BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, May 27, 2010 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
Members Absent:	None
Other Directors Present:	Charles Bryan, Jim Harris, James Hummel, Thomas Pitts
Counsel Present:	John Williams, Assistant Attorney General
Scribe:	Linda Byron, Staff Attorney, Legal Division, BWC

CALL TO ORDER
Mr. Smith called the meeting to order at 9:40 a.m.

ROLL CALL
Roll call was taken. All members but Mr. Haffey were present at the roll call. Mr. Haffey joined the meeting at approximately 9:45 a.m.

APPROVE MINUTES OF THE April 29, 2010 MEETING
Upon motion of Mr. Caldwell, seconded by Mr. Price, the minutes of the April 29, 2010 meeting were approved as written. Roll call was taken and the motion passed 5-0.

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

DISCUSSION ITEMS:

PORTFOLIO PERFORMANCE

Mr. Kweku Obed, Senior Associate with Mercer Investment Consulting, Inc. (hereinafter referred to as Mercer or Mercer Consulting), the Bureau's investment consulting firm, made a presentation discussing the first quarter 2010 portfolio performance. Mr. Obed referred to the First Quarter 2010 "Investment Performance" Report prepared by Mercer and provided to the Committee in advance of the meeting. The presentation is incorporated into the minutes by reference. Mr. Haffey joined the meeting during this discussion item at approximately 9:45 a.m.

Mr. Obed discussed the market environment. The Gross Domestic Product had a first quarter 2010 advance estimate (if actual say increased) of positive 3.2%. The federal funds rate, the rate at which banks lend to one another, remains near 0.00%. The March, 2010 spread between the 10-year nominal Treasury yield and 10-year TIPS yield is 2.24% which can be considered a measurement of inflation expectations. The U.S. civilian unemployment rate was near 10.0%, while the unemployment rate in Ohio is approximately 11.5%. Consumer confidence increased and retail sales were positive. In the first quarter 2010, value equities outperformed growth equities and small cap equities outperformed mid cap equities. Mid cap outperformed large cap funds. The three year returns for all style and market cap equity segments were negative. The S&P 500 returned a positive 5.4% in the first quarter 2010 with a one year return ending March 31, 2010 of positive 49.8%. The Russell 3000 had a positive return of 5.9% in the first quarter 2010 with a one year return ending March 31, 2010 of positive 52.4%. International equity lagged behind U.S. equity due to issues with Greece, but did have overall positive returns. The Barclays Capital (BarCap) Aggregate fixed income benchmark returned a positive 1.8% in the first quarter 2010. High yield bonds had a strong quarter. In the first quarter 2010, two new accounts in the State Insurance Fund (SIF) were opened. These accounts-- the ACWI ex-US and a new TIPS account-- are both to be managed by BlackRock. At the end of the first quarter 2010, the total funds balance was $19.14 billion. This represented a $628 million gain over the 2009 year-end balance of $18.51 billion.

Over the first quarter 2010, all of the Bureau's investment managers tracked their respective benchmarks with the exception of the Barclays Long Duration Government, Barclays Long Duration Credit and State Street TIPS accounts. Mr. Obed indicated that the tracking errors were caused by pricing differences between the manager and the custodian. He also added that Mercer understood the reason for the tracking errors and found them to be acceptable. Over the one year period, only the State Street Government/ Credit Long Duration Index failed to track the benchmark. Ms. Falls noted that she was not surprised with the tracking error on TIPS, but had to question a tracking error of 50 bps on the State Street Government/ Credit Long Duration Index for the one year period. Mr. Obed responded that pricing differences and cash flow accounted for the discrepancy. He reiterated that Mercer found the tracking errors to be understandable and acceptable.

The SIF accounts for almost 92% of the total asset allocation for the Bureau. The Coal Workers' Pneumoconiosis Fund (CWPF) and Disabled Workers' Relief Fund (DWRF) account for another 8%. The U.S. Equity asset allocation of 21.5% and the Long Duration Credit Fixed Income asset allocation of 26.5% account for almost 50% of the Bureau's entire investment portfolio. In comparing the asset allocation in the SIF as of March 31, 2010 with the policy benchmark, the fund is underweighted in long duration government bonds, aggregate fixed income and TIPS. It is overweight in domestic equity, long duration credit and short term investments. Ms. Falls indicated that she would like to see a chart of historical comparisons since the current portfolio allocation is so much different from when the Board first met in August 2007.

The performance summary of the portfolio was discussed. All returns were shown as of the period ending March 31, 2010. In the three months ending March 31, 2010, the Bureau's total funds portfolio had a positive 2.4% return. The one year return was positive 16.8% and the three year return was positive 4.6%.

The SIF returns were discussed. The SIF U.S. Aggregate and U.S. Long Government composites had three month returns of positive 1.7% and positive 1.1% respectively. The SIF U.S. Long Credit composite had a positive three month return of 2.2%. The SIF TIPS composite returned a positive 0.4% in the same period. The SIF Equity composite returned positive 4.5% in the three months ending March 31, 2010. The three year return was negative 4.7%. The SIF International Equity composite returned positive 1.4% in the three months ending March 31, 2010.

The DWRF composite had a positive three month return of 2.2% and a one-year return of positive 15.9%. The CWPF had a one year return of positive 16.0%. The Public Work-Relief Employees' fund had a three month return of positive 1.5%. The one year return was positive 6.7% and the three year return was 3.6%. The Marine Industry fund (MIF) returned positive 1.5% in the three months, positive 6.6% in the one year and positive 3.6% in the three years ending March 31, 2010. The Self-Insuring Employers' Guaranty fund had a flat three month return and a positive one year return of 0.2%. Ms. Falls added that a flat return was equivalent to a 0.00% return.

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Bruce Dunn, the Bureau's Chief Investment Officer, referred to the Invested Assets Market Value Comparison- Total Funds chart dated May 18, 2010. The chart is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Net investment income in April 2010 was $400 million representing a monthly net portfolio return of positive 2.1%. Bonds had a monthly net return of positive 2.6% for April 2010. Equities had a positive monthly return of 1.2% in the same period. Mr. Dunn indicated that long duration bonds outperformed short duration bonds. Operating cash balance was $143.0 million at the end of April 2010. In the 2010 fiscal year ending April 2010, the portfolio returned a positive 14.0% and net investment income totaled almost $2.4 billion. In the same period, the bond portfolio had a positive return of 9.6%. Equities returned a positive 28.7% in the same period.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES

Mr. Dunn referred to the Investment Asset Allocation- Combining Schedules as of April 30, 2010, dated May 17, 2010 and as of March 31, 2010, dated April 15, 2010. The schedules are incorporated into the minutes by reference and were provided to the Committee in advance of the meeting. Net cash in the State Insurance Fund (SIF) decreased from 2.4% to 1.9% in the period from March 31, 2010 to April 30, 2010. Bond allocation increased from 66.3% of the SIF portfolio to 66.8% in the same period while stocks remained flat. The Russell 3000 outperformed the S&P 500 in April 2010. Small and mid cap funds outperformed large cap. In the month of April 2010, the ACWI ex-U.S. had a negative return of 0.88%. The dollar strengthened against the Euro. Mr. Dunn indicated that approximately 20% of the ACWI ex-U.S. index is comprised of stocks denominated in Euros. Mr. Dunn then referred to the BWC Invested Assets chart as of May 26, 2010. The chart is incorporated into the minutes by reference and was provided to the Committee at the meeting. A corrected copy of the BWC Invested Assets chart as of May 26, 2010, dated May 28, 2010 was submitted after the meeting and provided to the Investment Committee members. The corrected chart is incorporated into the minutes. As of May 26, 2010, the total market value of bonds and equities had decreased by $536 million from April 30, 2010. In May 2010 to date, the market value of bonds had increased by $110 million, a positive return of 0.8%. In the same period, equities returned a negative 11.2%. Mr. Dunn indicated that this reduction represented a material correction in the equity market. He added that historically the market has had a 10% correction on average approximately every 11 months. He pointed out that this decline in May would qualify as a stock market correction which is generally defined on Wall Street as a decline of at least 10%. Mr. Smith agreed that these corrections are standard. Mr. Dunn pointed out that there are many positive signs in the United States such as: improved earnings, increased spending, a growing economy, raised consumer confidence, the availability of credit and the occurrence of acquisitions. The ACWI ex-U.S. index saw a significant decline in May as well. Generally, investors moved toward Treasury bonds in May in a flight to safety, given the uncertainty with Greece and growing sovereign debt risk of several other European nations. Long government bonds performed well in May to date, outperforming credit bonds for the first time in months. Long government fixed income returned positive 5.4% and long credit returned 0.4%. These returns widened the yield spread between the BarCap U.S. Long Government and BarCap U.S. Long Credit indexes from 160 bps at the end of April 2010 to 200 bps as of May 26, 2010.

CIO REPORT- APRIL 2010

Mr. Dunn referred to the CIO Report- April 2010, dated May 18, 2010. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. The Russell 3000 equity assets of SIF totaling almost $3.5 billion in market value were transferred from BlackRock as Transition Manager to the approved target managers Northern Trust and Mellon Capital on May 26, 2010. Northern Trust and Mellon are to begin trading on May 28, 2010, the last day of the month for trading the index prior to the announcement from Russell on the reconstitution of the index. In June 2010, the managers will form strategies in order to begin trading stocks to reach the new weights in the Russell reconstitution. The Russell 3000 will have less movement than the Russell 1000 or 2000 separately, but a 6% portfolio turnover is estimated. Ms. Falls asked if the Bureau had assets under management with the Transition Manager. Mr. Dunn replied that there is cash reserved in the transition account to pay the management fee, but no assets under management remain with the Transition Manager. The DWRF and CWF transitions are being prepared. Mr. Dunn indicated that both funds have benefitted from the timing of the transition since the market is lower than it was one month prior. Mr. Smith pointed out that the May 2010 portfolio return was negative 2.8% as of May 26, 2010. Mr. Dunn added that the liquidity of the long credit portfolio is to be monitored closely. The goal is to complete the DWRF and CWPF transitions by the end of the second quarter 2010, but this goal would not necessarily be reached due to legal documentation reviews and more challenging and unsettled market conditions arising recently.

MERCER RECOMMENDED INVESTMENT MANAGERS VALUE ADDED RESEARCH DATABASE RESULTS

Mr. Obed referred to the "Value Added Through Mercer Manager Research Recommendations" report, prepared by Mercer and dated December 31, 2009. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. The chart shows how Mercer "A/A-" rated managers would have performed versus the benchmark indexes. Mr. Obed indicated that some non-homogenous managers exist in each asset class and some managers are more opportunistic. The value added summary shows that small cap outperformed mid cap which in turn outperformed large cap. Additionally, long duration outperformed core. The emerging markets value added is 2.1%. Mr. Smith pointed out that the value added summary results are consistent with the asset class proposals on active versus passive management from Mr. Dunn. Mr. Harris asked about the Australian value added results. Mr. Obed noted that the market is less mature in Australia, making the market less efficient. Guy Cooper, Partner with Mercer Consulting, added that the amount of money invested in small companies would be less than in the U.S., providing for better returns.

MERCER EXCERPTS ON ASSET MIX DETAIL AND PROPOSED PHASES OF INVESTMENT POLICY DECISIONS

Mr. Cooper referred to the Asset and Liability Projection Model Summary State Insurance Fund report, prepared by Mercer and dated May 27, 2010 and originally presented at the March, 2009 Investment Committee meeting. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Cooper noted that Mix 4 and Mix 5 have some interesting factors to consider at a later date, with 5% of the portfolio being invested in real estate and private equity. Phase 1 has been completed with the exception of 5% being invested in long duration fixed income rather than high yield bonds. Investment of the 5% in high yield bonds is to be considered at a later time. Mr. Smith noted that he was comfortable with delaying the decision on high yield bonds. Mr. Cooper noted that the investment in high yield bonds would have some merit and that the Bureau could benefit from this investment. He added that the extreme high yield spreads were now gone. Mr. Smith asked if there were any entry point studies on investing in new asset classes and the timing of the market for this. Mr. Cooper responded that the long term strategy is most important. Ms. Falls indicated that the Committee had agreed to adopt Mix 6 and Phase 1, but had not officially agreed to table the issue of high yield bonds. Mr. Cooper noted that the BWC investment policy would not need to be changed since high yield bonds are not included as a targeted asset class in the policy. Mr. Price asked Mr. Dunn for his perspective on the Committee's proposal to wait to discuss high yield bonds. Mr. Dunn responded that he believes that the Bureau needs to explore other asset classes not included in the policy before agreeing to invest in real estate, high yield bonds and other new asset classes. Mr. Smith added that Mercer Consulting would be preparing in future meetings reports on potential new asset classes for discussion and understanding. He added that any consideration on adding new asset classes was being delayed so that it could be presented in the proper context. Mr. Cooper indicated that Phase 2 was finished. Phase 3 would include discussions on active management. It would also consider Minority and Women Owned Business Enterprises

(MWBE). Investment in private equity and real estate will be considered in that phase as well. Mr. Haffey asked if there were any statistics on investing in private equity since this strategy seemed to be increasing recently. Mr. Cooper responded that there seems to be resurgence in investing in private equity and more activity in that area. Mr. Smith added that this increased activity is due to the potential for higher capital gains tax rates.

ACTIVE/PASSIVE INVESTMENT MANAGER ASSET CLASS RECOMMENDATIONS- STATE INSURANCE FUND

Mr. Dunn referred to the Active Investment Management Asset Class Recommendations for the State Insurance Fund report, dated May 27, 2010. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn indicated that he has been thinking about potential asset classes for active management ever since the new investment strategy for SIF was approved one year ago. Investments in actively managed new asset classes would require a lengthy implementation period and could be staged. Additionally, new actively managed assets will need more intense monitoring. Mr. Dunn indicated that the Investment Staff currently monitors index managers every day. The staff is very satisfied with the tight tracking error. Mr. Dunn stated that he referred to Mercer database to provide support in deciding which asset classes should be actively managed. After reviewing the results of three different Mercer databases, it was noted that each database came to the same general conclusion as to which asset classes would be appropriate for active management. The goal will be to pick the best managers; not median managers. The best managers are ones that have been proven over many market cycles. Currently, only the SIF is being considered for active management. Mr. Dunn indicated he did not address any of the specialty funds in his active management of investment class recommendations. In the SIF, the current allocation is 30% equity and 70% fixed income. The Mercer results support better returns in fixed income with active management. In total, the percentage of the SIF being recommended for active management is 38% or approximately $6.76 billion. It is recommended that 20% of the SIF portfolio as reflected by long credit fixed income be actively managed. This would amount to approximately $3.5 billion at current portfolio market value or slightly over one-half of total assets being recommended for active management.

Mr. Dunn stated that Long Credit fixed income is a compelling asset class investment for active management. The Mercer database shows that its median active manager and its "A/A-" managers exceeded the benchmark by 0.8% and 1.4% respectively over the most recent ten year period. U.S. Long Duration fixed income active managers have a high 1.0% information ratio. Active management of long credit fixed income reduces credit risk since the managers are not forced to hold onto bonds until they fall below investment grade or the issuer goes bankrupt, as a passive manager must. Additionally, active managers are able to perform in-depth research on credits. There are benefits in active management in that the manager can underweight or overweight credits, but avoid extreme bets. The Bureau can place constraints on the active manager by taking away their ability to drastically change the bond duration. Mr. Dunn pointed out that this asset class is not conducive to most MWBE firms according to the Mercer database due to its more specialized focus. Mr. Obed agreed, indicating that there are very few large MWBE firms. Mr. Dunn referred to the Mercer Sample list of Managers of Highly Rated Active Strategies presentation, dated April 2010 and prepared by Mercer. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. There are only three active long duration credit "A/A-" managers listed in Mercer's database. Ms. Falls pointed out that PIMCO has $10.0 billion in assets in the long duration active management area. Mr. Dunn responded that half of that amount is invested in long credit fixed income and half is invested in long government fixed income. It is recommended that 20% of the 28% of SIF assets targeted to the U.S. Long Credit fixed income SIF mandate be actively managed. It is recommended that the remaining 8% continue to be passively managed. There is no timeline for implementation. Active management of long credit fixed income is recommended as a first priority due to the increased income potential, the amount of assets under management and the ability for risk control.

Long government fixed income assets were then discussed. The BarCap Long U.S. Government index currently consists of 123 issues. Approximately 89% of the market value weighting of this index consists of Treasury bonds. Mr. Dunn indicated that an active manager would need to take interest rate and duration bets in order to try to outperform passive management. Mr. Dunn added that this asset class does not create much opportunity to underweight or overweight bond sectors. Mr. Obed noted that managers cannot always predict interest rates, so passive management is recommended. Mr. Smith commented that the active management of the long credit bonds would need to be closely monitored to insure the managers stayed within our investment guidelines. He asked who would be making the recommendations. He specifically asked if the guidelines would be part of the selection process or part of the contractual limitations. Mr. Dunn replied that the limitations could be placed in the management contract.

Mr. Dunn referred to the U.S. TIPS fixed income asset class. The asset class itself is only 13 years old. Issues have a maturity of between 1-30 years. Mercer only has one recommended active manager for this asset class. The excess returns average 0.08% over the index with a median management fee of 0.14%. The only way to outperform the index is through duration bets and interest rate bets. TIPS are not recommended for active management.

The U.S Aggregate fixed income asset class is the broadest and most popular bond index among institutional investors. It consists of many different types of issues including treasury bonds, agencies, mortgage-backed securities, corporate bonds, municipals and sovereigns. The Mercer database shows excess returns of 0.54% with active managers over the bond index. The median management fee is 0.25%. This asset class includes several thousand issuers. Active managers have some ability to adjust the duration of the portfolio. With an average gross excess return of 0.54% and a median management fee of 0.25%, the U.S. Aggregate fixed income is recommended as a second priority for active management. It is recommended that 9% of this SIF portfolio asset class be actively managed and 6% be passively managed. Ms. Falls asked about the information ratio for the U.S. Aggregate mandate. Mr. Obed indicated that although the information ratio was not high, this was attributable largely to management style differences among managers. Ms. Falls also asked if betting on the yield curve is equivalent to betting on interest rate movements. Mr. Dunn responded that this was only partially true.

Mr. Dunn referred to the U. S. Large Cap asset class in the SIF portfolio. The current SIF target allocation for this asset class is approximately 16%. The Russell 1000 benchmark index is comprised of large and mid cap stocks and has a median management fee of

0.49%. Mr. Dunn indicated that this asset class is relatively efficient with a plethora of information being readily available. Even with diligent research, it is difficult to outperform the index. The Mercer database shows an average gross excess return of 0.46% above the index which is slightly below the median management fee. Based on this information, the recommendation is for passive management of the U.S. Large Cap asset class. The study by Mercer supports passive management of this asset class.

Mr. Dunn referred to the U.S. Small and Mid Cap Equity asset class. The current portfolio allocates 4% of the SIF to this asset class. Active management creates significant value added for this asset class. The Mercer database shows average excess returns of 1.50% with active management over passive management. The median management fee is 0.77%. The Mercer database shows the median excess returns over passive management have been 1.8% over the last ten years. The Mercer database shows A/A- rated active managers in the U.S. Small/Mid Cap Equity core have averaged 5.4% excess gross returns over the same period. Mr. Dunn pointed out that this asset class affords tremendous opportunities to exceed the benchmark. The asset class is much less efficient and has less common public knowledge. These characteristics allow for significant benefit with fundamental, detailed research from a knowledgeable active manager. Another benefit of this asset class is the broad representation of MWBE firms for active management. It is recommended that all 4% of the current SIF allocated to small and mid cap equities be actively managed. This is one of two recommendations of second priority active management asset classes within the SIF portfolio.

Mr. Dunn referred the Committee to Non U.S. equity. The SIF asset class target allocation for this asset class is 10%. The ACWI ex-U.S. is composed of approximately 80% developed markets and 20% emerging markets. The SIF portfolio targets are effectively 8% invested in developed markets and 2% invested in emerging markets. Mr. Dunn pointed out that most public funds are more highly weighted in emerging market equities than 2%. The benchmark index contains companies from 22 developed countries and 22 emerging markets. An active manager would have the opportunity to overweight and underweight countries and industry exposures in this asset class. The Mercer database shows that active management averages 1.11% gross excess returns over the index. The median management fee is 0.63%. Over the last 10 years, active management performance has exceeded the EAFE index by 2.3%. Active management can take advantage of the less efficient market and favorable exchange rates. This asset class is the most challenging to monitor, so it is recommended as a last priority. Mr. Smith and Mr. Haffey commended Bruce Dunn on the report, indicating that it provided strong leadership and direction for the Board.

Mr. Cooper indicated that Mercer Consulting supported the move. He pointed out that the Bureau was one of the few large funds that are fully passively managed in index funds. He indicated that Mercer is supportive of the switch to active management as part of a long term plan. He cautioned that the move to active management would require a lot of work, oversight, and monitoring. He added that there would be governance and implementation issues. He also warned that the Bureau has not had all of the other substantive discussions needed on this issue. He recommended that the Bureau proceed slowly and added that the entire process may take 2-3 years. Ms. Falls indicated that the presentation was a good starting point for further discussions on issues such as governance, oversight and resources. Mr. Harris pointed out that this creates a good opportunity to have further discussions in order to engage MWBE. Mr. Price commended Mr. Dunn on his excellent work. He emphasized that the inclusion of MWBE firms was important to him and his goal is to have the Committee move forward and complete the process. He added that he was excited at the direction that the Committee was moving. Mr. Smith agreed, indicating that the presentation provided good direction.

COMMITTEE CALENDAR

Mr. Smith directed the Committee to the 12-month Investment Committee Calendar, dated May 17, 2010. Mr. Smith pointed out that the June 2010 Investment Committee meeting will include a presentation on MWBE. He emphasized that it is important to maintain high quality management standards. He added that the goal of the Committee is to identify MWBEs that qualify and have the same high standards. He noted that the June 2010 meeting would also include an update on the BlackRock organization. Mr. Caldwell indicated that he was excited by the movement toward MWBE and noted that the applicants must be qualified. He added that both issues must be reviewed in tandem. Mr. Obed indicated that he anticipated a good discussion next month on MWBE, adding that other Mercer clients invested with MWBE firms.

ADJOURN

A motion was made by Mr. Haffey, seconded by Mr. Caldwell to adjourn the meeting at 11:30 a.m. Roll call was taken and the motion passed 6-0.