BWC Board of Directors

Investment Committee

Wednesday, April 29, 2009 2:00 p.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

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

CALL TO ORDER
Mr. Smith called the meeting to order at 2:02 pm.

ROLL CALL
Roll call was taken. All committee members were present at the roll call except Mr. Caldwell and Mr. Lhota.

APPROVE MINUTES OF THE MARCH 19, 2009 MEETING
Upon motion of Ms. Falls, seconded by Mr. Price, the minutes of the March 19, 2009 meeting were approved as written. Roll call was taken and the motion passed 4-0.

AGENDA
Upon motion of Mr. Price, seconded by Mr. Harris, the agenda was approved as written. Roll call was taken and the motion passed 4-0.

DISCUSSION ITEMS:

MOTION TO AMEND THE MARCH 19, 2009 MOTION REGARDING THE TRANSFER AND CONVERSION OF THE DWRF FUND

Bruce Dunn, Chief Investment Officer, clarified a March 19, 2009 motion that dealt with the transfer and conversion of the large cap U.S. equity portfolio separate account currently passively managed by Northern Trust for the Disabled Worker's Relief Fund (DWRF) to a passively managed commingled account named NTGI-QM Common Daily S&P 500 index. The March 19, 2009 motion listed the effective date of the conversion and transfer as July 1, 2009. Mr. Dunn clarified that the intent of the motion was to make the effective date be on or before June 30, 2009. Mr. Harris asked the specific reason for the revision. Mr. Dunn explained that due to the wording found on the March 19, 2009 motion, the fund's transfer and conversion was prohibited until the July 1, 2009 date. It was his intention and expectation that the transfer and conversion would occur prior to the July 1, 2009 date. A motion was made by Mr. Smith and seconded by Ms. Falls as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it amend its March 2009 motion regarding the transfer and conversion of the large cap U.S. equity portfolio currently passively managed by Northern Trust for the Disabled Workers' Relief Fund, solely for the purpose of permitting the transfer and conversion of that account to be executed on or before June 30, 2009. Roll call was taken and the motion passed 4-0.

MOTION TO AMEND THE MARCH 19, 2009 MOTION REGARDING THE TRANSFER AND CONVERSION OF THE COAL WORKERS' PNEUMOCONIOSIS FUND

Mr. Dunn then clarified a March 19, 2009 motion that dealt with the transfer and conversion of the large cap U.S. equity portfolio currently passively managed 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. The March 19, 2009 motion for this fund also listed the effective date of the conversion and transfer as July 1, 2009. Mr. Dunn asked that the effective date be amended to state an effective date of on or before June 30, 2009. A motion was made by Mr. Smith and seconded by Mr. Price as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it amend its March 2009 motion regarding the transfer and conversion of the large cap U.S. equity portfolio currently passively managed by Northern Trust for the Coal Workers' Pneumoconiosis Fund, solely for the purpose of permitting the transfer and conversion of that account to be executed on or before June 30, 2009. Mr. Price asked a question to clarify the intent of the current motion. A discussion was held to clarify that the current motion changed the effective date of the Coal Workers' Pneumoconiosis Fund transfer. Roll call was held and the motion passed 4-0.

Mr. Smith informed the committee that Mr. Caldwell was not present in the meeting as he had to take an important phone call and would return to the meeting as soon as he was able. Similarly, Mr. Lhota had been delayed by other business and would join the meeting as soon as possible.

UPDATE OF STATEMENT OF INVESTMENT POLICY AND GUIDELINES

Mr. Dunn discussed the objective of changing and updating the December 18, 2008 Statement of Investment Policy and Guidelines. The written report is incorporated by reference into the minutes. Mr. Dunn emphasized that he previously issued a memo advocating a change in asset allocation, as did Mercer, BWC's investment consultant. He reiterated that the change in asset allocation will benefit the Bureau of Workers' Compensation and the stakeholders in Ohio by providing higher returns and reduced risk. Mr. Dunn noted that the change in the policy and guidelines was also intended to streamline the statement and correct inconsistencies. He emphasized that a portion of the language in the prior investment policy applied solely to actively managed funds and therefore did not apply to the Bureau's current practice of holding passively managed funds. Those references to actively managed funds were removed. Mr. Dunn assured the committee that if the Bureau began to hold actively managed funds then the current version of the statement of investment policy and guidelines would be updated. Guy Cooper, Principal of Mercer stated that he also advocates the change in asset allocation with the positive changes occurring in the financial market environment. Mr. Smith questioned how to accomplish the adjustments in asset allocation and requested a timeline for implementation. Mr. Dunn stated that the committee will need to discuss the implementation of the changes in asset allocation at the next meeting. He emphasized that the goal would be to reach compliance with the new policy while working within the authority of the Board. Mr. Dunn assured the Board that the changes would be made as quickly as the Board wishes, but cautioned that it must also be done efficiently. Ms. Falls emphasized that prior to approving the new investment policy statement and changes in the asset allocation, the committee had spent a significant amount of time reviewing and reevaluating the changes using the Five Step Decision Making Framework as provided by Mercer to the Board in a packet of the same name on April 24, 2008. Additionally, Ms. Falls reiterated that the Board had spent over one year thoroughly reviewing the changes using the Overview of Process- Setting Investment Strategy form as provided by Mercer in the Kickoff- Asset/ Liability Modeling Investment Committee Meeting packet, dated November 20, 2008. The latter form entitled Establishing Investment Strategy contains a circular, cyclical five step method for establishing investment strategy. The steps include evaluating, in order, the "desired funding ratio, desired confidence level and implied investment objective" then the committee must "perform asset and liability modeling" then review "implied asset allocation" then "evaluate risks of implied asset allocation," and finally, "perform asset and liability modeling." The chart then returns to reevaluating the "desired funding ratio", the "desired confidence level" and the "implied investment objective" and moves through the process continuously. A copy of the chart on establishing investment strategy is attached and incorporated by reference. Ms. Falls noted that the committee has conducted extensive, significant discussions to understand the investment alternatives. The committee has also taken advantage of ample opportunities to ask questions and review and evaluate the answers before approving the changes. Ms. Falls complimented the Bureau staff in being detail-oriented and thorough in assisting the Board in going step-by-step through the process. Ms. Falls emphasized that the Board has performed extensive due diligence in making this decision. Mr. Smith noted that due to the large amount of money in the funds, it was imperative that the committee took more than a year to thoroughly complete the review process.

Mr. Dunn reviewed the changes in the Statement of Investment Policy and Guidelines with the committee. He reviewed each section of the new policy, noting the changes.

He noted that the table of contents had been changed to reflect the revisions. Mr. Dunn referred to the new investment objectives. He emphasized that careful consideration was taken when choosing the wording of the new statement of investment objectives. Mr. Dunn mentioned that the statement now refers to net assets, but does not provide specific amounts. He noted that the policy would need to be reviewed in the future to determine if specific amounts should be added. Mr. Dunn informed the Board that the word surplus had been changed to net assets. Also, any language that quoted the Ohio Revised Code was removed where possible. Under section III, the language referring to the Board responsibility of advising and consenting to the hiring of a Chief Auditor was removed. The Chief Investment Officer explained that this responsibility was addressed in other areas, that Michael Overmyer had been hired to oversee investment compliance and that this responsibility did not need to be reiterated in the investment policy statement. The reference to proposed dividends was removed from the Board responsibilities, as it was not necessary to include this language in the investment policy. Mr. Smith noted that the inclusion of these provisions was necessary at the creation of the investment policy statement, but the provisions were now obsolete due to the authority of the Board. In section III (B) under Staff Responsibilities, language was added to require the staff to consult with the investment consultant before making changes to asset allocations or the investment policy. Mr. Dunn referred to the removal of the phrase “maximum percentage” in section III (B) and the addition of a requirement that the Chief Investment Officer must comply with all regulatory obligations. Additionally, the requirement that all investment advisers file the current Form ADV with the U.S. Securities and Exchange Commission was further defined in the investment statement. Mr. Dunn mentioned that Mercer had filed the Form ADV and Mr. Smith added that other advisers had as well. In section III (E), referring to investment consultant responsibilities, Mr. Dunn reiterated that the intent of the policy change was to affirm the requirement that the investment consultant shall confirm procedural due diligence in selecting managers, rather than establishing that requirement. Mr. Smith inquired about the contract with Mercer. He asked specifically how their requirements differed from the procedure when it came to due diligence. Mr. Dunn answered that there are limits in their fee structure as to how many due diligence searches they must perform, but assured the committee that Mercer can assist in many future manager due diligence searches under their contract before any additional incremental fees must be paid to Mercer. With regards to section IV, subsection A, Mr. Dunn observed that the overlying philosophy is that asset allocation is prioritized higher than selecting one manager over another. Under this section, Mr. Dunn mentioned that the annual requirement for a formal asset/liability analysis for each fund was changed from annually to a three to five year cycle, but assured the committee that this analysis can be conducted more frequently if necessary.

Under Investment Policy Guidelines, section IV, the general guidelines in subsection (C) now limit the percentage of the funds’ assets that can be managed at the time of hiring by an investment organization that utilizes passive investment strategies. The percentage was reduced to 50% from 100%. Mr. Dunn emphasized that this provision applied only at the point of hiring and mentioned to the committee that although State Street manages more than 50% of the funds currently, they are still in compliance. He also mentioned that it might be necessary to diversify management in the future. Mr. Dunn observed that if new managers are hired, they cannot manage more than 50% of the fund at the time of hiring. Additionally, he noted that as long as an investment organization manages no more than 50% of the funds at the time of hiring, the percentage of funds managed does not need to be reduced if portfolio market value changes would take the percentage over 50% for a single manager.

Mr. Price referred the committee back to Section IV (B) on the rebalancing policy. He indicated that the Investment Committee had conducted extensive discussions on rebalancing and agreed to the steps for rebalancing. He noted that there had not been any changes in the process listed in the investment policy statement. Mr. Price also inquired as to when the Board would be informed of any rebalancing activity. Mr. Dunn responded that the steps listed in the rebalancing policy were created based on the prior discussions of the committee. Additionally, he noted that section IV(B)(5) sets forth the time period when the committee will be informed of the rebalancing activity. Mr. Dunn indicated that a portfolio rebalancing activity will typically be communicated to the Board via the monthly CIO Report distributed for the next scheduled meeting subsequent to the completion of such rebalancing activity. In fact, Mr. Dunn indicated that the details of the quarterly rebalancing activity that was completed in early April are provided in his CIO Report to be discussed later in this meeting.

In the fixed income investments section of Section IV, Mr. Dunn noted that the language was revised in order to create flexibility and adaptable wording that could apply to future changes. Language was added in the U.S. and Non-U.S. equity sections setting forth the goals of meeting benchmarks and reducing tracking errors for each type of investment. In addition, language was removed that referred to active management benchmarks and replaced with references to passive management. References to alternative investments were deleted from the policy statement, as well.

Under the derivatives heading, language was added that allows the Board to review the use of financial derivatives other than financial futures such as options or swaps. The requirement that the derivatives be rated AA or better has been removed. Under the Performance Objectives Section V, the references to investment managers was removed since that section was mostly focused on active management. The primary objective of each fund was set forth. The communications provision was removed since it has been addressed in the Responsibilities section of Section III. Additionally, since it is assumed that overall, the rate of return by the passive managers will meet or exceed the benchmarks, specific performance benchmarks for each asset class have been removed. Ms. Falls asked if the committee could return to the specific changes in the asset allocation provision. Mr. Dunn responded that it was his intention to explain all of the changes in the policy.

In section VII dealing with the investment policy statement review, it is required that the policy statement be reviewed at least one time per year, but expected that it will be reviewed more often. Mr. Dunn mentioned Section VIII which allows fair consideration to be given to qualified minority and Ohio based managers if the funds become more actively managed. It was noted that it is difficult to give extra consideration to minority and Ohio based managers at this time due to the passive management of funds. Appendix A sets forth general performance benchmarks. Mr. Smith asked if the committee could go back page 18, the asset allocation. Mr. Dunn noted that the asset allocation lists four fixed income mandates with their performance benchmarks for a total allocation toward fixed income of 70%. There are also two equity mandates with their benchmarks for a total target allocation of 30%. Ms. Falls clarified that the fixed income allocation was reduced from 80% to 70% and that the equity allocation was increased from 20% to 30%. She also noted that the non-U.S. equity category allocation was increased to account for the increase in total equity and that long duration fixed income had been reduced with greater emphasis being put on intermediate duration funds to partially offset the reduction in total fixed income. Ms. Falls observed that only allocations for the State Insurance Fund had changed. Mr. Dunn acknowledged that this was the case. Mr. Smith emphasized that a transition plan for implementation will be discussed at the next meeting in order to get into compliance with the new allocations. He reiterated that the Bureau would be out of compliance with the new policy until the transition plan had been discussed and implemented. He asked that the minutes reflect the Directors understand this. Mr. Harris inquired into the time frame for implementation of the new allocations. The Chief Investment Officer responded that this process would probably take until the end of the year for the selection of all new investment managers and would take at least until September or October 2009 for the initial new investment managers to be presented for recommendation. Mr. Dunn noted that the committee would first need to review the recommendation for new managers. The RFP (Request for Proposal) will likely be issued in June or July at the earliest. Additionally, the committee would need to discuss the selection process and decide priorities.

MOTION TO ADOPT REVISIONS TO THE BWC'S STATEMENT OF INVESTMENT POLICY AND GUIDELINES

A motion was made by Mr. Smith and seconded by Mr. Price as follows: that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve and adopt the revisions to the Bureau of Workers' Compensation's Statement of Investment Policies and Guidelines, as reflected in the red-lined version of the statement incorporated by reference into the minutes of the committee meeting, for reasons set forth in the memorandum of the Chief Investment Officer dated March 16, 2009, and the asset allocation recommendations for the State Insurance Fund prepared by Mercer Investment Consulting. Roll call was taken. The motion passed 4-0.

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Mr. Dunn presented the comparisons. A report is included and incorporated by reference into the minutes. Comparisons were made between the March 2009 and the February 2009 investment returns. Mr. Dunn also mentioned the change in the performance returns of assets for each asset sector between February 2009 and March 2009. Comparisons were also made between the March 2009 and the June 2008 fiscal year-to-date returns.

Mr. Dunn noted that equity and income had positive rates of return. Net investment income in March 2009 showed a net monthly return increase of 3.7%. TIPS had an increase of 5.9% for March 2009. Mr. Dunn noted that the first quarter 2009 earnings announced by corporations were so far better than expected. There was a strong rebound in the Bureau equity portfolio in March 2009 representing a monthly return of 8.7%. Short yields fell and there was only a slight improvement in yields offered in the JPMorgan prime money market fund compared to the U.S. government money market fund used by the Bureau. The Chief Investment Officer noted that there will likely be a recommendation next month to reduce the target weighting of long duration Treasuries with a similar increased weighting of long duration credit bonds for the State Insurance Fund portfolio. He also emphasized that currently, approximately 40-45% of the long duration fixed income portfolio is invested in treasuries, making the Bureau very vulnerable to rising interest rates with long duration treasuries that provide low relative yields.

CIO REPORT

Bruce Dunn, the Chief Investment Officer presented the March 2009 CIO Report. The report is included and incorporated by reference into the minutes. Mr. Dunn noted that the State Insurance Fund retained equity to build up liquidity due to a predicted reduction of premium income in the first quarter. The reduction in premium income in the first quarter was less than expected. There was also a view toward rebalancing. The implementation of the rebalancing strategy executed on April 8, 2009 increased equity from 16.3% to 18.5% for the State Insurance Fund. In order to execute the rebalancing, $ 240 million was needed to invest into equities to reach the required 18.5% target for rebalancing. The State Insurance Fund TIPS asset class was targeted for sale in order to execute the rebalancing. The TIPS asset class was targeted because it had the highest deviation above its target ownership allocation whereas long duration fixed income was below its target. Mr. Dunn emphasized that a transition manager was not engaged to execute the rebalancing because enough funds had been accumulated. Mr. Dunn observed that fees were saved because no transition manager was used. Mr. Haffey asked how often the managers are able to enter the market to rebalance. Mr. Dunn observed that index managers typically rebalance portfolios at the end of the month. Mr. Haffey also asked about the strategy for long duration fixed income funds. Mr. Dunn responded that an automatic rebalancing will occur over time. For instance, as long maturity bonds in the long bond index get inside a ten-year maturity with the passage of time, those bonds are dropped from the index by definition and must then be sold by the manager. This sale causes an automatic rebalancing. Ms. Falls thanked Mr. Dunn, the Chief Investment Officer and Ms. Damsel, the Director of Investments for their detailed work on the revisions of the investment policy statement. Guy Cooper of Mercer and Mr. Smith also complimented Mr. Dunn on the execution of portfolio rebalancing. Mr. Cooper stated the rebalancing procedures that were followed were a textbook example of how a rebalancing action should be executed by a client. Mr. Smith asked if the challenges facing Northern Trust, Barclay’s and State Street were affecting the management of our funds. Mr. Dunn replied in the negative.

COMMITTEE CALENDAR
Mr. Smith noted the agenda items listed on the calendar for the May, 2009 meeting.

ADJOURN
Motion was made by Mr. Smith, seconded by Mr. Harris, to adjourn the meeting at 3:27 pm. Roll call was taken and the motion passed 4-0.
Prepared by: Linda Byron, Staff Attorney, Legal Division, May 1, 2009