BWC Board of Directors
Investment Committee
Thursday, June 26, 2008, 12:00 PM
William Green Building
Neil Schultz Conference Center
30 W Spring St., 2ND Floor (Mezzanine)
Columbus, OH 43215

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

Other Members Present:
James Hummel
James Matesich
Philip Fulton
Charles Bryan
Kenneth Haffey

Others Present: John Williams, Assistant Attorney General

CALL TO ORDER

Mr. Smith called the meeting to order at 12:00 pm and the roll call was taken. All committee members were present.

MINUTES OF MAY 28 AND MAY 29, 2008

Motion was made by Mr. Harris, and seconded by Mr. Price, to approve the May 29, 2008 minutes. Bruce Dunn, Chief Investment Officer, indicated that the word decline was repeated on page three. Mr. Dunn further noted that in the CIO report section, Fraser Mega, should read Fraser Nega. Ms. Falls inquired as to whether Mercer Consulting had been supplied with a copy of the minutes for review. Mercer Consulting has been supplied with a copy of the minutes and acknowledged review of the minutes. Roll call was taken and the motion passed unanimously. With regard to the May 28, 2008 minutes, approval shall be deferred to the July 2008 meeting.

Discussion was made concerning a brochure titled "Developing an Investment Policy Statement." Ms. Falls emphasized the importance of noting that the Bureau currently has an investment policy statement that is in the process of being revised. Members of the Committee asked whether revisions could be made to the brochure. Administrator Ryan confirmed that the brochure had been printed in-house, and further revisions could be made. The Committee agreed to review the document and make suggestions for change.

The Committee discussed the Bureau’s transition process to achieve compliance with the Investment Policy Statement. Mr. Dunn noted that in terms of policy, the Bureau has not moved towards active management of the funds. He recommended that the Bureau’s investment consultant be permitted first to complete its asset liability allocation study. The Committee discussed whether it should be recommended that the prior targeted asset allocation transition process be suspended or whether the Bureau should delay implementation in order to allow the asset allocation study to be completed. Ms. Falls noted that there needs to be an acknowledgment that review of the Investment Policy Statement is underway.

NEW BUSINESS / ACTION ITEMS

Proposed Alternative Investment Options for Public Work-Relief Employers’ Fund and Marine Industry Fund

Regarding this agenda item, Mr. Dunn began by discussing passive and active management of investments. Mr. Dunn referred to two handouts presented to the Investment Committee. With regard to passive management, there are two choices: separate account management and commingled account management. The client has more control with separate account management. In addition, a separate account arrangement would permit a client to avoid the use of derivatives. However, a separate account arrangement would be costly and inefficient for the management of relatively small investment funds, such as the Public Work-Relief Employers’ Fund and the Marine Industry Fund. Economies of scale are better achieved for a fifteen million dollar fund and a twenty two million dollar fund with a commingled account structure. Further, the fees for a separate account structure would be excessive for such small funds. Barclays had been recommended and approved for commingled account management of the two small aforementioned funds. This has not been finalized as a consequence of securities lending with the utilization of derivatives by Barclays in a commingled account structure, and concerns over whether this would be out of compliance with the Bureau’s Investment Policy Statement. Mr. Dunn noted that a separate account management arrangement is not viable for small funds. Mr. Dunn then presented three alternative actions to be considered by the Investment Committee for the two aforementioned funds per his memorandum dated June 13, 2008: (i) Barclays as investment manager, (ii) State Street as investment manager, and (iii) maintain current interim strategy until an investment strategy is presented by Mercer upon conclusion of thier asset-liability. Although their fund management policy permits the use of derivatives in their commingled accounts, State Street has never exercised their right to use derivatives. The Bureau Investment Policy Statement would need to permit the use of derivatives if the Bureau makes the decision to utilize a commingled account arrangement with State Street. In addition, there will be further evaluation of the options while maintaining a one hundred percent investment allocation to the JP Morgan US Government Money Market Fund.

Guy Cooper of Mercer Consulting indicated that a great deal of work will be involved with returning to the beginning of the evaluation process, and widening the net for evaluating more investment alternatives. Mr. Smith asked Mr. Dunn for his recommendation to the

Investment Committee. Mr. Dunn recommended consideration of a commingled account structure with State Street or Barclays with consideration of the use of derivatives. Mr. Dunn offered a preference for State Street at this time given the current Investment Committee sentiment on derivatives use since State Street does not actually employ the use of derivatives in the management of its passive indexed commingled fund offered. Ms. Falls noted her belief that the use of derivatives to hedge is sound investment policy. However, she stated she is not comfortable pursuing action that requires amendment of policy without the group's complete understanding of the change. Ms. Falls emphasized a thorough evaluation of other alternatives for fund managers was her preference. Mr. Smith sought clarification from Assistant Attorney General John Williams as to whether or not revision of the Investment Policy Statement would be required to utilize State Street. Mr. Williams stated yes, the policy would need to be revised to permit the use of derivatives. Mr. Price inquired as whether or not a contract with State Street would allow derivatives. Kristin Finney-Cooke of Mercer Consulting replied that the agreement with State Street would require the Bureau to permit the use of derivatives. Mr. Price asked if a contract could be terminated if State Street began to use derivatives. Mr. Dunn and Ms. Finney-Cooke replied that a contract could be ended under those circumstances. Mr. Smith asked if a policy statement revision regarding the use of derivatives could be specific to the investment manager. Mr. Cooper and Ms. Finney-Cooke indicated that the Investment Policy Statement could be revised so as to limit the provision to a specific manager. Ms. Finney-Cooke discussed the Securities and Exchange Commission investigation of State Street with regard to their active investment management. Mr. Dunn noted that there have been no issues with State Street's passive management team.

Mr. Caldwell indicated that since the Bureau staff and Mercer Consulting can be watchful on the use of derivatives, his comfort level with the use of derivatives has increased. Ms. Finney-Cooke stated that Board education on derivatives would be useful. Mr. Harris inquired as to why Mr. Smith and Ms. Falls had differing opinions on the use of derivatives. Mr. Smith has a pragmatic approach to the issue, while Ms. Falls has a policy based approach to the issue. Mr. Cooper discussed securities lending, and the underlying risk associated with securities lending. State Street is more conservative than Barclays with regard to cash collateral pool investment guidelines pertaining to securities lending. Mr. Cooper recommended opening up the request for quote (RFQ), and investigating whether there are additional options for the Bureau to use for a commingled passive management approach. Mr. Smith inquired as to the timeline for the reissuance of an RFQ. Mr. Dunn indicated that the RFQ timeline process from issuance to manager recommendation could be approximately two months. Mercer Consulting will explore options and report back at the July meeting to the Investment Committee on the advisability of reissuing an RFQ.

According to Mr. Williams, the April 2008 vote to utilize Barclays needs to be reconsidered. Mr. Smith indicated that since the Investment Committee received information from Bureau investment staff on derivatives use by Barclays in its management of the cash collateral securities lending pool used by the commingled fund applicable to the Bureau, the Investment Committee shall reconsider the possibility of using Barclays. Ms. Falls discussed transitional implementation issues.

RFP for Commingled Passive Index Managers

The Committee discussed Mr. Dunn's recommendation to delay issuance of the RFP for commingled passive index managers for the State Insurance Fund, the Disabled Workers' Relief Fund and the Coal Workers' Fund until such time as Mercer Consulting can provide investment strategy recommendations in coordination with the Deloitte actuarial study. Motion was made by Ms. Falls, seconded by Mr. Harris, as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it delay the issuance of Requests for Proposals (RFPs) for commingled passive indexed investment managers, previously approved by the Board in May 2008, for the reasons set forth in the memorandum of the Bureau's Chief Investment Officer dated June 13, 2008, and to allow consideration of revisions to the Statement of Investment Policy and Guidelines. Roll call was taken and the motion passed 6-0.

DISCUSSION ITEMS

Monthly and Fiscal Year to Date Portfolio Value Comparisons

Discussion was made by Mr. Dunn concerning portfolio values. A handout was included in the presentation, and is incorporated by reference into the minutes. May of 2008 was a poor month for the performance of bonds. There was a negative 1.5% return for bonds for the month, while S&P 500 indexwhile equities increased 1.3%. Mr. Dunn indicated the overall portfolio return for the Bureau for the fiscal year to date ending May, 2008 was between 5-6%.

Portfolio Performance

A presentation was made by Mercer Consulting on the first quarter performance of 2008. A handout was included in the presentation, and is incorporated by reference into the minutes. Ms. Finney-Cooke presented on such performance issues as the economic environment, market return, performance summary, etc. With regard to the performance of the equity market, there was negative performance in the first quarter. Mr. Price inquired as to how close Ms. Finney-Cooke believed the economy was to a recession. Ms. Finney-Cooke replied that a recessionary economy cannot be determined until the economy is in it. Ms. Finney-Cooke discussed fixed income performance. There was high performance for TIPS. This is good for the Bureau since the Bureau is invested heavily in TIPS. International equity markets performed poorly, but the Bureau has no exposure to that market sector.

Discussion was made of the performance summary for the total portfolio, including benchmark comparisons. Mr. Smith inquired as to which managers drove underperformance. Ms. Finney-Cooke indicated this was difficult to track, as there is only a ten basis points difference when looking at underlying managers. Discussion was made of the format for future performance reports and changes they will reflect. A critical inquiry involves how the Bureau is doing in relationship to asset classes invested by the various managers. Mr. Lhota would like to see graphs and slides for future reports.

CIO Report – May 2008

Mr. Dunn provided the Board with highlights from his report, which is incorporated by reference into the minutes. There has been one additional private equity sale that closed in May 2008. There is one more private equity sale remaining to be completed. Mr. Dunn noted that he has completed the application process for renewal to be licensed as Bureau chief investment officer under Ohio Revised Code requirements. An annual financial disclosure statement has been submitted to the Ohio Ethics Commission by each of the unclassified exempt members of the Investment Division.

ADJOURNMENT

Upon motion by Ms. Falls, seconded by Mr. Caldwell, the meeting was adjourned at 2:00 pm. Roll call was taken, and the motion passed 5-0. Mr. Lhota was not present for the roll call.

Prepared by Tom Woodruff, BWC staff counsel.