BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, November 19, 2009 9:30 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:	Charles Bryan Jim Harris James Hummel Jim Matesich Thomas Pitts
Members Absent:	None
Counsel Present:	John Williams, Assistant Attorney General

CALL TO ORDER
Mr. Smith called the meeting to order at 9:28 a.m.

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

APPROVE MINUTES OF THE OCTOBER 29, 2009 MEETING
Upon motion of Mr. Price, seconded by Mr. Caldwell, the minutes of the October 29, 2009 meeting were approved as written. Roll call was taken and the motion passed 6-0.

Mr. Smith noted that an additional item needed to be discussed as an answer to a question posed by Ms. Falls during the October 29, 2009 meeting. Ms. Falls had asked if there needed to be any changes to the Investment Guidelines due to the addition of some asset classes. James Barnes, the Bureau's Chief Legal Officer had researched the issue and provided an opinion that no changes were needed. Mr. Smith asked Ms. Falls if she was satisfied with that opinion. She responded in the affirmative.

AGENDA
Mr. Smith requested consideration of the Investment Committee Charter be added to the agenda. Upon motion of Ms. Falls, seconded by Mr. Haffey, the agenda was approved as amended. Roll call was taken and the motion passed 6-0.

NEW BUSINESS/ACTION ITEMS:

INVESTMENT COMMITTEE CHARTER
Mr. Smith indicated that the Investment Committee had reviewed proposed changes to the Investment Committee Charter during the October 29, 2009 meeting. Those changes had been reviewed and approval recommended by the Governance Committee. 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 approve its amended charter and refer it to the Board of Directors for review and approval. Roll call was taken and the motion 6-0.

PASSIVE INDEX MANAGER RFP FINALIST RECOMMENDATION
STATE INSURANCE FUND
Mr. Dunn, the Chief Investment Officer (CIO), noted that Barclays was being recommended for three fixed income mandates for the State Insurance Fund (SIF). Mr. Dunn noted that last month, the Committee had approved State Street Global Advisors for the Long Credit and TIPS mandates. Today, he would review those mandates, plus the Long U.S. Government mandate.

Mr. Dunn referred the Committee to the Passive Index Management RFP Process presentation dated November 19, 2009. The presentation is incorporated into the minutes by reference. Mr. Dunn noted the RFP process is essentially identical for all SIF mandates.

BARCAP U.S. LONG GOVERNMENT INDEX FIXED INCOME MANDATE
Mr. Dunn noted that the Committee was reviewing a new mandate of the Long U.S. Government passive fixed income index. This mandate represents a targeted 9% of the SIF invested assets. Experience of the investment manager is very important for this mandate as the benchmark consists of 128 issues, the majority of which are U.S. agency issues, but comprise only 13% of the index market value. Mr. Dunn pointed out that some of the agency securities in the index have optionality and some issues can be difficult to find to buy as they have low liquidity. The benchmark

index includes 34 Treasury bonds with a minimum 10 year maturity allowing for nearly full replication for Treasury bonds but not for agencies in the benchmark index. Mr. Dunn indicated that a separate account was found to be preferable to a commingled account for this mandate, especially due to the Bureau being a non-ERISA and non-securities lending investor where the universe of similar investors is limited for commingled managed funds. Mr. Dunn assured the Committee that this manager selection was sensitive to the IPS manager concentration rules. He also indicated that giving this mandate to one manager, rather than splitting it among two or more managers, was recommended since this mandate represented a targeted 9% of the SIF invested assets. Ms. Falls asked for the average duration of the Long U.S. Government bond index. Mr. Dunn responded that it was 12 years. He also noted that the RFP Evaluation Committee was recommending Barclay's Global Advisors (BGI or Barclays) as this mandate manager.

Mr. Dunn noted that BGI is a very large fixed income manager. The firm has almost $450 billion of passive index assets under management (AUM). Approximately $38 billion AUM is passively managed to U.S. Government only indices. Barclays has over $225 billion AUM for total U.S. fixed income (FI) passive index assets which is almost double the amount that State Street Global Advisors (SSgA) manages. BGI has a proven stratified sampling approach. BGI was recommended because the firm had a very low annual tracking error over the past five and ten year periods for this mandate. The CIO noted the fee schedule, indicating that on the estimated $1.5 billion investment, the fee is a little over 3 basis points (bps) or $500,000 per annum.

BARCAP U.S. LONG CREDIT INDEX FIXED INCOME MANDATE
Mr. Dunn referred the Committee to the U.S. Long Credit index FI mandate. This is the largest SIF mandate at around $5.0 billion. For this mandate, two managers are recommended. Mr. Dunn pointed out that having two managers would help to spread out the manager risk and allow for more portfolio diversification. Barclays has over 20 years of experience managing assets to the benchmark index and has managed Bureau assets for over 2.5 years. . Barclays' has delivered low tracking error in managing to the benchmark index. BGI is recommended as a finalist manager of the Long U.S. Credit mandate for a targeted 8% of the total SIF invested assets. There is a total of $5.0 billion in the mandate with $3.6 billion to be managed by State Street and $1.4 billion recommended to be managed by BGI. The management fees on an estimated $1.4 billion would be $1,200,000 per annum. BGI's fees are higher than State Street's fees. Mr. Smith noted that those fees were still extremely low.

BARCAP U.S. TIPS INDEX FIXED INCOME MANDATE

Mr. Dunn referred the Committee to the TIPS FI mandate. It was determined that a separate account structure was preferable for this mandate. This mandate represents a 17% total asset allocation target for SIF. Two finalist managers were chosen by the RFP Evaluation Conmmittee for this mandate. The CIO noted that the fee differential between the two managers for the TIPS mandate is relatively small compared to other fixed income mandates covered in the RFP. Currently Barclays manages more assets than State Street in FI TIPS. Barclays manages over $16 billion of a popular TIPS exchange traded fund called Barclays iShare. BGI has managed TIPS passively for clients since 2001. The Evaluation Committee recommends Barclays for the TIPS mandate for a targeted 12% of total SIF invested assets, estimated to be $2.0 billion. Mr. Dunn noted the percentages of total SIF assets managed by State Street and Barclays. For Barclays, with a 12% recommendation for this mandate plus the other recommended percentages of 10% in Non-U.S. equities, Long Government bonds of 9% and Long Credit bonds of 8%, there is a total percentage of 39% of SIF assets recommended for management by BGI. State Street will manage a total of approximately 46% of the Bureau's total assets consisting of 40% with the SIF and 6% represented by the Bureau's specialty funds. Mr. Dunn pointed out that the TIPS per annum management fee for Barclays is between 1 and 2 bps higher than with State Street.

Guy Cooper indicated that Mercer has participated in all phases of the review from the development of the RFP through the evaluation and the recommendations. He noted that the evaluation process was a thorough process and he was in complete agreement with the selections. Mr. Dunn added that the Investment Division was monitoring the integration of BlackRock and Barclays closely. He also noted that he and Lee Damsel, the Bureau's Director of Investments, had a 45 minute private conference call with Larry Fink, the Chairman and Chief Executive Officer (CEO) of BlackRock to discuss the merger. Mr. Dunn assured the Committee that a significant amount of planning and thought process by BlackRock and Barclays senior management had gone into integrating Barclays with BlackRock. All of the firm's assets under management after the merger will be client assets whereby BlackRock serves in a fiduciary role. He stated to the Committee that there will not be any proprietary trading conducted by BlackRock. Once the merger is completed, BlackRock will have a split of assets under management between 57% passive index and 43% active management or cash. Mr. Dunn indicated that this was a good balance with a combined quantitative and active management approach. He noted that BlackRock has had no major client losses due to the merger, according to its CEO. Mr. Smith asked about BlackRock's approach to an asset allocation that consisted completely of fixed income. Mr. Dunn responded that BlackRock Solutions was a highly regarded fixed income risk management and trading processing program and that the firm takes a more quantitative approach to fixed income versus equity. He noted that BlackRock has approximately 160 clients with $1.0 billion or more of AUM with the company. He also reiterated that he and Ms. Damsel intend to meet with BlackRock Senior Executives on their next trip to New York.

FINALIST MANAGER PRESENTATION

The Executives from BGI entered the room at this time. These Executives were Carl Gilchrist, Principal and Senior Relationship Officer of BGI, and Chris Barr, Principal and Co-Head of U.S. Fixed Income Strategy at BGI. Mr. Dunn introduced Chris Barr and mentioned Mr. Barr had previous positions with Goldman Sachs, Bear Stearns and Merrill Lynch before joining Barclays in 2005 and that he began his career with the Pension Benefit Guaranty Corporation in Washington, D.C. Mr. Dunn also mentioned that Mr. Barr was also the head BGI fixed income transition manager in March and April 2007 during which time he effectively led the Bureau's largest transition of $9 billion from the Lehman Aggregate into the Long Government Credit index. Mr. Gilchrist noted that this was a very challenging and volatile period for the Bureau. Mr. Gilchrist indicated that BGI is involved in all sectors of the fixed income market and is a key observer of trends. He noted the fixed income business has been affected by the current economy. Mr. Gilchrist referred to some of the benefits of the upcoming integration of BGI with BlackRock. The merger will make BlackRock the largest investment advisor in the world with over $3.0 trillion AUM. The merger will combine various product types and styles, creating an unrivaled budget for research and technology. Barclays is a top tier counterparty, trading over $1 trillion annually. BGI has $348 billion in indexed bond strategies with $502 billion in global fixed income under management. BGI provides a direct economic benefit by being able to trade more cheaply, leverage markets and identify spreads. Barclays defines their total performance management strategy by using a combination of returns, risks and costs. Mr. Gilchrist added that BGI's fixed income business will combine well with BlackRock's business from both an organizational and a philosophical standpoint. Mr. Smith asked what the product label will become of the Barclays fixed income indices. Mr. Gilchrist responded that the business name will change to BlackRock, but the indices will still be named Barclays since they are owned by Barclays Capital. Mr. Smith asked about rumors of the federal government looking to try to recover the money from the Lehman Brothers buyout by tapping the BlackRock merger. Mr. Gilchrist replied that there are talks about possible litigation to undo the Lehman deal, but assured the Committee that these discussions refer to the parent company, not BGI.

Mr. Barr discussed Barclays fixed income strategy. He noted that normally the goal with FI is to buy all of the securities of an index, but noted that with some FI investments, there is no bond exchange or there are a limited number of securities whereby not all securities can be purchased. He indicated that Barclays has detailed knowledge of the benchmark and uses rigorous portfolio construction to match the benchmark risks. For the last 11 years, the BlackRock firm has used the BlackRock Solutions system called Aladdin for portfolio construction. Barclays emphasizes efficient trading for risk management. Mr. Barr reassured the Committee that BGI makes sure that the firm understands the risk factors before executing. Barclays does a thorough performance analysis by its Investment Review Committee as well as getting daily updates from index providers. BGI looks at risk and exposure and creates module funds to match the design of the index. The portfolio construction is divided into risk factors and separated into government and credit bonds. Mr. Barr noted that specific risk factors are reviewed by industry group if the investor cannot buy every bond. As an example, the Barclays Capital intermediate credit index begins with over 2,600 issues and then is broken down into sector, then sub-sector continuing down to optionality with 39 issues. The goal is to optimize the risk factors using key rate duration, convexity, duration-times-spread and transaction costs. This study provides efficient returns by controlling risk and minimizing costs. The factors ensure that the expense is not found to be greater than the amount of risk reduction. The Bureau's Long Government and Long Credit index portfolio profiles were shown for the period ending 9/30/09. For long government, the Bureau portfolio managed by BGI has 54 issues compared to 128 in the benchmark. Not all issues have been purchased since some were found to be more expensive than the amount of risk that they were reducing. The portfolio profile is run every day. It was noted that investor interest in TIPS has grown due to increased sensitivity to inflation. BGI is one of the largest TIPS managers in the world. For TIPS, Barclays looks at the entire index and will buy all 28 bonds in the index in weighted proportions. Mr. Barr indicated that the Bureau would not get the same favorable prices without having BGI as the counterparty executing all trades.

FINALIST MANAGER QUESTIONS AND RESPONSES

Mr. Smith asked about the inflation and deflation risks. He noted that the breakeven yield factor between TIPS and nominal Treasuries was 2%, so currently inflation was not an issue. Also, based on the most recent speech by Ben Bernanke, Chairman of the Federal Reserve, there are no signs of an asset bubble yet. Mr. Cooper asked if there was the belief that government credit quality would change. Mr. Barr answered that the bonds are backed with the government guarantee and the industry relies upon that guarantee. Mr. Smith asked about the devaluation of the dollar and the possibility of higher interest rates. Mr. Gilchrist responded that there is a divergence of opinion, but ultimately the belief is that no matter whether the general outlook is very positive or very negative, the outlook for the dollar is positive. Mr. Smith asked about a moderate general outlook. Mr. Gilchrist replied that there is no clear answer with forecasters on both sides of the debate. Ms. Falls pointed out that 70% of the SIF is currently invested in FI. She asked the Barclays' Executives to explain what worries them about that asset class as a whole. Mr. Barr responded that there continue to be challenges with liquidity, credit spreads, credit costs and volatility, but that all of those factors are moving in the right direction. Ms. Falls noted the current regulatory reforms and asked if BlackRock was considered to be "too big to fail." Mr. Gilchrist answered that this was not likely, as BlackRock is not involved in the deposits of money, but rather operates purely as an asset manager. He added that if BlackRock were to fail, then client assets would be reassigned to another custodian. The failure of BlackRock would not cause the financial system to collapse, in his opinion. Ms. Falls asked how regulatory reform in Washington was affecting their business model. Mr. Gilchrist noted that CEO Larry Fink regularly meets with regulators. Mr. Barr added that BlackRock's CEO is very diligent about keeping informed since his goal is for the long term success of the business. Mr. Haffey agreed, indicating that his position mandates him to keep abreast of the current regulations. He added that the regulations are constantly changing in Washington. Ms. Falls asked about the seriousness of the risk of the U.S. Government losing its AAA rating. Mr. Barr responded that BGI looks at the market for answers and sees no current fear of that circumstance. He pointed out that borrowing cost levels are dictated by the market. He also indicated that there was more concern about the degradation of credit in the government agencies and the longevity of the rating agencies themselves. Mr. Smith noted that Barclays needed to continue to keep tracking errors and fees low, and thanked them for their presentation. At this point, the BGI Executives left the room.

Ms. Falls made a motion, 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 Barclays Global Investors as the Long U.S. Government Fixed Income Passive Index Manager for the State Insurance Fund, representing a targeted nine percent (9%) 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 November 19, 2009, and the memorandum prepared by Mercer Investment Consultants dated November 17, 2009, and upon such terms as are outlined in Barclays' 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. The memorandum prepared by Mercer Consulting dated November 17, 2009 is incorporated into the minutes by reference.

Ms. Falls made a motion, 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 Barclays Global Investors 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 eight percent (8%) 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 November 19, 2009, and the memorandum prepared by Mercer Investment Consultants dated November 17, 2009, and upon such terms as are outlined in Barclays' 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.

Ms. Falls made a motion, 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 Barclays Global Investors 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 twelve percent (12%) of total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Index Manager RFP Evaluation Committee dated November 19, 2009, and the memorandum dated by Mercer Investment Consultants dated November 17, 2009, and upon such terms as are outlined in the Barclays' Response for Proposals issued July 2, 2009, and such other terms that are favorable to the Bureau. Roll call was taken and the motion passed 6-0.

Ms. Falls pointed out that the wording about TIPS being passively managed was not in the prior motion. After discussion, it was decided that the motion would be amended to be consistent with the other motions prior to the Board meeting scheduled for the following day. Mr. Smith thanked Bruce Dunn and Guy Cooper for a thorough presentation.

DISCUSSION ITEMS:

PORTFOLIO PERFORMANCE
MERCER QUARTERLY REPORT- THIRD QUARTER 2009
Jordan Nault, Senior Associate with Mercer, referred the Committee to the Investment Performance Third Quarter 2009 report. The report is incorporated into the minutes by reference. The third quarter 2009 Gross Domestic Product is estimated at 3.5%. Interest rates continue to remain low and are predicted to remain low in the upcoming year. Ms. Nault noted that bond credit spreads continue to narrow. The national unemployment rate for October 2009 is 10.2% and the average in Ohio during that same period is 10.1%. Value-oriented stocks outperformed growth stocks across

all segments of the equity market. Small caps outperformed large cap equities. The MSCI EAFE gained 19.5% in the third quarter. In local currency, there was a positive return of 14.9% for the quarter. The Barclays Capital High Yield index had a positive return of 14.2% for the quarter. The Barclays Capital Aggregate index had a positive third quarter gain of 3.7%. Ms. Nault indicated that the third quarter money market return was flat. The SIF had a 91.7% asset allocation, with DWRF at 6.4% for $1.2 billion and BLF at 1.4% at $256 million as of September 30, 2009. State Street managed 48.5% of Bureau invested allocated assets as of September 30, 2009. Northern Trust managed 22.1% and Barclays managed 9.2% of Bureau invested assets as of September 30, 2009. The TM#1 manager allocation was 12.7% for aggregate FI and the TM#2 manager allocation was 4.4% for international equity as of September 30, 2009. The Bureau asset allocations for the SIF are shown in comparison to the benchmark.

Ms. Nault referred the Committee to the performance information. Mr. Matesich asked for an accounting as to what constituted a small or large margin when there is a tracking error versus the benchmark. Ms. Nault responded that any amount over 30-40 bps would be considered a large margin. The three month return was 7.9%, the year to date was 7.5% and the one year return was 1.4% for the SIF portfolio. Ms. Nault pointed out that the SIF did not track the policy benchmark, but assured the Committee that the amounts do not capture all of the new exposures. She noted that the SIF U.S. Aggregate Composite, at a 12.7% allocation did not have a performance history. Mr. Matesich noted that the SIF three month and year to date returns had a tracking error of more than 30-40 bps. Ms. Nault assured him that they were of less concern due to the transitions. She added that the interim policy benchmark reflected the former policy benchmark. Mr. Cooper pointed out that the one year return was a positive 11.4% in one of the scariest periods in economic history. TIPS had a positive three month return of 3.0% and a positive year to date return of 7.9%. Ms. Nault pointed out the TIPS' returns had lagged the benchmark by a greater amount than normal. She attributed the variance to different pricing sources. Ms. Falls pointed out that the tracking error for TIPS was over 150 bps. She was surprised that pricing differences account for such a variance. Mr. Dunn stated that over time, the pricing sources revert to the mean. He indicated that the Committee needed to monitor the pricing sources on a longer term basis. Ms. Nault assured the Committee that this would continue to be monitored. Mr. Cooper added that the amounts are correct and are monitored monthly by both Mercer and the Bureau Investment Division. Ms. Falls indicated that the tracking error can be compared with BlackRock and State Street in the future. The three month return for SIF public equity was a positive 15.5% with a positive 19.0% for the year to date and a negative 7.0% for the one-year period ended September 30, 2009. Ms. Nault noted that these amounts each tracked the benchmark. Ms. Falls asked how often the funds held by the transition managers are being monitored. Ms. Nault answered that they are tracked on a monthly basis. The returns for DWRF were shown as a positive 8.6% for the three month period with a positive 8.1% for the year to date and a positive 12.4% for the one year period. The long duration FI for DWRF was a positive 8.2% for the three month, 4.3% for the year to date and 18.75% for the one year while the three month benchmark was 8.5%. For the BLF composite, the three month return was a positive 8.6% with a positive 8.3% year to date return and a positive 12.1% for the one year return. The intermediate duration FI had a three month positive return of 3.2% with a 3.3% benchmark for the same period. The SIEGF composite had a positive three month return of 0.1% and a positive one year return of 0.7%. For manager updates, Ms. Nault noted that Mercer Consulting is continuing to meet with BlackRock and BGI executives and following any senior executive changes made. Ms. Nault told the Committee that a Missouri school pension fund had filed suit against SSgA for sec lending redemption issues. Ms. Falls noted that the self insured specialty fund was invested in money market accounts and asked when it was scheduled to be reviewed. Mr. Cooper answered that it was scheduled for review in March. Ms. Falls pointed out that the fund was $53 million in size with no return. Mr. Smith asked which vehicles were being reviewed for investment. Mr. Dunn answered that the prime money market fund was being examined, but added that the difference was approximately 10 bps for prime money market accounts versus government money market funds which currently yield around 10 bps. He noted that a short term duration investment strategy had to be maintained for the self insured specialty fund. Mr. Smith pointed out that the low return was the cost of liquidity. Mr. Bryan added that the Bureau needed to consider varying discount rates to reserves. Mr. Smith replied that this was being factored in by Mercer.

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Mr. Dunn referred the Committee to the Invested Assets Market Value Comparison Total Funds chart. The chart is incorporated into the minutes by reference. He noted that October was the first negative month in the fiscal year. He assured the Committee that equity was due for a pause. Net investment income was negative $116 million, representing a monthly net portfolio return of negative 0.6% for October 2009. Bonds had a positive return of 0.1% for the same period. The bond market value decreased $409.6 in October 2009 due primarily to the scale transition to international equity. The TIPS allocation has decreased from $3.56 billion to $3.20 billion. Ultimately, $800 million to $1.2 billion of the transition will be funded by TIPS, with the long government bonds funding the allocation previously. The bond return was offset by $415.8 million in purchases. Mr. Dunn indicated that the reduction in net cash balances was seasonal with no current premium income, but continued payment for claims. The JPMorgan government money market fund yield was 0.10% on 10/31/2009. Mr. Dunn noted that the prime money fund returned 0.20% for that same period.

In the fiscal year to date comparisons, net investment income returned a positive 7.3% for fiscal year 2010. The return for bonds consisted of $1.2 billion in bond sales for a fiscal year return of positive 6.2% for fiscal year 2010. Equity has returned a positive 12.8% for the first four months of fiscal year 2010.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES

Mr. Dunn referred the Committee to the Investment Asset Allocation Combining Schedules as of September 30, 2009 and October 31, 2009. The schedules are incorporated into the minutes by reference. The CIO pointed out that the SIF S&P 500 transition away from Northern Trust as manager into the Russell 3000 index with a chosen transition manager occurred during October. The Russell 3000 index exposure increased to $3.7 billion. The stocks asset allocation increased from 26.9% as of September 30, 2009 to 29.2% on October 31, 2009. He added that the Bureau is nearing the 30% target allocation for stocks. The cash allocation for the SIF decreased from 3.6% at the end of September 2009 to 2.4% at the end of October 2009. Mr. Dunn noted that the Investment Asset Allocation Combining Schedule as of September 30, 2009 shows the asset allocation comparison for the prior month. Mr. Dunn referred the Committee to the BWC Invested Assets as of November 18, 2009 chart that he handed out. The chart is incorporated into the minutes by reference. As of November 18, the portfolio investment return was a positive 2.4% for the month. November to date equities had a positive return of 6.8% and bonds had a positive return of 0.6% for the same period. For November 2009 to date, the market value portfolio for bonds plus equities had an increase of $435 million. The Bureau's asset allocation market value as of 11/18/2009 also included cash held by all Bureau investment managers. Mr. Dunn pointed out that the asset allocations for both bonds and equities were shown on the sheet. Mr. Smith asked if the Invested Assets Market Value Comparison as of the end of October 2009 or the current chart was more accurate. Mr. Dunn responded that the current chart was more accurate when discussing the current asset allocations. He noted that the Transition Managers might need cash for the transitions. The fiscal year to date return from July to October 2009 was a positive 9.7%. In the fiscal year to date, equities had a positive return of 20.4% and FI had a positive return of 6.7%. Mr. Cooper indicated that the target asset allocations can vary by plus or minus 3%.

CIO REPORT

Mr. Dunn referred the Committee to the CIO Report of October 2009. The report is incorporated into the minutes by reference. The Priority #1 transition was completed in mid-August. State Street is the target manager for this U.S. Aggregate fixed income mandate. The complete transfer is expected to occur in December 2009. For the Priority #2 transition, a staged approach is being used to transition a targeted 10% asset allocation into international equities. In the third phase, $400 million in TIPS was used to buy international equities to bring the asset allocation up from 4.6% to 7.2%. Mr. Dunn noted that currently the domestic allocation is higher than the 23% allowable upper range limit. The target amount is 20%. He indicated that if the domestic allocation was still above the target allocation on December 31, 2009, then the allocation must be reduced. The Russell 3000 index transition account might be used to fund the final phase of the international equity transition. Originally, the intent was to fund the fourth phase by selling FI securities. The intent now is to fund the Priority #2 transition fourth phase to achieve a targeted 10% international equities allocation with the sale of domestic equity. Mr. Smith noted that this approach was prudent and appropriate. Mr. Dunn stated that Barclays was the transition manager chosen for the transition from the S&P 500 to the Russell 3000. He noted that the Bureau had to close out for accounting purposes the equity holdings of the Northern Trust managed separate account with the transfer price of these assets being $614 million less than the cost basis, resulting in a realized loss of $614 million. He noted that the loss was reflected as realized since the assets were marked to market upon transfer, but there was no real impact in the Bureau net assets level. This loss is reflected in the November 2009 Enterprise Report.

Ms. Falls mentioned the need to revisit the Motion of the Investment Committee to Approve Barclays Global Investors as a Manager for the U.S. Treasury Inflation Protected Securities Fixed Income Mandate for the State Insurance Fund. Ms. Falls made a Motion of the Investment Committee to approve Barclays Global Investors as a Manager for the U.S. Treasury Inflation Protected Securities Fixed Income Mandate for the State Insurance Fund, 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 Barclays Global Investors as a U.S. Treasury Inflation Protected Securities Fixed Income Passive Manager for the State Insurance Fund for a portion of this asset class mandate, such portion representing a targeted twelve percent (12%) of total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Index Manager RFP Evaluation Committee dated November 19, 2009, and the memorandum prepared by Mercer Investment Consultants dated November 17, 2009, and upon such terms as are outlined in the Barclays' Response for Proposals issued July 2, 2009, and such other terms that are favorable to the Bureau. Roll call was taken and the motion passed 6-0. A point of order was called. Ms. Falls made a motion, seconded by Mr. Price as follows: I move to reconsider the first motion. Roll call was taken and the motion passed 6-0. Ms. Falls made a motion, 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 Barclays Global Investors as a U.S. Treasury Inflation Protected Securities Fixed Income Passive Manager for the State Insurance Fund for a portion of this asset class mandate, such portion representing a targeted twelve percent (12%) of total State Insurance Fund invested assets, for the reasons set forth in the presentation of the Passive Index Manager RFP Evaluation Committee dated November 19, 2009, and the memorandum prepared by Mercer Investment Consultants dated November 17, 2009, and upon such terms as are outlined in the Barclays' Response for Proposals issued July 2, 2009, and such other terms that are favorable to the Bureau. Roll call was taken and the motion passed 6-0.

MERCER REPORT ON ASSET-LIABILITY MODELING- INITIAL RESULTS- DISABLED WORKERS' RELIEF FUND AND BLACK LUNG FUND

Marsha Ryan, the Bureau Administrator, referred the Committee to an evaluation on investment of the specialty funds. She indicated that these funds serve various types of workers or injuries. The Deloitte study looked at the funds and recommended comprehensive changes. The Bureau is reviewing those changes while also looking at maintaining the requirements of the funds. Ray Mazzota, the Chief Operating Officer added that the Bureau was required by House Bill 100 to have an independent review of the rates. Of the recommendations, the first five dealt with the Disabled Workers' Relief Fund (DWRF) including a discussion on the "pay as you go" program, a review of rate reform and long term public policy. He noted that the Bureau needed to look at how to equitably distribute the funds. It is believed that extensive legislative change will be needed.

Neil Cornell, Principal of Mercer thanked Tracy Valentino, Chief of Fiscal and Planning, and Liz Bravender, Director of Actuarial Operations, for assisting him with his evaluation of the specialty funds. Mr. Lhota left the meeting at this point. Mr. Cornell indicated that Mercer Consulting builds economic scenarios to project the results out for a 10 year period. Economic growth is predicted based on the equity market while also looking at inflation pressures. A 75 bps rate is used to adjust the rate up or down. Mr. Cornell referred the Committee to the Strategic Asset Allocation Analysis- CWPF and DWRF report dated November 19, 2009 prepared by Mercer Consulting. The report is incorporated into the minutes by reference. The economic growth scenarios use a low, medium and high inflation model with ideal growth, the medium base case and stagflation. Mr. Cornell noted that the analyses did not employ a stochastic method.

The base case shows the most likely outcome, as the 50th percentile and the median outcome. Stagflation with low economic growth and high inflation represents a worst case scenario as the 5th percentile. The ideal growth scenario with a high economic growth environment and low inflation represents the best case scenario and is the 75th percentile.

Mr. Cornell discussed the results of the study on the Coal Workers' Pneumoconiosis Fund (CWPF). He noted that the fund pays pension benefits and medical expenses. Only new employers are paying premiums into the fund. The funding ratio on June 30, 2009 was 3.63 while the SIF funding ratio is between 1.25 and 1.35. The fund has a very healthy funding status. Mr. Cornell stated that the goal was to maintain the funding status, hence there is no apparent reason to take additional investment risks. The goal is also to reduce risk and volatility. He noted that the long duration asset classes were not a good match for the fund as a shorter duration was better. Mix A shows the current baseline policy at 80% equity and 20% FI including 20% TIPS and 59% to long credit. The liability hedge is very high. Mix B looks at shorter duration with 79% to TIPS with a small allocation of 1% to cash. The hedge goes down to 64%. Ms. Falls asked how the liability was hedged. Mr. Cornell answered that the asset value fixed income was multiplied by the duration of the fixed income. That sum was divided by the sum of the liability times the duration sensitivity. He added that equity has no duration since they cannot anticipate how equities are going to move with interest rates. Mr. Cooper asked what the goal amount was for the hedge. Mr. Cornell replied that the goal was not to over-hedge. Mr. Cooper stated that the Bureau would not be able to get to the ideal with equities, but needed to ensure they did not go significantly over the ideal hedge with bonds. Mix E has an allocation of 25% equity and 75% FI. Mix G has 20% equity and 80% FI. Funding ratios increase under all scenarios except stagflation. Under stagflation with the high inflation, long bonds decrease in value. The alternative mixes funding ratios in 2019 show a wide range of results. Under Mix A, the ideal growth results in a 587% funding ratio and 321% with stagflation. The difference is 266%. With Mix B, the difference decreases to 172%. Mix C has increased volatility with long bonds and a wide range of results. With Mixes D, E and F, increased equity results in a better base rate scenario. Those mixes also increase the possible results. Mr. Cooper noted that the recommendation seems to result in a fine-tuning of the existing strategy. Mr. Bryan pointed out that if nothing happens, then the funding ratio of 2-3 times is needed. Ms. Ryan indicated that there is some risk that the definition of occupational disease will be expanded or that there will be an emergence of another disease from working in mines. She concluded that the risk was low, but must be kept in mind. Mr. Bryan asked if those changes would be on a state level. Ms. Ryan replied that they would be national. Ms. Falls noted the results of Mix D had the smallest variance. Mr. Cooper agreed; adding that Mix G is also recommended despite the wider range of results, but with more balancing in TIPS and Aggregate asset classes. Mr. Cornell stated that Mix D and E have some merit. Mr. Cornell mentioned the issue of medical inflation, indicating that TIPS will not assist with that issue. Mr. Smith noted that they need to study all mixes in depth.

Mr. Cornell referred the Committee to the issue of DWRF. He noted that claims prior to 1987 are eligible for DWRF. DWRF was fully reserved from 1987-1993. Since 1993, the program has changed to a "pay as you go" fund. The funding ratio is not appropriate for a "pay as you go" fund. Mr. Bryan asked if the prefunded balance came from total assets accumulated due to past reserve. Ms. Falls answered that it was based on the past balance. Mr. Bryan asked what the amount of unfunded liability was. Mr. Mazzota responded that it was $2.0 billion with $1.2 billion in invested assets. Mr. Bryan noted that the Bureau had an $800 million shortfall from the beginning. The current prefunded balance is $1.2 billion. The goal is to protect the prefunded balance. John Pedrick, the Chief Actuarial Officer, stated that the balance includes accrued premiums as assets. The goal is to protect against the future. The report includes a graph showing the asset levels including investment returns and premiums decreases as claims grow exponentially. Mr. Cornell pointed out that as time moves forward the $1.2 billion is being spent. Mix C shows the asset allocation required to preserve the prefunded balance at over 100%. Mix A shows the current asset allocation. Mix B reflects the new SIF asset allocation. Mr. Cooper pointed out that some of the prefunded balance is going to be spent since Mix C has 30% FI. Ms. Falls mentioned the imbedded objective of trying to maintain the prefunded balance, indicating that the mixes will need to be thoroughly reviewed. The base case market value increases from Mix A to Mix B. Mr. Cornell noted that Mix B is not favorable under the recession scenario. Under Mix C with ideal growth the assets have doubled, while with the recession scenario, they have decreased by half. Mix A and B result in erosion of the prefunding balance even with the base case. Mix B shows improvement in the ratios in all scenarios except the recession scenario. Mix C results in a 102% funding ratio after 10 years. Mr. Cooper noted that the Committee needed to decide on an objective for the fund, then the asset mix that best meets that objective.

COMMITTEE CALENDAR

Mr. Dunn referred the Committee to the Investment Committee Calendar. The calendar is incorporated into the minutes by reference. He noted that the upcoming meetings will include presentations on new index managers and discussions about the transition updates. Mr. Dunn added that the Evaluation Committee has completed a substantial portion of its due diligence checks for the benchmark mandates. Next month will have a presentation on one passive index manager. January 2010 will contain strategic education pieces including a presentation on high yield funds. Mr.

Dunn pointed out that next month will include continued discussion on DWRF and CWPF specialty funds.

ADJOURN:
Motion was made by Ms. Falls, seconded by Mr. Haffey, to adjourn the meeting at 12:07 p.m. Roll call was taken and the motion passed 5-0.

Prepared by: Linda Byron, Staff Attorney, Legal Division, December 1, 2009