BWC Board of Directors

Investment Committee

Thursday, March 19, 2009 12:30 p.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present:	Robert Smith, Chairman Alison Falls Larry Price David Caldwell James Harris William Lhota
Other Members Present:	James Hummel Thomas Pitts Charles Bryan Kenneth Haffey James Matesich
Members Absent:	None

CALL TO ORDER
Robert Smith called the meeting to order at 12:30 pm.

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

APPROVE MINUTES OF THE FEBRUARY 19 MEETING
Upon motion of Mr. Smith, seconded by Alison Falls, the minutes of February 19, 2009 were approved, 5-0.

AGENDA
Upon motion of Alison Falls, seconded by William Lhota, the agenda was approved as written. Roll call was taken and the motion passed 6-0.

NEW BUSINESS / ACTION ITEMS:

MERCER INVESTMENT CONSULTING CONTRACT FOR FIRST RENEWAL OPTION Motion was made by Mr. Smith, seconded by Ms. Falls, as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it renew the current contract with Mercer Investment Consulting, Inc, for a one year period beginning July 1, 2009. Roll call was taken and the motion passed 6-0.

MERCER UPDATED REPORT ON ASSET-LIABILITY MODELING Presentation on the State Insurance Fund asset-liability modeling projection report was made by the Mercer Consulting team, including Guy Cooper, Richard Nuzum, and Jordan Nault. A power point presentation dated March 19, 2009 is incorporated into the minutes. Bruce Dunn, Chief Investment Officer, made discussion of various asset mixes, and advocates for asset mix five, as represented in the Mercer presentation. In short, a ten percent increase in equity allocation and ten percent decrease in fixed income allocation is recommended by Mr. Dunn. There is a need for more diversification within the equity portfolio allocation with some exposure to overseas markets at a ratio of two to one domestic to international equity allocation. As discussed in the memorandum of Mr. Dunn dated March 16, 2009, and incorporated into the minutes, mix five presents a substantially greater long term expected rate of return of 6.74% when compared with the current implemented policy mix of 6.22% rate of return projected. Mix 5 also provides a significantly lower standard deviation of expected returns than the current implemented investment policy mix. The balanced fixed income mix represented by mix 5 of 32% long duration bonds, 15% intermediate duration bonds and 5% high yield bonds supports the approximately 55% of SIF liabilities that are indemnity related. The equity mix of 30% combined with the 17% allocation to TIPS bonds supports the approximate 45% portion of SIF liabilities related to medical cost liabilities which are correlated to future inflation rates. To be fully implemented, mix 5 will require more discussion and education with the investment consultant and the Board on high yield bonds, private equity and real estate investment opportunities.

Mercer continued their discussion of the asset-liability projection model, evaluating four asset mixes, including the current asset mix under the Smoothed Discount Rate approach. There is no additional funding ratio risk with any of the proposed mixes and strategies. The three proposed strategies produce better results and less risk than the strategy currently in place. In Mercer's opinion, mix six is the best choice for near-term implementation considerations for the State Insurance Fund. The primary distinction between mix five and mix six is that mix five includes a five percent investment in alternative investment asset classes whereas mix 6 substitutes U.S. public equities for these alternative assets. According to Mercer, the current strategy in place provides the lowest rate of return and greatest risk in relationship to Mercer's proposed alternatives for a smoothed discount rate. Mercer stated the following conclusions to the presentation: Mixes 4,5 and 6 should provide better expected rate of return results with less risk than the current implemented asset allocation, as defined by standard deviation of expected return, and mix 6 is a little better than mix 4.

Discussion was made by Mercer of approving phase one of policy implementation. Reference is made to page thirteen of the power point presentation. Next, background work should begin with regard to phase two (adding higher yield bonds) and moving from twenty to thirty percent equities in the mix. Mr. Lhota inquired as to the definition of a high yield bond. Mr. Cooper noted it is not an investment grade bond. Eventually, the proposal of Mercer will require the Bureau to move on to phase three of the implementation, for completion. Mr. Smith noted ten action steps will be required to complete the entire process. Ms. Falls noted that a substantial restructuring of the fixed income portfolio will be necessary. The focus on portfolio value at risk pertaining to fixed income is very important. Larry Price inquired as to what makes Mercer confident that the Bureau is ready to move into private equity investments? Mr. Dunn noted that he believes there is a good opportunity in private equity markets whether it is six months or two years from now. A focused effort will lead to higher returns. Mr. Dunn has substantial experience (fifteen years) in private equity and real estate investment asset classes. Mr. Dunn indicated that investing in pooled partnership funds would be a long term goal for investments in private equity and in real estate. Mr. Dunn also indicated that if private equity funds were considered for investment again in the future, there would be greater selectivity and fewer funds chosen at higher average capital commitment levels when compared to the previous private equity process which resulted in the ownership of 68 different partnerships.

Mr. Price expressed concern over moving too fast in this area. Mr. Dunn is a proponent of the three phases of Mercer for implementation. Inquiry was made as to whether or not the Bureau staff was prepared for a restructuring of the portfolio to include alternative investments. Mr. Dunn responded that he believes current staff is capable of addressing and executing a potential future commitment to private equity investments but that current staff is not capable of addressing real estate investments without adding some staff expertise in addition to himself.

Ms. Falls noted that the Investment Policy Statement should move towards one that the Board would move in a measured manner with the IPS approved and implemented. Next month, there will be proposed changes to the IPS based upon Mercer recommendations. Mr. Caldwell agreed with Ms. Falls' assessment that the full implementation of any long-term asset allocation strategy will require more educational steps. It is the consensus of the Board to use a smoothed discount rate for modeling assumptions. Mercer made discussion of equity benchmarks, the Standard and Poors 500 and the Russell 3000. The S&P 500 represents only large cap companies. The composition of the Russell 3000 is broader and includes both small-cap and mid-cap companies in addition to large cap companies. Mercer recommended using the Russell 3000 as the U.S. equity benchmark. Discussion was made of global markets. Mr. Cooper mentioned the possibility of refinements to TIPS and the long duration bond strategy that were proposed to him by Mr. Dunn.

Mr. Dunn noted a benchmark index is important for each asset class invested. Mr. Dunn indicated his desire to consider a shift away from U.S. Treasuries towards credit bonds in possible future benchmarks. Mr. Dunn would like one half of the long-term fixed income benchmark holdings to be devoted to the credit portion of the benchmark index to increase yield and reduce exposure to Treasuries. There is concern about the vulnerability of the State Insurance Fund to possible poor performance of long duration Treasuries over the long term. The credit portion of the long duration bond index is currently yielding 4% more than the U.S. government portion of this index. A shift towards more credit bonds could improve bond portfolio performance over the long term. Mr. Smith requested Mr. Dunn to prepare IPS language to begin implementation of phase one of the Mercer proposed investment policy decision timelines provided in the Mercer powerpoint presentation.

DISABLED WORKERS' RELIEF FUND AND COAL WORKERS' PNEUMOCONIOSIS FUND LARGE CAP EQUITY SEPARATE ACCOUNT PORTFOLIOS
Northern Trust was previously selected via the request for proposal process as the passive indexed investment manager of the large cap equity portfolios of the Disabled Workers' Relief Fund and Coal Workers' Pneumoconiosis Fund. The contract expires June 30, 2009. These portfolios are currently separate account passively managed. Northern Trust indicated to Mr. Dunn that the current management fee structure of ¾ of one basis point per annum on average month-end valuation is no longer adequate for Northern Trust to cover its inherent costs in administering these two accounts. Mr. Dunn indicated that there are two proposed alternatives now offered by Northern Trust for the Bureau to consider. These alternatives are to either (1) convert both accounts to a commingled fund structure passively managed account offered by Northern Trust without securities lending at a lower fee structure of ½ of one basis point per annum on average month-end values or (2) maintain the existing separate account structure in place at a minimum fee of $75,000 per annum for each account. Mr. Dunn recommended that conversion to a commingled account fund without securities lending would be in order. This conversion would reduce already low investment management fees by one-third. Mr. Dunn mentioned there would be utilization of futures contracts by the manager of the commingled fund to minimize tracking error. Mr. Dunn indicated that the account conversion would require closing each separate account which would involve the complete sale of each of the 500 stock holdings for bookkeeping accounting purposes at their market value at account closing date, even though these holdings would not actually be sold in the open market but would instead be transferred in kind to Northern Trust for receipt by the commingled fund. The market value of these stocks at time of conversion would then be adopted as the new original cost basis of the commingled fund for the Bureau.

Motion was made by Mr. Smith, seconded by Mr. Harris, as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it transfer and convert the large cap U.S. equity portfolio currently passively managed separate account by Northern Trust for the Disabled Workers' Relief Fund to a passively managed commingled account named the NTGI-QM Common Daily S & P 500 Index Fund - Non Lending that is currently managed by Northern Trust, effective July 1, 2009, for the reasons set forth in the memorandum of the Chief Investment Officer dated March 9, 2009. Roll call was taken and the motion passed 6-0.

Motion was made by Mr. Smith, seconded by Ms. Falls, as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it transfer and convert the large cap U.S. equity portfolio currently passively managed in a separate account by Northern Trust for the Coal Workers' pneumoconiosis fund to a passively managed commingled account named the NTGI-QM Common Daily S & P 500 Index Fund - Non Lending that is currently managed by Northern Trust, effective July 1, 2009, for the reasons set forth in the memorandum of the chief investment officer dated March 9, 2009. Roll call was taken and the motion passed 6-0.

Mr. Lhota inquired as to the accounting issue concerning the closure of separate accounts. Although a loss must be recorded, the Bureau is not worse off economically and its net asset value level is not affected as all invested assets are carried at market value. Ultimately, the Bureau is better off as a result of this conversion to a commingled account structure due to lower management fees. Mr. Dunn pointed out that the unrealized losses on these two large cap equity separate accounts aggregate approximately $137 million as of the close of market yesterday. Ms. Falls noted that this commingled fund recommended does not permit securities lending.

DISCUSSION

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS
Mr. Dunn presented the portfolio value comparisons. A report is included, and incorporated into the minutes. Comparison was made of January 2009 and February 2009, and June 2008, to February of 2009. Mr. Dunn also handed out a table with estimated updated portfolio values as of March 18, 2009. Mr. Dunn indicated that the investment portfolio increased in value 3.2% for the month of March to date which essentially offsets the negative February performance, with the net asset level being relatively unchanged since January 31, 2009.

BROKERAGE ACTIVITY SUMMARY REPORT – FISCAL YEAR 2008
Lee Damsel, Director of Investments, presented the report. A power point presentation is incorporated into the minutes. The report is being presented to the Investment Committee and Board for the period covering fiscal year 2008 ending June 30, 2008 in fulfillment of the Investment Policy Statement requirement that an annual summary of trading activity by brokerage firm be presented by staff. Ms. Damsel reported very low trading costs for equities and that there was no unusual trading activity during the reporting period covered. Ms. Falls requested that all broker / dealers be identified by name in the report. Ms. Damsel replied that this report would be revised to list all brokerage firms and that the revised report would be posted on the BWC website providing Investment Committee materials. Ms. Damsel asked Dan Blevins, Senior Investment Manager, to verbally mention the additional brokerage firms omitted from the report that represent the smallest amounts of brokerage activity for each of fixed income and equity trading. Mr. Blevins named these additional firms to the Investment Committee.

CIO REPORT FEBRUARY 2009

Mr. Dunn presented the report. A written report is incorporated into the minutes. There was discussion of miscellaneous investment asset sales. Mr. Dunn mentioned that the miscellaneous assets sale program that commenced last month has sold assets for proceeds of $1.6 million. With the investment staff working in conjunction with the Fiscal & Planning Division, certain identified miscellaneous assets that were determined to be permanently impaired were written down by approximately $12.4 million which became a reported realized loss rather than a reported unrealized loss. These actions had no impact to the Bureau's net asset level for the month since these assets were carried at negligible value. With regard to the coin fund, Mr. Dunn reported the Bureau received an additional $1 million dollars in cash last month.

COMMITTEE CALENDAR

Mr. Smith made brief discussion of an overview of the schedule for April.

ADJOURN:

Motion was made by Ms. Falls, seconded by Mr. Harris, to adjourn the meeting at 2:25 pm. Roll call was taken and the motion passed 5-0. Mr. Caldwell was not present for the roll call.

Prepared by: Tom Woodruff, Director Self Insured Department
March 23, 2009