BWC Board of Directors

Investment Committee

Thursday, October 30, 2008, 12:00 p.m.
William Green Building
Neil Schultz Conference Center
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present:	Robert Smith, Chairman Alison Falls Larry Price David Caldwell James Harris
Members Absent:	William Lhota
Other Members Present:	James Hummel Jim Matesich Thomas Pitts Chuck Bryan

CALL TO ORDER
Mr. Smith called the meeting to order at 12:05 pm.

ROLL CALL
Roll call was taken. All committee members were present.

APPROVE MINUTES OF THE SEPTEMBER 25, 2008 MEETING
Approval of the minutes was deferred until the November 2008 meeting.

NEW BUSINESS / ACTION ITEMS:

INVESTMENT COMMITTEE CHARTER REVIEW
Ms. Falls discussed revision of the committee charter. She noted the sentence "All committee actions must be ratified or adopted by the Board of Directors to be effective" should be added as the last sentence to the purpose section of all committee charters.
Motion was made by Ms. Falls, seconded by Mr. Price, as follows: that the Investment Committee of the Workers' Compensation Board of Directors refer the Investment Committee charter to the Governance Committee to consider the recommended changes as discussed here today. Roll call was taken and the motion passed 5-0.

DISCUSSION:

CAPITAL MARKET UPDATE

Kristin Finney-Cooke of Mercer Consulting presented on several significant investment matters. A power point presentation was included, and is incorporated by reference into the minutes. Discussion was made of market cycles, including data from the Chicago Board Options Exchange Volatility Index. There is a high level of volatility this month. Ms. Finney-Cooke indicated that in her presentation, the U.S. stock market is currently in a bear cycle that began October 9, 2007. Discussion was made by the directors regarding conditions, and market return subsequent to a down period. Mr. Caldwell asked for the definition of a bull and bear market. The answer was a 20% change in market value, but there is some subjectivity as to the start and end dates. Director Falls noted that unlike some previous bear markets, we are now in a significant global market downturn. Ms. Finney-Cooke emphasized the importance of mitigating risk with a diverse portfolio through both the bond market and the stock market. Mr. Smith added the best way to mitigate risk is to diversify both stock and bond holdings, although both stocks and bonds have experienced recent negative returns. Ms. Finney-Cooke discussed tactical and strategic (long term) asset allocation. Mr. Smith indicated the capital markets tend to overshoot during periods of extreme pessimism and extreme optimism noting that page 7 of the Mercer presentation show how both bull and bear markets did overshoot the actual economic indicators. Mr. Matesich discussed asset allocation during a shock period. Ms. Finney-Cooke stated modeling is used to construct a portfolio. The modeling process includes different environments (high inflation, recession, etc.) Discussion of rebalancing asset allocation during a shock period ensued. Ms. Finney-Cooke indicated that tactical investing is a recipe for failure.

Mr. Smith indicated that the U.S. federal government rescue packages will eventually improve the ability to access cash by borrowers. Ms. Finney-Cooke noted there is some indication of improvement in credit markets according to the recent decline in the London Interbank Offered Rate. Mr. Smith noted that in the current market environment, asset allocation is more important than benchmarks with a special focus on cash for the near term needs and bonds for the anticipated needs in the intermediate term. Mercer will continue to study appropriate strategic asset allocation planning for acceptable risk levels in its asset-liability modeling project for the Bureau. Mr. Smith observed if the target asset allocation is changed, we should consider staging to take advantage of dollar cost averaging to avoid inadvertent market timing. BWC should avoid tactical changes and maintain discipline. Ms. Falls noted that it is important to pay attention to liquidity risk in addition to credit risk, counterparty risk, etc. In BWC's system, liquidity must be maintained so that claims can continue to be paid without interruption. It is important to address liquidity risk in a portfolio with respect to asset allocation.

Mr. Hummel inquired as to whether consumer spending had reached a bottom point. Ms. Finney-Cooke indicated no. Ms. Falls noted that credit card defaults are increasing significantly. Ms. Falls stated her opinion that the current deleveraging process occurring will put a damper on growth. Ms. Finney-Cooke noted that investment managers are moving to a different analysis of risk.

Mr. Smith asked Bruce Dunn, Chief Investment Officer, for an update on the investment portfolio of the Bureau. Mr. Dunn indicated the estimated unaudited portfolio market value decline of stocks and bonds during the month of October through October 29 was $1.48 billion, representing a portfolio return of negative 8.8%. Stocks during October to date had an estimated negative return of 20.2% and bonds had an estimated negative return of 6.3%. The total return of the Bureau's portfolio was estimated at a negative 14.6 % return year to date.

Charles Bryan joined the meeting at 1:00 pm. Mr. Dunn indicated that cash balances are projected to decline by December 2008 such that BWC will need to redeem $150 million from outside investment managers of the State Insurance Fund in December of 2008. Mr. Dunn indicated the BWC Fiscal & Planning Division periodically provides the Investment Division with detailed operational cash flow projection reports that evidences that need for this redemption action from its investment portfolio. Mr. Dunn also indicated that BWC is experiencing a smaller decline in portfolio performance during the past several months in relationship to most large pension funds having significantly higher equity portfolio allocations.

PORTFOLIO REBALANCING DISCUSSION

Mr. Dunn led a discussion regarding portfolio rebalancing. Mr. Dunn indicated that the Bureau has a Portfolio Rebalancing Committee consisting of Administrator Ryan, the BWC Chief Investment Officer, the BWC Chief Operating Officer and the BWC Chief Fiscal & Planning Officer. A memorandum prepared by Mercer, dated September 30, 2008 is incorporated into the minutes. Mercer indicated that because of the volatile market conditions, including decreased liquidity, it would not be prudent to attempt a rebalancing of the portfolio. At the end of September 2008, the Bureau was in compliance with investment policy asset allocation requirements. Much has changed in October and the Bureau's equity position went lower than its minimum target allocation of 17% of the total portfolio value due to the significant value decline in equities in early October. Mr. Dunn indicated the Portfolio Rebalancing Committee met on October 10, 2008 to review portfolio asset allocation and determined it would not be prudent to attempt any portfolio rebalancing at this time due to extremely unsettled and volatile market conditions and poor liquidity to sell bonds in order to buy stocks. Ms. Finney-Cooke stated it only makes sense to rebalance during normal market conditions. This is not a normal market. Transaction costs and market volatility could require multiple rebalancings. Mr. Smith noted there has been a good process occurring regarding portfolio rebalancing. There has been good dialogue and deliberations between BWC staff, Mercer staff and the Board. All appropriate steps have been taken in evaluating this issue. The credit market is extremely challenging, and may worsen further, thus making it unwise to rebalance. Mr. Smith indicated that one should look to the credit market to see if credit spreads have reduced to more normal levels, prior to rebalancing. Ms. Falls indicated that rebalancing should be considered prospectively. Ms. Falls asked that the minutes reflect the committee acknowledges the portfolio may be out of balance on occasion. Mr. Dunn noted that the Bureau was not out of compliance with targeted asset allocation ranges at the end of the quarter for the State Insurance Fund and the two larger ancillary funds. Mr. Smith acknowledged an exception to a requirement of rebalancing, given the current market conditions. This has been given much discussion, thought and consideration, in light of the memorandum prepared by Mercer Consulting. Mr. Dunn made reference to the investment policy, with regard to compliance and portfolio rebalance. There is a need for clarification of the investment policy concerning portfolio rebalancing such as when to execute any rebalancing action and by how much within the defined targeted asset allocation range. Mr. Price inquired as to how often portfolio asset allocation is monitored. Mr. Dunn stated the internal staff rebalancing policy requires weekly monitoring, but BWC investment staff, in fact, monitors asset allocation daily. Mr. Smith suggested consideration be made of revising the policy to state rebalancing criteria based upon either date certain and/or amount certain, as well as market conditions. Exceptions to mandated quarterly rebalancing should be defined. Mercer will evaluate this and report back to the Board for discussion at the November meeting, and the committee is expected to recommend to the board a revised rebalancing policy at the December 2008 meeting.

STATE STREET UPDATE

Discussion was led by Mr. Dunn. BWC is moving forward with the commingled fund strategy concerning the Marine Fund and Public Workers' Relief Fund, to be managed by State Street. This could include possible securities lending. Mr. Dunn explained that there is evidence of problems and risk associated with securities lending in the current market environment as evidenced by losses, failure to honor redemption requests and lawsuits. BWC currently has no active securities lending program. Mr. Dunn and Lee Damsel, Director of Investments, will meet with State Street to discuss this matter and will report to the committee at the November meeting. Mr. Dunn indicated that recently he has been discussing the securities lending program with State Street. Mercer is discussing the subject of securities lending with clients suffering losses. Discussion is being made concerning not moving forward at this time with a securities lending program associated with the intermediate duration fixed income mandate for these two ancillary funds, and assessing all risks involved with securities lending, to ensure that informed and prudent decision making can be undertaken with regard to securities lending. Mr. Dunn discussed the commingled option, and the client's ability to choose whether to use or not use securities lending. Mr. Dunn stated that BWC can tell State Street that it will not be in a securities lending program but still invest in its available commingled fund previously approved by the BWC Investment Committee and Board of Directors. Mr. Dunn and Ms. Damsel continue to engage in due diligence concerning BWC's relationship with State Street. Ms. Falls noted that the Board has had much discussion and educational review of securities lending in the past. However, in light of the new financial conditions Ms. Falls recommended that the committee revisit the issue to consider revising the investment policy to suspend securities lending. Mr. Smith indicated we could also just not authorize securities lending with this mandate and that this will be with a topic at the November meeting.

ASSET / LIABILITY MODELING

Presentation was made by Ms. Finney-Cooke. A power point presentation was included and is incorporated into the minutes. BWC and Mercer have been collaborating on a project to analyze BWC's tolerance for risk. Mr. Smith noted a standard correlation of asset classes and risk is the basis of most asset allocations and asked if Mercer has done any work on studying correlations during periods of significant economic shocks (such as we are now experiencing). Ms. Falls raised the issue of developing capital market assumptions, including a long range expected rate of return on major asset classes.

MINORITY INVESTMENT MANAGER EDUCATION

Ms. Finney-Cooke made a presentation on this issue. A power point presentation was included and is incorporated by reference into the minutes. Ms. Finney-Cooke indicated minority and women owned business enterprises provide an opportunity to increase potential return to the fund per unit of active risk, by utilizing more nimble investment mandates. Minority and women owned business enterprises might be an emerging firm defined as managing assets of \$2 billion or less, but are not always so as some minority firms cited in her presentation do manage larger asset pools. Mandates may be placed to work directly with a minority and women owned business enterprise, or the investment may be made through a "manager of managers" program approach. There are also staged and graduation investment programs available. Mr. Smith noted that BWC anticipates hiring active managers in the future, so he thought it would be a good idea for the committee to become familiar with the evaluation and implementation steps now.

CIO REPORT

The report was provided by Mr. Dunn. Highlights of the report were made by Mr. Dunn. The report is incorporated into the minutes. Mr. Dunn emphasized that virtually all of the \$94.6 million of realized losses from securities sales reported by the Bureau in September 2008 were the result of four issuers (Fannie Mae, Freddie Mac, Lehman Brothers, and Washington Mutual) that were removed from the Bureau's respective stock and bond benchmark indices due to their poor financial conditions. The removal of these four issuers from the relevant benchmark index required the respective outside passive index investment managers to promptly sell these issues in order to maintain consistency and expected portfolio tracking performance to the benchmark index. Mr. Dunn indicated that discussion with BWC outside investment managers confirmed that corporate bonds have poor liquidity in the current weak credit markets.

Motion was made by Ms. Falls, seconded by Mr. Harris to adjourn the meeting at 2:05 pm. Roll call was taken and the motion passed 4-0. Mr. Caldwell had left the meeting just prior to the motion.

Prepared by: Thomas Woodruff, Interim Director Self Insured Department
October 31, 2008