to create a readily available funding source to help manage State Fund's liquidity and emergency needs as well as to add incremental income by matching loans (or advances) to the reinvestment of cash in fixed income securities maturing in 5 years or less. The target spread over the FHLB advance rate should exceed the established benchmark.

The following types of assets are allowable:

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. 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 SEC Rule 144A.
4. General obligations of any State for which the faith and credit of the State are pledged for the payment of principal and interest.
5. 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.

#### **I. COIN Portfolio**

The objective of the COIN portfolio is to preserve State Fund's principal and surplus and enable State Fund to purchase and sell COIN approved investments, including both equity and debt securities as allowed by Sections 926 through 926.3 of the Insurance Code. COIN is a program administered by the California Department of Insurance that is intended to identify potential investment opportunities for State Fund and admitted California insurers with an emphasis on Green Investments as defined in Insurance Code section 926.1, that that promote social, economic, and environmental benefits for people living in California.

The following types of investments and securities are permissible:

1. Investments in equity or debt securities, or loan, or deposit obligation, or other investment or investment transaction allowed by Insurance Code Sections 926.1, 926.2 and 926.3 and identified by COIN as a COIN qualified potential investment opportunities.
2. Investments can be made in community development infrastructure debt securities including all debt issued by the State of California or a California state or local government agency, if all or a portion of the debt has as its primary purpose community development for, or that directly benefits, underserved or low-to-moderate-income communities or includes affordable housing, or community facilities or community services providers (including providers of education, health, or social services) or promotes economic development that demonstrates benefits, including, but not limited to, job creation, retention, or improvement, or provision of needed capital, to underserved or low-to-moderate-income individuals, families, or communities, including urban or rural communities, or businesses or nonprofit community service organizations.
3. Investments can be green investments that emphasize renewable energy projects, including, but not limited to, solar and wind power, water and waste management, sustainable agriculture, mixed-use development, affordable housing opportunities, multimodal transportation systems, and transit-oriented development, can advance economic development, jobs, and housing.

#### **J. Green Bond Portfolio**

The primary purpose of Green Bond Portfolio is to preserve State Fund's principal and surplus by investing capital in projects with environmental benefits, while achieving same or better risk-adjusted returns from green bonds as compared to the traditional issues of the similar credit quality and duration. Green bonds are defined by market data providers, such as Bloomberg, as environmental, sustainability-oriented bonds and may include renewable energy, sustainable resource use, conservation, clean transportation or adaptation to climate change.

Allowable securities include the following assets and with Board approval can include other asset classes as allowed under applicable regulations:

1. Obligations of US Government Agencies and Government Sponsored Entities (GSEs).
2. 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.
3. Pursuant to Insurance Code sections 1192 and 1196.1(f)(5) publicly traded, interest bearing, fixed income securities issued by a corporation or business trust or limited partnership 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.

4. Pursuant to Insurance Code sections 1192 and 1196.1(f)(5) non-registered, privately placed, interest bearing, fixed income securities issued by a corporation organized under the laws of the United States or any State thereof, or the Dominion of Canada or any province of the Dominion of Canada which are payable in US dollars and which securities can be purchased or sold pursuant to SEC Rule 144A.
5. Pursuant to Insurance Code sections 1192 and 1196.1(f)(5) non-registered, privately placed, interest bearing, fixed income securities issued by a corporation organized under the laws of the United States or any State thereof for the express purpose of financing an infrastructure project or projects located in the United States. For this investment guideline, “infrastructure projects” are transactions entered into by corporations to operate or maintain or rebuild utility networks, water, conventional power generation, renewable power generation, gas pipelines transport, LNG terminals or transactions providing essential services such as toll roads, bridges, tunnels, rail roads, seaports, airports, bus networks parking, storage, communications towers, waste management, fiber or data centers.
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.
8. Commercial mortgage-backed securities (CMBS) issued by the US Government Agencies and GSEs.

#### **K. Alternatives Portfolio**

The objectives of the alternatives portfolio are to preserve State Fund’s principal and surplus by enabling State Fund to invest in alternative assets, as permitted by Article 4.5, Section 1210 (also called “discretionary investments” and/or “Leeway Basket”) of the California Insurance Code, with due consideration of environmental, social, and governance (ESG) factors, and to improve State Fund’s risk-adjusted returns by diversifying market risk and enhancing yields, while protecting State Fund’s portfolio against inflation.

Notwithstanding potential overlaps with the other portfolios, the following types of alternative securities issued by (or investing in) entities domiciled and 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 are permissible:

1. Private Equity / Debt (i.e. privately placed stock or interest bearing securities issued by a corporation, business trust, limited partnership, or any other privately held entity permitted to issue private obligations);
2. Infrastructure Equity / Debt (i.e. publicly traded and privately placed stock or interest bearing securities issued by an entity for the express purpose of financing infrastructure projects); ~~and~~
3. Real Assets (i.e. high-quality, income-producing diversified properties among real estate sectors, apartment, industrial, office and retail, in major metropolitan markets throughout the continental United States).

4. Multi-Asset Funds (i.e. investment vehicles limited to a combination of any mix of the securities described above).
5. Money market mutual fund (i.e. publicly traded and registered with the U.S. Securities and Exchange Commission) pursuant to section 1192.9.
6. The following types of alternative assets are not permissible:
  - A. Derivative Instruments;
  - B. Cryptocurrencies;
  - C. Currencies;
  - D. Commodities (physical or via derivatives);
  - E. Collectibles (such as art and antiquities); and
  - F. Money market mutual fund that holds any assets in foreign investments, as defined in Section 1240.

**L. Cash and Cash Equivalents:**

The objective of the cash portfolio is to preserve State Fund’s surplus and principal, to maintain liquidity, and to provide a readily available funding source for settlement of trades, claims payments, and other necessary operational expenses.

The cash and cash equivalent portfolio shall be managed in accordance with the Short-Term Investment Policy Statement & Guidelines Resolution that is periodically adopted and approved by the Investment and Risk Committee and the Board of Directors.

**M. Performance Benchmarks**

The benchmarks are for individual portfolios. At a minimum, the benchmark will be reviewed and reauthorized by the Board on an annual basis.

1. The benchmark for the Core Fixed Income portfolio is ICE BofAML, 1-10 Year US Treasury Index: 2.5%, ICE BofAML 1-10 Year US Composite Agency Index: 5%, ICE BofAML Broad US Taxable Municipal Securities Index: 12.5%, ICE BofAML US Bullet Corporate Excluding Yankees Index: 20%, ICE BofAML 1-5 Year AAA-A US Bullet Corporate Excluding Yankees Index: 15%, ICE BofAML 5-10 Year AAA-A US Bullet Corporate Excluding Yankees Index: 10%, and ICE BofAML US Mortgage Backed Securities Index: 35%.
2. Performance objective of the Non-core Fixed Income Portfolio is a total return of 50 basis points (net of fees) over the ICE BofAML US Corporate Index.
3. The benchmark for the aggregate equity portfolio is ~~65% Russell 1000 Index and 35% MSCI USA Investable Market index (IMI) High Dividend Yield Index~~ the Vanguard Dividend Appreciation Index Fund (VDADX), which will serve as a proxy for the S&P U.S. Dividend Growers Index:
  - ~~A. The benchmark for the active equity portfolio is 65% Russell 1000 Index and 35% MSCI USA Investable Market index (IMI) High Dividend Yield Index.~~
  - ~~B. The benchmark for the passive equity portfolio is S&P 500 Growth Index.~~
  - A. Due to wide-ranging nature of equity investments, the investment team will work with each underlying investment manager to select an appropriate benchmark that is specifically

tailored for their respective equity strategy. The investment team will continuously monitor the chosen benchmarks to ensure they remain appropriate for performance measurement.

4. The performance objective of the FHLB portfolio is to achieve a spread in excess of the FHLB advance rate that is greater than 40 basis points on each trade.
5. The benchmark for the Preferred Securities portfolio is 65% ICE BofA Preferred Securities, Fixed Rate (POP1), 20% ICE BofA Preferred Securities, High Yield Fixed Rate (POHY), and 15% ICE BofA 7% Constrained Adjustable Rate Preferred Securities (POAC).
6. The yield target for the Green Bond portfolio will be the benchmark market yield of the ICE BofAML 5-10 Yr Single-A US Corporate Index (MLC6A3USD). The benchmark of the green bond portfolio will be reviewed on an ongoing basis as the green bond market continues to evolve to ensure it is representative of the USD green bond universe.
7. Due to the varying and complex nature of the alternatives portfolio, the investment team will select an appropriate benchmark for each underlying mandate prior to the initial investment. All alternatives investments, including benchmarks, will be reviewed by the investment team and approved by the Chief Financial Officer and Chief Investment Officer. The investment team will continuously monitor the chosen benchmarks to ensure they remain appropriate for performance measurement.
  - a. The goal of the infrastructure debt portfolio is to earn total return of 50 basis points (net of fees) over the ICE BofAML US Corporate Index, while maintaining an appropriate level of diversification to mitigate risk.
  - b. The goal of the private markets portfolio is to earn a long-term net of fees rate of return which is equal to, or exceeds the total return of an equivalent public market index (such as the Russell 3000 Index), while maintaining an appropriate level of diversification to mitigate risk.
  - c. The goal of the real assets portfolio is to earn a long-term net of fees rate of return which is equal to, or exceeds the total return of the National Council of Real Estate Investment Fiduciaries (NCREIF) Fund Index - Open End Diversified Core Equity (NFI-ODCE).

RESOLVED, that this Resolution No. 2566 shall replace Resolution No. 2509 effective February 26, 2025.

BOARD of DIRECTORS of the STATE COMPENSATION INSURANCE FUND