BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, October 29, 2009 10:00 a.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present:	Robert Smith, Chair Alison Falls, Vice Chair David Caldwell Kenneth Haffey Larry Price William Lhota, ex officio
Other Members Present:	Jim Harris James Hummel Jim Matesich Thomas Pitts
Members Absent:	Charles Bryan
Counsel Present:	John Williams, Assistant Attorney General

CALL TO ORDER
Mr. Smith called the meeting to order at 10:05 a.m.

ROLL CALL
Roll call was taken. Mr. Haffey was not present at the roll call.

APPROVE MINUTES OF THE SEPTEMBER 24, 2009 MEETING
Upon motion of Ms. Falls, seconded by Mr. Price, the minutes of the September 24, 2009 meeting were approved as written. Roll call was taken and the motion passed 5-0.

AGENDA
Upon motion of Mr. Price, seconded by Ms. Falls, the agenda was approved as written. Roll call was taken and the motion passed 5-0.

NEW BUSINESS/ACTION ITEMS:

PASSIVE INDEX MANAGER RFP FINALIST RECOMMENDATION- STATE INSURANCE FUND

Bruce Dunn, the BWC Chief Investment Officer (CIO), referred the Committee to the Passive Index Management RFP Process report dated October 29, 2009. The report is incorporated by reference into the minutes. He noted that the RFP Process report provides recommendations for a Finalist investment manager for the U.S. Aggregate Fixed Income, the Long U.S. Credit Fixed Income and the U.S. Treasury Inflation Protected Securities (TIPS) mandates. These mandates constitute the three largest fixed income (FI) mandates of the State Insurance Fund (SIF) and excludes the U.S. Long Government Index mandate. He referred the Committee to page 2 of the report, sequencing the steps of the RFP process. As mentioned in the previous Committee meeting of last month, the same process will be used for recommendations of all passive index finalists. The Evaluation Committee consists of four members: Bruce Dunn, the Chief Investment Officer, Lee Damsel, the BWC Director of Investments, Dan Blevins, the BWC Senior Investment Manager and Guy Cooper, Mercer's Senior Consultant. Four respondents answered the RFP: Barclays Global Investors, Mellon Capital Management, Northern Trust and State Street Global Advisors (SSgA or State Street). Mr. Dunn assured the Committee that the Evaluation Committee is very sensitive to the Investment Policy Statement (IPS) manager concentration rules that limit the maximum percentage of the Bureau assets that can be managed by one passive index firm to 50% and limiting the maximum of a firm's managed assets by asset class represented by the Bureau to 5%. Mr. Dunn indicated that the Evaluation Committee was especially sensitive to the 50% rule. Since all of the Bureau's assets are passively managed, no single firm can manage more than $9 billion of the Bureau's assets due to the limitation.

Mr. Smith pointed out that the RFP responses seem to be limited to four firms. He asked if the IPS limitations and the evaluation criteria were valid since the responses were limited to four or if the size of the pool and the number of managers in the area caused the limited responses. Mr. Cooper responded that the index business is a scale business and warned that fees would be higher if the assets were split further. Mr. Smith noted that the Investment Division has substantially driven down fees. Mr. Cooper agreed, indicating that the amount of fees needed to be balanced against the amount of risk reduction. Mr. Cooper noted that the Bureau must have some percentage of asset limitations on investment firms. Mr. Cooper added that the issue should be reviewed, but assured the Committee that the matter was not urgent. Mr. Smith and Ms. Falls agreed that the issue should be considered. Mr. Dunn added that the possibility of active management was being reviewed and, if recommended and approved, would lead to more diversity of investment managers.

In choosing an Investment Manager to recommend, the Evaluation Committee looked very thoroughly at FI RFP responses since the Bureau would be heavily invested in that asset class. They also considered commingled versus separate accounts and the possibility of having a single manager versus multiple managers for each mandate. For the FI mandates being considered, the Evaluation Committee visited each Finalist firm and conducted all day, thorough evaluations, including meeting with senior staff. Mr. Haffey arrived at this point in the Investment Committee meeting. Mr. Dunn noted that State Street began working with the Bureau in 2005 during the migration from 100% active management to passive managed commingled funds during that interim time period. He reiterated that State Street had performed an excellent job when the firm had managed all of the Bureau's investment assets during that interim period. Economies of scale offered by a large manager are very important when choosing a firm for passive indexed management in order to minimize transaction costs and reduce fees. The U.S. Aggregate benchmark index represents over 8,000 securities. This benchmark index will allow access to all major sectors of the FI portfolio including Mortgage Backed Securities and Asset Backed Securities. Ms. Falls mentioned that since leaving the Governance meeting, she was sensitive to the limitations of the Investment Policy Statement. She inquired as to whether a new asset pool needed to be added to the IPS because the Committee was moving into the U.S. Aggregate FI area. She asked specifically if there was a definition of asset class. Mr. Smith added that he was wondering about the statutory limitations and also questioning if the move into the aggregate FI arena constituted a change in asset class. Mr. Dunn responded that the Bureau was already invested in the U.S. Aggregate index by means of a transition account currently managed by a Bureau transition manager. It was ultimately decided that James Barnes, the Bureau's Chief Legal Counsel, would research the issue and provide a response.

Mr. Dunn told the Investment Committee that one finalist stood out above the rest for the U.S. Aggregate fixed income mandate. State Street Global Advisors (SSgA) is recommended for the U.S. Aggregate FI mandate which represents 15% of the SIF invested assets. State Street is a very large index manager with almost $300 billion of assets under management (AUM) for clients with various FI benchmarks. SSgA has almost $100 billion AUM in total U.S. index FI assets. Almost $35 billion of SSgA's AUM is passively managed to the Barclays Capital U.S. Aggregate benchmark index. State Street has over $1.7 trillion in total AUM. State Street has over 13 years experience in managing institutional client assets to the benchmark index. SSgA has an effective and proven stratified sampling approach used to match the returns of the benchmark with excellent results. State Street has a very low tracking error and emphasizes risk controls. The size and scale of the firm allows for low transaction costs. SSgA has managed the

Bureau's FI portfolio for 4 years. In 2005-2007, the same SSgA team passively managed over $15 billion of the Bureau's assets to this benchmark index as mentioned earlier. The reasonableness of the management fee is also beneficial. The yearly management fee averages less than 1.25 basis points (bps) for the full mandate estimated at $2.4 billion at initiation. The firm has a declining management fee structure whereby the average fee decreases as the amount of money invested increases. The average fee is 1.21 bps on $2.4 billion under management.

Mr. Dunn referred the Committee to page 8 of the presentation, referring to the Long U.S. Credit FI mandate. This mandate represents over 1,000 securities in the benchmark index with widely varying liquidity. It represents a targeted 28% of the SIF total assets. It was decided that a separate account was preferable to a commingled account. The separate account affords complete transparency to access and monitor all holdings on a daily basis. There was no sizeable commingled fund offered for non-ERISA investors with non-securities lending limitations as required in the IPS, which would make the Bureau a predominant investor in such a commingled account. The separate account fund was preferable in allowing complete flexibility with no restrictions on investing or redeeming funds. Mr. Dunn noted that rebalancing or cash needs issues may become a problem with the restrictions of a commingled fund. The Evaluation Committee was very sensitive to the IPS manager concentration rule and the large size of the mandate. It was decided that it was essential to split this mandate, giving the SIF Long Credit FI portfolio to more than one manager. The splitting of the benchmark mandate has benefits in that the two managers will achieve broader diversification since the mandate cannot be fully replicated, but must employ a stratified sampling technique. The Evaluation Committee decided that the first of the two finalists would be presented at the current meeting with the second finalist being presented at the November Investment Committee meeting. It is recommended that SSgA receive a 20% allocation of the Long U.S. Credit FI mandate, estimated to be $3.4 billion. Mr. Dunn pointed out that the 20% asset allocation does carry a higher annual fee than the Aggregate FI mandate, but assured the Committee that the management fee was very competitive at $1,250,000 for $3.4 billion in market value. Mr. Smith indicated that it was typical to have a higher fee with this type of mandate.

Mr. Dunn referred the Committee to the U.S. TIPS FI mandate. He noted that it was a growing market, but still very specialized. The total size of the current U.S. TIPS market is around $500 billion. That amount has increased from $350 billion since the Bureau first entered the market. There is a growing interest in TIPS from both domestic and international investors due to the focus on inflation. The Bureau's U.S. TIPS investment policy target is approximately $3.3 billion, which is 17% of the total asset allocation target. The Bureau's TIPS' target represents almost 1% of the total U.S. TIPS market. Due to the size of the index, the Bureau needed a large and experienced manager. There are only 28 issues that comprise the benchmark index. It was decided that separate account managed funds are preferable due to the non-ERISA and non-securities lending limitations. The Bureau already has a 6% exposure of total assets being managed by SSgA for the Bureau specialty funds. The recommended target for this mandate is 5% to be managed by SSgA, estimated at $850 million. This mandate represents a targeted 17% asset allocation for the SIF portfolio. Mr. Dunn noted that the Bureau needed to scale back its position with State Street with the current recommendations of having State Street manage 20% of the total assets with the Long Credit mandate and 15% of the total assets with the Aggregate index, combined with the over 6% of current specialty funds asset management exposure. The Evaluation Committee recommends that 5% of total Bureau assets represented by the TIPS FI mandate be managed by State Street. Even with the reduction of the U.S. TIPS mandate to State Street, SSgA will be managing around 46% of the Bureau's total assets. A second finalist will be recommended to manage the remaining 12% of SIF assets as represented by TIPS. The management fee will be around 1.29 bps or approximately $110,000 per annum. Mr. Dunn pointed out that the minimum annual fee on less than $500 million assets under management is $75,000 as proposed by SSgA. Since the Bureau is investing more than $500 million, the average annual fee is reduced from 1.50 to 1.29 basis points. Mr. Cooper added that the recommendation involves taking money away from SSgA. Mercer attended all the meetings involved in this recommendation, and he reiterated that Mercer supports all of these recommendations involving SSgA.

Mr. Smith mentioned a lawsuit brought by the California Attorney General against State Street. Jordan Nault, Senior Associate with Mercer, added that State Street has three pending legal issues. The first is a $200 million lawsuit filed by the California Attorney General against State Street Bank and Trust. The lawsuit involves foreign currency exchange trading and California pension funds. She noted that this lawsuit should be monitored. Additionally, there are two other legal issues. Those issues are specifically with SSgA. The second lawsuit deals with activities in 2007 involving SSgA while managing short term FI actively managed accounts where their clients are claiming that they were not informed about the risks. The SEC has filed a Wells notice, warning the company that the agency might be filing a civil action. The third legal issue deals with the securities lending program and redemption restrictions on funds that engage in securities lending. Ms. Nault indicated that SSgA has $600 million in legal reserves set aside. She noted that none of the legal issues deal with passive investing, but also added that the publicity can be distracting. Mr. Haffey asked how SSgA's legal issues compare to similar investment management companies. Mr. Cooper responded that Northern Trust has at least as many legal issues as State Street, while Barclays Capital has fewer. Mr. Smith asked about the enterprise risk and verified that State Street would be acting as an advisor, but would not have custody of the capital. Mr. Dunn replied that J.P. Morgan has custody of the funds because these three FI mandates for SIF will be managed as separate accounts. Mr. Pitts inquired if the lawsuits were typical of the securities industry or if they were new issues due to heightened scrutiny based on the current economic climate. Mr. Cooper responded that the first two lawsuits are due to the current economic environment while the third dealing with foreign exchange could happen at any time. He added that SSgA is the custodian of Barclays' funds. Since SSgA does not control the Bureau's funds, there is not any risk from that standpoint. Mr. Cooper noted that there is a risk of State Street being less profitable. He stated to the Committee that State Street charges an average of 4 bps on passive managed assets under management. Ms. Nault added that SSgA is still attracting new clients.

Ms. Falls asked about the relative size of the Bureau's passively managed funds as opposed to the total market for TIPS. She indicated that SSgA has over $13 billion AUM for U.S. TIPS including $3.0 billion from the Bureau's SIF assets currently passively managed. Mr. Dunn referred the Committee to page 14. He responded that SSgA would manage $850 million in TIPS compared to $13 billion of TIPS being currently managed by SSgA. State Street manages over $25 billion in TIPS globally. Mr. Pitts asked about the U.S. Aggregate FI mandate. He asked if State Street would have access to a large enough pool to track the index since the Bureau's policy prohibits securities lending. Mr. Dunn responded that there would be a low tracking error due to State Street's special skill set. He added that liquidity would be a consideration and investments would be chosen based on matching the sectors, duration and quality of issues represented in the benchmark index. Mr. Cooper added that SSgA can choose among the 8,000 securities, reiterating that not all of them have to be purchased. He noted that the Bureau would have a large portfolio so the advisors would be very accessible and available. Mr. Lhota asked if any large clients had left SSgA. Mr. Dunn replied that he had asked State Street this question several months ago and was told none had left at that time for passive management mandates. Mr. Haffey commended the presentation and the presenters. He pointed out that nearly $2 million in fees would be going to State Street and added that the amount of fees was very fair and very good. He commended the Investment staff on working with State Street to keep the fees low. The presenters from SSgA entered the room at this time. Mr. Smith thanked the members of State Street for handling the Bureau's assets during the time of prior crisis at the Bureau. He also questioned the pending litigation.

Mr. Dunn introduced the three presenters from State Street-- John Kirby, James Mauro and James Thorsen. James Thorsen is a Vice President of SSgA. He is also a Senior Relationship Manager and a Team Leader for the firm's Public Funds' clients. James Mauro is primarily responsible for managing government securities. He has managed the Bureau's TIPS assets since 2007. John Kirby is the Global Co-head of SSgA Fixed Income Beta Solutions and as such is considered to be one of the highest ranking FI managers of the firm. He has been the manager of the Bureau's Long Government and Credit portfolio since 2007 and managed the Bureau's U.S. Aggregate indexed fixed income portfolio between 2005-2007. Mr. Thorsen thanked the Committee and the Investment Staff for the opportunity to be here. He pointed out that the SSgA presenters constituted the top senior FI talent of SSgA. He noted that State Street Corp. was a bank holding company with over 200 years of fiduciary history. The corporation has $19 trillion in assets under custody with over $1.7 trillion in AUM in Boston. There are 27,000 employees globally with 1,800 in SSgA. Operating-basis earnings have grown consecutively for the last 31 years. State Street was one of the first firms to accept TARP funds. The TARP funds were repaid in June 2009. The corporation passed the Federal Reserve's stress test and applied capital funds raised of $2.3 billion from newly issued equity and the remainder from unsecured notes to fully repay these TARP funds. Mr. Thorsen noted that the corporation has had some disclosure and management issues. Some legal settlements have already been paid. There is also a pending regulatory action. Mr. Thorsen indicated $193 million is remaining in the litigation fund. Mr. Thorsen emphasized that the legal problems deal with liquidity issues and not with securities lending. Mr. Thorsen explained that the litigation with the California Attorney General deals generally with foreign exchange (FX) trading, custody disputes and certain foreign exchange trades. The disputes deal with the .terms of the contract dating back to the RFP. He emphasized that the Bureau is not part of that portion of the business. Mr. Thorsen added that the Committee should be aware that Ron Logue, the current CEO of State Street, would be retiring in March 2010. He will stay on as Chairman of the Board of Directors through the end of the year to assist with the transition of Jay Hooley, President and Chief Operating Officer as his replacement. Mr. Smith noted that State Street would need to keep Mr. Dunn informed of the status of the litigation. Mr. Dunn replied that SSgA had always been forthcoming. Mr. Thorsen added that SSgA has regularly scheduled quarterly due diligence meetings with the Bureau investment staff.

Mr. Thorsen referred the Investment Committee to the SSgA presentation. On page 3, it was noted that State Street built its name on passive index FI. State Street has $1.7 trillion in AUM. SSgA has $68 billion in net new assets under management in 2009. Mr. Smith asked about defection of clients. Mr. Thorsen responded that there has been some migration from the firm. He stated that there is nothing noticeable that attributes this migration to the litigation. He assured the Committee that their mission has been consistent and unwavering and they continue to be highly attentive to client service. Mr. Lhota asked for clarification. He noted that if the clients were not leaving due to the litigation; they must be leaving due to performance. He asked for the size of the migrating clients. Mr. Thorsen answered that their clients, as with others, are struggling with the market. He added that the migrating clients were small. He also noted that international equities are one of the fastest growing areas. Mr. Lhota indicated that State Street was a bank and asked which regulatory agencies oversaw their operations. Mr. Thorsen responded that the Federal Reserve, the Comptroller, the Department of Labor and the Securities and Exchange Commission oversee their corporation. On page 4 of the presentation, it was shown that State Street has $278 billion total FI under management. $90 billion of that is managed in Boston. Almost 50% of that is in separate accounts. They have 10 portfolio managers and 6 traders. On page 5, State Street's philosophy was emphasized. SSgA focuses on minimizing tracking error by identifying risk, reflecting on portfolio construction, emphasizing implementation by using replication or sampling, monitoring holdings and managing risk. The firm follows strict rules. It also practices month end rebalancing. Mr. Smith inquired if there was any incentive compensation for outperforming the benchmark. Mr. Kirby responded that compensation was only based on reducing tracking error and satisfying the client. He added that the U.S. Aggregate passive indexed strategy employed by SSgA will replicate sector exposures and use samples at the issuer level. TIPS will use full replication while U.S. Long Credit will replicate at the broad classification with sample at the issuer level. He noted that Long Credit will require a finer degree of sampling. Mr. Kirby told the Committee that the firm ensures legal compliance by holding weekly and monthly scheduled meetings. Ms. Falls asked how the Long Credit sampling was performed. Mr. Kirby replied that the firm would identify the Long Credit index at the issuer level. The portfolio management team would develop a list of securities that delivers a better tracking error. The developed list of securities to buy is then sent to the trading desk. The trading desk reviews the list to determine if the trades can be made. Ms. Falls asked how SSgA determines the statistical measure of the tracking error. Mr. Kirby responded that the list shows quantitative data of the portfolio.

Mr. Mauro discussed the TIPS portfolio. He noted that there would be full replication. In 2004, the Treasury announced an expansion of TIPS. For full replication, State Street will buy every bond in the index at the appropriate weight creating very low tracking error. State Street manages $15 billion in TIPS locally and globally manages $27 billion in TIPS. Mr. Mauro noted that transaction costs create a challenge since this Treasury asset suffers liquidity issues at times. SSgA uses the leverage of its global presence and its contacts to reduce transaction costs. Mr. Mauro noted that TIPS liquidity has improved as the market has moved through the financial crisis. He added that a lot of investors are out of the market, but the large investors have stayed. The one year tracking error is 2.2 bps. SSgA has managed the Bureau's TIPS strategies since 2007. The transition was implemented successfully and the management has run smoothly since 2007. Mr. Smith noted that TIPS creates protection from both inflation and deflation. Mr. Mauro indicated that the TIPS inflation adjustment index begins at a ratio of one and grows with inflation. He added that the index ratio can go no lower than one, so it is protected at par. Mr. Matesich clarified that bps stood for basis points. Mr. Thorsen emphasized that State Street has had a good, successful relationship with the Bureau for the last four years. He added that SSgA manages $85 billion in assets from 143 Ohio clients. He pointed out that the firm has the stability of using the same people with the same philosophy and process. He emphasized that historically they have had good consistent dialogue between the executives and the Bureau staff. Mr. Smith thanked Mr. Dunn and Ms. Damsel for limiting the tracking error. Ms. Falls thanked everyone for presenting a thorough review discussing asset allocations and asset liability.

Ms. Falls noted that the market trends are moving toward passively managed long credit. Mr. Kirby replied that there is a firmer dedication to matching assets with liabilities leading investors such as corporate pension funds toward focusing more on long credit FI. He suggested that the trend will remain. Ms. Falls asked if interest in passively managed long credit is growing. Mr. Kirby responded that he is optimistic that the interest will remain as firms are better able to capture excess returns and able to more closely match the liability return. Mr. Smith asked what percentage of the growing interest is attributable to public funds. Mr. Kirby responded that public funds are not mandated to invest in that area, so the percentage is lower. Mr. Thorsen added that many public funds are trying to "get up off the mat." He noted that most public funds have realized that they are underfunded and most are focusing on reassessing contribution/matching requirements and benefit levels. He added that there is some tilt more toward credit with public funds; but not a huge tilt. Mr. Harris referred the Committee to page 3, asking how the AUM is split between company stocks and ESOPs. Mr. Thorsen responded that it is likely that the entire amount of company stocks constitutes ESOPs. Mr. Pitts asked about the process for implementation of the U.S. Aggregate portfolio. Mr. Kirby noted that they are unable to perform full replication with the aggregate portfolio as they can with TIPS. Instead, they replicate various sector exposures of the mortgage and the credit markets. He added that State Street has access to mortgage pools and the portfolio has some liquidity. State Street also uses TBAs for the residential mortgage-backed securities exposure of the benchmark index. They also use a sample of index returns. At this point, the State Street executives left the room. Ms. Nault added that she had a large client who had migrated from SSgA. She specifically indicated that State Street has lost a $600 million long duration fixed income account due to tracking error whose funds were managed to a customized benchmark. Mercer serves as investment consultant to this corporate client account. Mr. Cooper directed the Committee to his October 26, 2009 memo that recommends the appointment of SSgA for the SIF. The memorandum is incorporated into the minutes by reference.

A motion was made by Ms. Falls and seconded by Mr. Haffey as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve State Street Global Advisors as the exclusive U.S. Aggregate Fixed Income Passive Index Manager for the State Insurance Fund for this full asset class mandate, representing a targeted fifteen percent (15%) of total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Indexed Manager RFP Evaluation Committee dated October 29, 2009, and the memorandum prepared by Mercer Investment Consultants dated October 26, 2009, and upon such terms as are outlined in State Street's response to the Request for Proposals issued July 2, 2009, and such other terms as are favorable to the Bureau. Roll call was taken and the motion passed 6-0.

A motion was made by Ms. Falls and seconded by Mr. Price as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve State Street Global Advisors as a Long U.S. Credit Fixed Income Passive Index Manager for the State Insurance Fund for a portion of this asset class mandate, such portion representing a targeted twenty percent (20%) of the total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Index Manager RFP Evaluation Committee dated October 29, 2009, and the memorandum prepared by Mercer Investment Consultants dated October 26, 2009, and upon such terms as are outlined in State Street's response to the Request for Proposals issued July 2, 2009, and such other terms as are favorable to the Bureau. Roll call was taken and the motion passed 6-0.

A motion was made by Ms. Falls, seconded by Mr. Caldwell as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve State Street Global Advisors as a U.S. Treasury Inflation Protected Securities Fixed Income Manager for the State Insurance Fund for a portion of this asset class mandate, such portion representing a targeted five percent (5%) of total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Index Manager RFP Evaluation Committee dated October 29, 2009, and the memorandum prepared by Mercer Investment Consultants dated October 26, 2009, and upon such terms as are outlined in State Street's response to the Request for Proposals issued July 2, 2009, and such other terms as are favorable to the Bureau. Roll call was taken and the motion passed 6-0.

ANNUAL REPORT DRAFT

Mr. Dunn referred the Investment Committee to the Asset Class Annual Report for Fiscal Year 2009. The report is incorporated into the minutes by reference. Marsha Ryan, the Bureau Administrator, noted that the Ohio Revised Code requires annual reporting. The report will be reviewed by the Investment Committee and the Board of Directors. The final version will then be submitted to the Governor. An initial Asset Class Annual Report was created last year, but there have been some further additions to the annual report being presented for fiscal 2009. This fiscal year 2009 annual report is a more fulsome, readable version. It will be submitted in draft form with comments. The final version will be submitted after the Auditor of State releases the Bureau's audited annual financial statement. Mr. Smith complimented the report. Ms. Falls and Mr. Haffey agreed. A motion was made by Ms. Falls and seconded by Mr. Haffey as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve the Annual Report on the performance and value of each investment class, as prepared by the Chief Investment Officer and submitted October 29, 2009, and that it thereafter submit the report to the Governor and Legislative Leaders in fulfillment of the Board's obligation under Revised Code Section 4121.12(F)(12). Mr. Lhota asked about the fact that the report was in draft form. Mr. Smith noted that it needed to be approved by the Board. Ms. Ryan and Mr. Barnes indicated that the report will remain in draft form until the financial numbers are released by the Auditor of State. Mr. Lhota clarified with Ms. Ryan and Mr. Barnes that no changes are intended. Roll call was taken and the motion passed 6-0.

INVESTMENT COMMITTEE CHARTER REVIEW

Don Berno, Board Liaison and Ann Shannon, Legal Counsel referred the Committee to the Investment Committee Charter. The charter is incorporated into the minutes by reference. Mr. Berno indicated that the Membership and Meeting sections were restructured to make them as consistent as possible with the other Committees' charters. Under Purpose, it was recommended that the last bullet about other duties be removed since this is referenced later in the charter. On page 2, under Meetings, Mr. Berno stated that the sentence referring to additional meetings should be removed as being unnecessary. Ms. Shannon noted that the Board of Directors language should be stricken from the sixth duty. The charter was reorganized by statutory requirements and other obligations and responsibilities. Many sections were amended to add and list the code citations sequentially. Under Duties, points 4, 5, 6 and 7 were attached to each Committee's charter, allowing each Committee to coordinate with other Committees, annually review the charter, create Subcommittees and perform other necessary duties. The amended charter is to be sent to the Governance Committee to approve the changes. A motion was made by Ms. Falls and seconded by Mr. Caldwell as follows: I move 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 6-0.

Mr. Price asked if the 50% and 5% maximum rules were set by the Board in order to practice good fiscal prudence. Ms. Falls responded in the affirmative, noting that she is entirely comfortable with State Street. She added that Mercer should focus on the size of the tracking error going forward.

DISCUSSION ITEMS:

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Mr. Dunn referred the Committee to the Invested Assets Market Value Comparison Total Funds Chart and the BWC Invested Assets Chart as of October 28, 2009. Both reports are incorporated into the minutes by reference. Net investment income in September 2009 was $ 463 million. In September, the portfolio returned a positive 2.5%. In September 2009, the bond market had an increased return of positive 2.2%. Equities returned a positive 3.9% during the same period. From August through September, there was a decline in the bond market value due to the international equity transition, causing $ 390 million in net sales due to the transition. Mr. Dunn pointed out that in the fiscal year to date, the portfolio has returned a positive 7.9%. In the fiscal year to date, bonds have returned a positive 6.1% and equities have returned a positive 15.6%. In the BWC Invested Assets report as of October 28, 2009, Mr. Smith noted that the market value decrease in equities should be listed as October 2009. Mr. Dunn noted that there was a correction in the equity market in October 2009 to date. Both bonds and equities had modest decreases in portfolio market value during October 2009 to date. October 2009 to date had a decrease of $100 million in bonds and equities. The October 2009 month to date portfolio had a negative overall return of 0.5%. Ms. Falls pointed out that the market value seemed to hit a low point in October 2008. Mr. Dunn indicated that the portfolio was up about $3.5 billion from October 2008 and that it was at $200-300 million at its lowest point in October 2008.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES

Mr. Dunn referred the Committee to the Investment Asset Allocation charts of August 31, 2009 and September 30, 2009. The reports are incorporated into minutes by reference. Mr. Dunn indicated that there is an increased move out of government bonds into international equities. The S&P 500 index had a positive return of 3.7% for September 2009. The ACWI international equities investment was 2.1% in August 2009. Stocks had increased 2.9% in total asset allocation in the month of September 2009 largely due to the staged second transition phase into international equities. Cash had decreased from 4.5% at the end of August 2009 to 3.6% at the end of September 2009 to 2.3% by October 28, 2009. Mr. Dunn assured the Committee that this decrease was seasonal and that it had been expected.

CIO REPORT

Mr. Dunn referred the Committee to the CIO report of September 2009. The report is incorporated into the minutes by reference. He pointed out that the report contained a transition update. The Priority #1 transition was successfully completed by mid-August 2009, but the current transition manager will remain until State Street is approved as the SIF U.S. Aggregate index manager and all background checks and legal documentation is completed. The first two phases of the SIF transition from government bonds into international equities have been completed. The entire transition should be completed next month. Mr. Dunn pointed out that recently the international stocks have outperformed the domestic stocks, especially as the U.S. dollar has weakened. He added that it was appropriate to diversify the equity portfolio of the Bureau. In October 2009, there was a large transition movement from the S&P 500 index into the Russell 3000 index. Barclays was the transition manager. A summary of this Priority #3 transition will be provided in next month’s CIO Report. Mr. Smith noted that the transitions were going well. Mr. Dunn agreed, indicating that there has been good execution. Mr. Cooper added that this was due to very skillful transition managers and Bureau staff. Ms. Falls commended the Bureau staff and Mercer Consulting on their careful planning of a sizeable transition. Mr. Haffey asked Mr. Dunn to provide a summary of the current economic assessment of Bureau investment managers. Mr. Dunn replied that there are varying degrees of optimism. He noted that liquidity had improved. Barclays is the most pessimistic about growth. The Gross Domestic Product had increased 3.5%. This percentage was higher than the estimated 3.2% that was expected. Mr. Cooper indicated that the recession was officially over. Mr. Price pointed to the 2010 fiscal year goals. He indicated that one goal consists of identifying and evaluating minority and female investment managers. He noted that he wanted some substance to be provided for moving toward that goal. He added that he had asked about the maximum percentages earlier in order to determine their purpose since the 5% and 50% limitations were exclusionary. He noted that the Bureau had to find ways to diversify and reiterated that with over $19 billion in assets, he believes that this is possible.

COMMITTEE CALENDAR

Mr. Dunn referred the Committee to the Investment Committee calendar. The calendar is incorporated in the minutes by reference. It was noted that in November, the Committee will review the recommendations for a second fixed income passive index manager. Mercer will also present the third quarter 2009 performance report next month. The Committee will also have a dialogue on specialty funds resulting from Mercer modeling research and there will be an update on the SIF transition.

ADJOURN

A motion was made at 11:55 a.m. by Mr. Caldwell to adjourn. The motion was seconded by Mr. Price. Roll call was taken and the motion passed 6-0.

Prepared by: Linda Byron, Staff Attorney, Legal Division, November 3, 2009