Office of the State Treasurer

Investment Policy
for the
Pooled Money Investment Account

June 29, 2005

STATE TREASURER'S OFFICE

STATEMENT OF PORTFOLIO MANAGEMENT GOALS, OBJECTIVES AND POLICIES

POOLED MONEY INVESTMENT ACCOUNT-PMIA

All state money held by the State Treasurer in Treasury trust accounts, and all money in the State Treasury,..... is appropriated for the purpose of investment and deposit as provided in article 4.5, Section 16480 et. al. of the Government Code.

GOAL I. PORTFOLIO SAFETY/DIVERSIFICATION

The pool will be managed to insure the safety of the portfolio by investing in high quality securities and by maintaining a mix of securities that will provide reasonable assurance that no single investment or class of investments will have a disproportionate impact on the total portfolio.

OBJECTIVE: In addition to the safety provided by investing in high quality securities, the safety of the portfolio is enhanced three ways by maintaining a prudent mix (i.e., diversity) of investments: 1) Spreading investments over different investment types minimizes the impact any one industry/investment class can have on the portfolio; 2) Spreading investments over multiple credits/issuers within an investment type minimizes the credit exposure of the portfolio to any single firm/institution; and 3) Spreading investments over various maturities minimizes the risk of portfolio depreciation due to a rise in interest rates. An unforeseen liquidity need allows no options if ***"all your eggs are in one basket."***

POLICY: The portfolio shall contain a sufficient number and diversity of marketable securities so that a reasonable portion of the portfolio can be readily converted to cash without causing a material change in the value of the portfolio. Limitation and eligibility as to specific investments are to be determined by the Pooled Money Investment Board in the case of Commercial Paper, the Treasurer's Office Investment Committee in cases of new dealer authorizations and approval of new corporate investments, and the Treasury Investment Division in all other matters.

GOAL II. LIQUIDITY

The pool will be managed to ensure that normal cash needs, as well as scheduled extraordinary cash needs can be met. Further, adequate liquidity shall be maintained to ensure the unforeseen cash needs, whether ordinary or extraordinary.

OBJECTIVE: The pool will maintain a ***"cash flow generated"*** portfolio balance sufficient to cover specifically the one month prepared cash forecast, as well as generally the six month prepared cash forecast. Further, sufficient marketable treasuries will be maintained to cover unforeseen withdrawals or delayed deposits.

POLICY: First priority is given to maintaining specific calendar liquidity, as dictated by the most recent cash forecast. Second priority is the maintenance of Treasury Bill positions adequate to meet unscheduled needs. Final consideration would be given to "*other"* investments deemed appropriate to portfolio maintenance, enhancement, or restructuring.

GOAL III. RATE OF RETURN

Pooled investments and deposits shall be made in such a way as to realize the maximum return **consistent with safe and prudent treasury management.**

OBJECTIVE: The rate of return will be maintained on a consistent level representative of current market yield direction.

POLICY: Sales gains/losses will not be incurred to the point of radically altering the final quarterly apportionment rate. Significant sales gains will be offset for restructuring purposes to maintain consistent current return, as well as maximizing future portfolio performance. Significant sales losses shall be incurred only by consent of the Treasurer, or when sufficient profits negate the alteration of the apportionment rate. Range bonds and inverse yielding securities are examples of the types of investments which are precluded by the above stated objective.

CONFORMANCE

All of the foregoing goals, objectives and policies shall be observed by the Chief of Investments or his designee, monitored by the Treasurer's Investment Committee, and reviewed continually by the Treasurer or his/ her assistant.

STATE TREASURER'S OFFICE

STATEMENT OF PORTFOLIO MANAGEMENT GUIDELINES

POOLED MONEY INVESTMENT ACCOUNT-PMIA

The State Treasurer's Investment Division has set forth a general declaration of portfolio goals, objectives and policies. Following are various guidelines necessary to the good faith observance of these policies.

I. GUIDELINES FOR MAINTAINING SAFETY/DIVERSIFICATION

There are few statutory limitations placed on individual categories of authorized investments. However, this does not entitle the investment staff to ***"carte blanche"*** participation in these security types. In the absence of direct statutory limitations, the "***prudent person rule"*** shall be utilized by the investment staff. As market conditions change, altering credit risk, marketability, yield spreads, and securities availability, application of this rule shall govern any investment decision. This application shall be discussed as soon as time permits with the Chief of Investments. At the Chief of Investments determination, the situation may be discussed with the full investment committee or brought directly to the attention of the Treasury Management.

Following are various considerations/limitations as they pertain to specific investment types:

A. ***U.S. Treasury Securities***

1) Maximum maturity: Statutory: 30 years.
   Policy: 5 years.

2) Maximum par value, total portfolio: None.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit: Full faith and credit of the Federal Government.

Treasury Bills are maintained for liquidity, trading, and yield enhancement as the underlying security in a Reverse Repurchase transaction. Treasury strips and full coupon securities are purchased for average maturity preservation, liquidity, and trading.

B. *Federal Agency Securities*

1) Maximum maturity: Statutory: 30 years.
   Policy: 5 years.

2) Maximum par value, total portfolio: None.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit: Despite there being no statutory limitations concerning this category, prudent investment practice necessitates constant credit analysis of certain issuing agencies. Although there exists an implicit or explicit government guarantee of the various agency issues, market perception often limits the liquidity of these issues.

C. *Bankers Acceptances-Domestic/Foreign*

1) Maximum maturity: Statutory: None.
   Policy: 180 days.

(This maximum maturity is a criterion used to determine eligibility for purchase by the Federal Reserve. Our authority is based on the eligibility as determined by the Fed. However, since the Fed has discontinued its eligibility requirements and purchases, this criterion is no longer applicable. Currently, a majority of acceptances are created only for 180 days.)

2) Maximum par value, total portfolio: None.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit:

   a) The history of the acceptance market is spotless on ***"Failures to redeem."*** This is true even through the years of WW II.

   b) Geopolitical location is of prime concern when considering potential candidates. Internal, as well as border political and economic stability of the host country are of prime concern.

   c) Liquidity as far as both credit risk and marketability in the secondary level are addressed.

   d) Although statutory authority does not limit eligibility according to ranking or rating, previously listed general criteria eliminate lesser credits.

D. ***Certificates of Deposits***

1) Maximum maturity: Statutory: None.
   Policy: 5 years.

2) Maximum par value, total portfolio: None.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit:

   a) Criteria concerning loan make-up, LDC exposure, geographic location, market perceptions, and financial condition all serve to eliminate lesser names.

   b) Liquidity as far as both credit risk and marketability in the secondary level are addressed. There must be a market for the name in which at least three major dealers will bid or offer at a given moment.

E. ***Collateralized Time Deposits***

1) Maximum maturity: Statutory: None.
   Policy: 5 years.

2) Maximum par value, total portfolio: None.

3) Maximum par value per name: Statutory: Shall not exceed the net worth of the institution.
   Policy: Same.

4) Maximum par value per maturity: None.

5) Credit: Institutions must be rated average or better, or above a ***"D"***, by a recognized rating service utilized by the State Treasurer's Office (STO) Investment Division, and must pass a credit evaluation by the STO Staff. This evaluation may include a review of such criteria as geographic location, market perception, loan diversity, management factors, overall fiscal soundness and the Community Reinvestment Act Rating of the institution. If, while holding a pool deposit, an institution is downgraded below acceptable levels by the rating agencies, the following steps shall be taken:

a) Notify the Deposits Section to monitor collateral closely.

b) Review financials and update credit report.

c) Determine the appropriate plan of action which may include early termination of the time deposit, or allow the time deposit to mature.

6) Collateral must comply with Government Code, Chapter 4, Bank Deposit Law Section 16500 (et seq.) and the Savings and Loan Association and Credit Union Deposit Law G.C. Section 16600 (et seq.).

F. *Commercial Paper*

1)	Maximum maturity:	Statutory:	180 days.
		Policy:	180 days.
2)	Maximum par value, total portfolio:	Statutory:	30% of the current portfolio.
		Policy:	Same.
3)	Maximum par value per name:	Statutory:	10% of outstanding
		Policy:	Same.
4)	Maximum par value per maturity:	None.	

5) Credit: Commercial paper eligible for investment under this subdivision must be rated ***"Prime"*** quality as defined by a nationally recognized organization which rates such securities and must be issued by a corporation, trust, special purpose corporation, or limited liability company approved by the Pooled Money Investment Board. Furthermore, these entities must be either (1) organized and operating within the United States and have total assets in excess of five hundred million dollars ($500,000,000) or (2) must be organized within the United States and have programwide credit enhancements including, but not limited to, overcollateralization, letters of credit or surety bonds.

G. ***Corporate Bonds/Notes***

1) Maximum maturity: Satutory: None.
   Policy: 5 years.

2) Maximum par value, total Portfolio: None.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit: Securities eligible for investment under this subdivision must be issued by corporations (including banks) organized and operating withi the United States and shall be within the top three ratings of a nationally recognized rating service.

H. ***Repurchases (RP) and Reverse Repurchase (RRP)***

1) Maximum maturity: Satutory: None.
   Policy: 1 year.

2) Maximum par value, total Portfolio: Statutory: None.
   Policy: RRP is limited to 10% of the current portfolio.

3) Maximum par value per name: None.

4) Maximum par value per maturity: None.

5) Credit:

   a) Must have on file, a signed Security Loan Agreement and/or General Repurchase Agreement. (Repurchase Agreement may be either STO General Agreement or PSA Standard Agreement.)

   b) Reverses and reverse repurchases are only done with long established and/or well capitalized broker-dealers.

The Reverse Repurchase Program is designed to augment the overall portfolio yield in a safe and prudent manner. It is not viewed as a tool with which to effect specific portfolio moves or plan major market strategy. The portfolio carries reversed securities at negative book and the re-investment at positive book. As a result, the reported size of the portfolio represents the true cash participation of its members. All reverses are cash matched either to the maturity of the re-investment or an adequately positive cash flow date which is approximate to the maturity of the re-investment. For example, if cash flow is positive on January 27 and negative on January 31, then the reverse may mature on the 27th, and the re-investment may be taken to the 31st. Cash flow is evened out, and a positive spread is achieved. Only securities already held in the portfolio and unencumbered may be reversed. No item purchased against reverse will be used as a reversible security while the original reverse is outstanding (i.e., the STO does not leverage one liability with another). The against reverse re-investment will be limited to maturities under one year, effectively limiting the appropriate securities to generic money market issues. Because of the role played by the Reverse Program in this office, customized or structured products are not considered appropriate re-investment candidates. All costs, earnings, and spreads are fixed at the beginning of each transaction.

II. GUIDELINES FOR MAINTAINING LIQUIDITY

First priority will be the cash flow needs as reported on both the monthly and six month cash forecasts. These forecasts will be updated daily using the current investment input, as well as adjustment information provided by Cash Management personnel.

Sufficient Treasury securities will be maintained for unscheduled cash needs. It has been determined that Treasury Bills having maximum maturity of 1 year will be used for this purpose. Because of their Government guarantee, as well as the short maturity, the exposure to market risk is minimal.

Due to the make-up of the portfolio participants, an average maturity of 120 days to eighteen months will be maintained.

III GUIDELINES FOR MAINTAINING RATE OF RETURN

Always keep in mind the need to provide a consistent rate of return not only to the quarterly participants of the pool, but the longer term depositors as well. It is often the case that investments made with long term deposits create the base rate to the portfolio. Since sales gains/losses impact the portfolio on a quarterly basis, large gains/losses are to be avoided. Failure to offset either gains or losses proportionately would result in a saw-toothed apportionment rate history. For this reason, extreme positions or styles of trading are prohibited.

An informal weekly meeting, with the Chief of Investments, Assistant Chief, and Investment Manager, will be held to discuss current investment philosophies and upcoming economic releases. Decisions of value and direction are made to accommodate the occurrence of all those events which might be considered reasonable and probable.

Although securities trading is allowed for purposes of enhancing portfolio return, specific limitations have been established to protect the portfolio rate of return:

1) Prior to taking a position, apparent value and size will be discussed between the Chief and Treasury Trader involved.

2) During a ***"when issued"*** (W.I.) period our long position shall never exceed the amount we are willing to purchase.

3) Short positions will not be taken at any time.

4) Trading positions are to be reported daily to the Chief of Investments.

Changes to the

State Treasurer's Office

Investment Policy for the Pooled Money Investment Account

The only change to the policy, as approved November 8, 2004, was to add limited liability companies to the type of entities allowed to issue commerical paper. This additional investment authority incorporates changes made to Government Code §16430 by Chapter 16, Statutes of 2005.