

**Investment Committee**

**Thursday, November 20, 2008, 1:00 p.m.**

**William Green Building**

30 West Spring Street, 2<sup>nd</sup> Floor (Mezzanine)

Columbus, Ohio 43215

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Members Present: Robert Smith, Chairman  
Alison Falls  
Larry Price  
David Caldwell  
James Harris  
William Lhota, ex officio

Other Members Present: James Hummel  
Thomas Pitts  
Chuck Bryan  
Kenneth Haffey

**CALL TO ORDER**

Mr. Smith called the meeting to order at 1:00 pm.

**ROLL CALL**

Roll call was taken. All committee members were present.

**APPROVE MINUTES OF THE SEPTEMBER 25, 2008 MEETING & OCTOBER 30 MEETING**

Upon motion of David Caldwell, seconded James Harris, the minutes of September 25, 2008 were approved, 6-0. Upon motion of Alison Falls, seconded by Larry Price, the minutes of October 30, 2008 were approved 6-0.

**NEW BUSINESS / ACTION ITEMS:**

**INVESTMENT COMMITTEE CHARTER REVIEW**

Motion was made by Ms. Falls, seconded by Mr. Caldwell, as follows: that the Investment Committee of the Workers' Compensation Board of Directors refer its amended charter to the Board of Directors for review and approval. Roll call was taken and the motion passed 6-0.

**FIXED INCOME COMMINGLED PASSIVE INDEX MANAGER UPDATE**

Bruce Dunn, Chief Investment Officer led a discussion on this subject matter. Mr. Dunn's written report dated November 10, 2008 on the issue is incorporated by reference into the minutes. Mr. Dunn noted the timeline of events that have occurred regarding the Request for Quotations process since the initial approval by the Board of Barclays Global Investors as the recommended Commingled Index Manager for the Public Work-Relief Employees' Fund and the Marine Industry Fund in April 2008 through the August 2008 meeting whereby the Board rescinded the approval of Barclays Global Investors and approved the recommendation that State Street Global Advisors serve as such manager. Barclays and State Street had similar scores with respect to the request for quotations submission as graded by the RFQ Evaluation Committee. The two firms' divergent approaches to derivatives management, learned subsequent to the initial recommendation and vote in April 2008, guided the Bureau's ultimate choice of State Street Global Advisors. Mr. Dunn discussed the additional due diligence conducted with regard to evaluating the two firms. The current market environment also required the Bureau to revisit securities lending as part of this investment mandate. Mr. Dunn indicated it is not advisable for the Bureau to proceed with securities lending at this time due to the current financial crisis of the U.S. economy and deteriorating credit conditions. Mr. Dunn reaffirmed the recommended selection of State Street as the Commingled Fixed Income Passive Index Manager for these two ancillary funds and the suspension of securities lending. This does not require a change to the Investment Policy Statement. With regard to investment manager quarterly due diligence conducted by the investment staff, Mr. Dunn and Lee Damsel, Director of Investments, met with many high-level investment professionals of State Street Global Advisors in their Boston offices last week, including an informative and positive meeting with the chief executive officer of State Street Global Advisors.

Motion was made by Ms. Falls, seconded by Mr. Caldwell as follows: that the Investment Committee recommend to the Board of Directors of the Bureau of Workers' Compensation to proceed to implement the Intermediate Duration Fixed Income Commingled Passive Index Investment with State Street Global Advisors, as originally approved in August 2008 for both the Public Work Relief Employees' Fund and the Marine Industry Fund, for the reasons set forth in the memorandum of the Chief Investment Officer date November 10, 2008. Roll call was taken and the motion passed 6-0.

Motion was made by Robert Smith, seconded by Mr. Price as follows: that the Investment Committee recommend to the Board of Directors of the Bureau of Workers' Compensation to suspend securities lending activity in the approved Intermediate Duration Fixed Income Commingled Passive Index Investment with State Street Global Advisors for both the Public Work Relief Employees' Fund and the Marine Industry Fund, for the reasons set forth in the memorandum of the Chief Investment Officer dated November 10, 2008. Roll call was taken and the motion passed 6-0.

#### **INVESTMENT POLICY STATEMENT REVIEW**

Discussion was made of portfolio rebalancing, and ambiguities in the Investment Policy Statement regarding portfolio rebalancing actions. Mr. Dunn indicated it is unclear as to

when rebalancing is to occur in the current portfolio rebalancing language in section IV.B of the Investment Policy Statement and it is also unclear what will trigger the rebalancing. It is unclear as to what specific reasons may justify not rebalancing. A report prepared by Mercer Consulting dated November 17, 2008 is incorporated into the minutes. The report was discussed by Kristin Finney-Cooke. Discussion was made of the current market conditions. An awareness of market volatility and high transaction costs are considerations involving rebalancing. Discussion was made of possible revisions to the Investment Policy Statement. Mr. Dunn discussed exceptions to rebalancing and documented reasons as to why the Bureau should not rebalance the portfolio at this time. Ms. Falls raised the issue of a possible partial revision of the Investment Policy Statement. Mr. Dunn indicated a need for clarification on when to rebalance, and what triggers a rebalance. Mr. Smith indicated his preference to change the Investment Policy Statement with a two step process – the first to create an exception to the rebalancing mandate, and the second step to be a thorough review of the rebalancing language. Further discussion on these issues ensued. Ms. Falls noted that a lack of liquidity in the markets may make rebalancing difficult. Mr. Dunn recommended that Bureau needs discretion to not rebalance if the markets have such low liquidity that harm will be done to the Bureau as a result of rebalancing.

Motion was made by Mr. Smith, seconded by Mr. Harris, as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it amend current section IV.B of the Statement of Investment Policy and Guidelines to include language pertaining to exceptions to the implementation of required rebalancing actions. The exact changes adopted as a result of this motion are incorporated by reference in these minutes

Ms. Falls made the following motion: "Upon such report by the Administrator, the Board will request the Administrator and the CIO for a plan and an expected timeline to return to compliance with the policy.

Discussion was made of this amendment to the motion regarding rebalancing. The discussion focused on having a decision to not rebalance reported to the Board for Board ratification, and request for a proposed timeline and plan for return to compliance. Mr. Price cautioned the Board to not do too much.

There was further discussion by Mercer Consulting, including discussion with regard to a need for consistent rebalancing procedure. Mr. Smith noted that if the policy is amended, then Ms. Fall's amendment to the motion is not necessary, as the intent of the motion itself is to authorize Bureau management to make a determination of rebalancing. Mr. Lhota observed that the amendment is unnecessary because the policy states when the impacted financial markets become sufficiently liquid, the staff will rebalance. Mr. Smith believed the amendment would put the burden back on the Board, when the decision to not rebalance should be kept at the management level. Mr. Lhota agreed with that comment. The motion to amend died for lack of a second.

Mr. Dunn wants a fuller discussion with the Investment Committee with regard to Mercer's additional recommendations. There needs to be sufficient sensitivity to transaction costs. Mr. Price noted a need to allow the Bureau more time to assess additional recommendations. Ms. Finney-Cooke suggested monthly rebalancing, but is amenable to the idea of quarterly rebalancing. More frequent rebalancing may be appropriate as the market allows. Ms. Falls wants Mercer Consulting to report on other investment policy statements that define conditions where rebalancing would not be appropriate.

The exact changes adopted as a result of this motion will be incorporated in the minutes of this meeting of the committee. Roll call was taken and the motion passed 5-1. Ms. Falls voted no.

### **ANNUAL REPORT ON THE PERFORMANCE AND VALUE OF EACH INVESTMENT CLASS**

Discussion was made of the Annual Report, as mandated by RC 4121.12(F) (12) on the performance and value of each investment class. This Annual Report dated November 7, 2008 was prepared and submitted by Mr. Dunn in his written report dated November 10, 2008 to the Investment Committee and Board and is incorporated into the minutes. The discussion was led by Mr. Dunn. William Lhota inquired as to the value of the document. It was noted that it does have historical value. Ms. Falls indicated that the annual report may follow the letter of the law but may not follow the spirit of the law as investment asset classes may need to be broken down further into subclasses for future annual reports submitted. Motion was made by Mr. Smith, seconded by Mr. Harris, as follows: that the Investment Committee recommend to the Bureau of Workers' Compensation Board of Directors approve the Annual Report on the performance and value of each investment class, as prepared by the Chief Investment Officer and dated November 10, 2008, and to submit the report to the Governor and legislative leaders in fulfillment of the Board's obligation under Revised Code section 4121.12(F) (12). Roll call was taken and the motion passed 6-0.

### **MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS**

The document prepared for comparisons is incorporated into the minutes. Discussion was made by Mr. Dunn with regard to comparing results from October 2008 to September 2008 and from October 2008 to June of 2008. There was a reduction in the market value of total invested assets in excess of two billion dollars from the end of June 2008 to the end of October 2008. Mr. Dunn indicated that liquidity is slowly returning to the credit markets.

### **PORTFOLIO PERFORMANCE**

The report was delivered by Ms. Finney-Cooke of Mercer Consulting. The report is incorporated by reference into the minutes. Discussion was made of key issues and risks, recession risks, and the continuing problem of liquidity. There was only moderate growth projected for perhaps the second half of 2009. Mr. Smith asked for clarification of her comment that the market was fairly valued. Mr. Harris inquired as to whether unemployment projections consider the auto manufacturers. The answer was no. Mr.

Price inquired as to the distinction between unrealized and realized losses. Mr. Dunn indicated that realized losses are the result of the actual sale of invested assets whereas unrealized losses are market value comparisons of assets still currently owned. Mr. Dunn noted according to figures as of October 31, 2008, there was a net unrealized loss of two billion, five-hundred thirty-eight million dollars from end of June 2008 through end of October 2008.

### **PRIVATE EQUITY SALE COMPLETION SUMMARY REPORT**

A written report prepared by the BWC Investment Division is incorporated by reference into the minutes. This report was presented to the Investment Committee by Ms. Damsel. Mr. Dunn started with a brief overview of the sales process and praised the work and efforts of all parties involved in accomplishing the successful completion of the private equity sale. UBS Investment Bank served as an advisor to the sale. UBS utilized a two stage auction approach. The sale process took two and one half years to complete from the time the decision was made to sell all private equity investments by the former Oversight Commission in March, 2006. There was substantial involvement and interaction with both outside legal counsel Benesch Friedlander and internal legal staff to complete this sale process. A total of \$813 million was committed for investment in 68 different private equity partnerships. Ms. Damsel mentioned the aggregate proceeds from partnership sales realized by the Bureau represented approximately a 3% discount from September, 2006 book values. Ms. Damsel indicated that this small discount compares very favorably with discounts of approximately 50% being offered in the current secondary market for large private equity partnership portfolios being brought to market.

### **CIO REPORT OCTOBER 2008**

The report was provided by Mr. Dunn. Highlights of the report were made by Mr. Dunn. The report is incorporated into the minutes. With respect to Investment Staff, a candidate for the senior investment manager position has accepted an offer of employment. As of January 2009 when such person is expected to join staff, there will be seven out of eleven staff members possessing the credential of certified financial analyst. The last private equity sale occurred in October of 2008. Discussion was made of current liquidity of the Bureau and the frequent discussions that occurred between the Investment Division staff and the Bureau's outside investment managers that led to an internal cash management strategy formulated with the Fiscal and Planning Division.

### **COMMITTEE CALENDAR**

Mr. Smith noted that discussion on portfolio rebalancing will continue at the next Committee meeting.

Motion was made by Mr. Smith, seconded by Mr. Harris, to adjourn the meeting at 2:30 pm. Roll call was taken and the motion passed 4-0. Mr. Lhota and Mr. Price had left the meeting just prior to the motion.

Prepared by: Thomas Woodruff, Interim Director Self Insured Department  
November 24, 2008