BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, July 28, 2010 10:30 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:	Jim Harris, James Hummel, Thomas Pitts
Members Absent:	None
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 10:48 a.m.

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

APPROVE MINUTES OF THE JUNE 17, 2010 MEETING
Upon motion of Mr. Haffey, seconded by Ms. Falls, the minutes of the June 17, 2010 meeting were approved as written. Roll call was taken and the motion passed 6-0.

AGENDA
Upon motion of Mr. Caldwell, seconded by Ms. Falls, the agenda was approved as written. Roll call was taken and the motion passed 6-0. Mr. Smith indicated that the agenda included a continued discussion on investing with Minority and/or Women Owned Business Enterprises (MWBE) and a presentation by Mercer Consulting, the Bureau's investment

consulting firm, (hereinafter referred to as Mercer or Mercer Consulting), reflecting on the plan for action that the Investment Committee had made three years prior. This plan was almost completed. The presentation would also include possibilities for the Committee's future plans. The presentation would discuss the strong performance of the Bureau's Investment Committee as well as reflect on the lessons that had been learned in the preceding three years.

DISCUSSION ITEMS:
MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS
Mr. Dunn, the Bureau's Chief Investment Officer referred to the Invested Assets Market Value Comparison-Total Funds chart dated July 20, 2010. The chart is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. During June 2010, the portfolio had a net return of 0.7%, representing an increase of $125 million in net investment income. Mr. Dunn indicated that through May and June 2010, investors continued to invest heavily in Treasury bonds. This move was fueled by fears of a double dip recession, debt issues in Europe, the continued fall in the equity market and the slow economy. He noted that the Bureau had found a successful balance in the portfolio between equity and fixed income (FI) asset classes. He added that one asset class will typically do better than the other asset class each month. The Bureau's portfolio is more heavily invested in FI for steady income. The bond portfolio had a net monthly return of positive 2.7% in June 2010. The equity portfolio had a negative net return of 4.4% in the same period.

For the just completed full fiscal year 2010, the Bureau's total portfolio had a positive return of 12.0% and provided $2.05 billion in net income. The bond portfolio returned 13.0% in fiscal year 2010, while the equity portfolio returned 12.3% during the same period. In comparison, in the fiscal year to date ending April 2010, the equity portfolio return had been 19.0% higher than the bond return. Equity had returned a positive 28.7% over this ten month period, but, as a result of the May and June drop in the equity markets, had returned 12.3% for the entire fiscal year. Mr. Dunn indicated that the equity returns had rebounded strongly in the month of July 2010. The long credit index, the Bureau's largest fixed income asset, returned over 20.0% in fiscal year 2010. The Bureau retained exposure to credit bonds in the extensive State Insurance Fund portfolio transition activity that occurred, but sold long government bonds in order to increase its exposure in equities from 20% to 30% and to reach the targeted asset allocation in the U.S. Aggregate FI benchmark transition account. Intermediate FI represented by the U.S. Aggregate FI index had a positive increase of 9.5% in fiscal year 2010. Similarly, TIPS had a positive return of 9.5% in the same period. Long government bonds had a higher return than intermediate bonds at positive 12.2% in fiscal year 2010. The long government credit index, which includes both the long government and long credit, returned 16.5% in fiscal year 2010. Currently a targeted 59% of the Coal Workers' Pneumoconiosis Fund (BLF) and Disabled Workers' Relief Fund (DWRF) portfolio assets are managed passively to the long government credit index. The upcoming transition with those funds will remove the benchmark long government credit indexed portfolio. In the two month period starting July 1, 2009 through August 31, 2009, the MSCI ACWI ex-U.S. index returned a positive 13.0%. After several negative months, the ACWI ex-U.S. index ended up fiscal year 2010 with a positive return of 10.0%. Mr. Smith commented that international funds were adversely affected by the strengthening of the U.S. dollar. Mr. Dunn added several factors are influencing the market. The Euro currency makes up approximately 20% of the index, but the index has other prominent currencies such as the British Pound and the Japanese Yen. The European economy has suffered. The U.S. dollar exchange rate was 1.21 several months ago and has risen to 1.30 recently. The European stock markets reacted favorably when the stress test results on European banks was released recently. Mr. Dunn noted that emerging markets performed relatively well over the fiscal year compared to the developed equity markets in the U.S. and internationally.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES

Mr. Dunn referred to the Investment Asset Allocation-Combining Schedules as of May 31, 2010, dated June 14, 2010 and as of June 30, 2010, dated July 20, 2010. The schedules are incorporated into the minutes by reference and were provided to the Committee in advance of the meeting. The bond allocation in the State Insurance Fund (SIF) increased 2.0% in the month of June 2010 from 68.6% to 70.6%. In that same month, the bond allocation for all combined BWC portfolios increased by 1.9%. Stock allocation in the SIF decreased 1.3% in the month of June 2010. Cash in the SIF was reduced from 2.2% to 1.5% in the same period. The Barclays Capital Government Long Term Index outperformed all of the other bond indices in the SIF, while TIPS lagged.

QUARTER-END PORTFOLIO TARGET ASSET ALLOCATION RESULTS AND VARIANCES

Mr. Dunn referred to the Investment Asset Allocation by Fund-Target Variance chart, dated July 15, 2010. The chart is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn indicated that all asset allocations were within their target ranges as of June 30, 2010. The long credit index was above the target by 2.6% as of June 30, 2010, but was still within the acceptable range. The variance reflects the outperformance of this index compared to the rest of the asset classes represented. The U.S. Aggregate fixed income index had not reached the 15% target when the transition began in July, 2009 and is 0.6% under the target as of June 30, 2010. TIPS were above the target at the end of 2009 and continued above target through the end of June 2010. The Russell 3000 had been close to exceeding the target previously, but had decreased over the prior three months. The transitions of the DWRF and BLF portfolios are being addressed. Mr. Dunn stated that both funds should be at or near their new target asset allocations by September 30, 2010 barring a significant, unanticipated change in the market.

Mr. Dunn referred to the BWC Invested Assets chart as of July 27, 2010, that he prepared. The chart is incorporated into the minutes by reference and was provided to the Investment Committee just prior to the July 28, 2010 Investment Committee meeting in order to reflect the most current portfolio valuations. Mr. Dunn pointed out that equities had rebounded in the month of July 2010 with a positive return of 8.3% to date. Mr. Dunn indicated that approximately half of the Bureau's market value decline in equities over May and June, 2010 had been recovered in July, 2010 to date. Bonds had returned 0.00% in the month of July 2010 to date. He indicated that earnings have rebounded in companies that are sensitive to economic activity such as UPS, Fed Ex and Caterpillar, for example. He added that employment had not increased significantly, although orders had improved. Consumers were cautious, but were spending more. Transportation activity had increased. Mr. Dunn added that fears about Europe in general, and Greece specifically, had abated recently, causing a positive market rebound in July, 2010. Yields had only increased slightly and the gross domestic product had not shown significant growth. Mr. Smith commented that the Bureau's current asset allocation was working well with the contrast between increased earnings and high unemployment. Mr. Haffey added that the educational sessions were helpful when discussing investment advice with clients.

The five-year portfolio return information obtained from J.P. Morgan as the BWC investment performance provider was discussed. The portfolio returned 5.24% for the five-year period ended June 30, 2010. The most recent two year return was similar at 5.23%. In fiscal year 2009, the portfolio returned negative 1.1%. For fiscal year 2010, the entire portfolio returned a positive 12.0%. Equity has been flat in the last five years. FI fueled the positive returns of the portfolio. The discount rate has been lowered from 4.5% to 4.0%. The expectation is for the portfolio to return a reasonable rate over the discount rate in the future. It is anticipated that the returns will be higher than 5.25%. Mr. Smith indicated that in the three-year period ending May 2010 overall, bonds had a positive 20.0% return and stocks had a negative 20.0% return.

CIO REPORT- JUNE 2010

Mr. Dunn referred to the CIO Report- June 2010, dated July 19, 2010. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn added that the planning is completed for the transition of the BLF and DWRF portfolios with full completion of the transition expected by the end of the third quarter 2010. Mr. Dunn pointed out that the market environment had improved from mid-May 2010 through June 2010 for the sale of long credit FI and the purchase of U.S. Aggregate Fixed Income for the transition. The chosen BWC transition manager agrees. Ms. Falls complimented the staff for the portfolio asset allocation target variances chart to show how the Board's decisions were being implemented. She added that the chart also shows the outstanding performance in meeting the lofty goals that had been set, even considering the market conditions.

MERCER PRESENTATION ON MINORITY AND WOMEN BUSINESS ENTERPRISE (MWBE) INVESTMENT MANAGERS AND MANAGER SELECTION APPROACHES

Mr. Kweku Obed, Senior Associate with Mercer Consulting, referred the Committee to the MWBEs and Institutional Investors-Trends and Approaches presentation, dated June 17, 2010. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. The definition of a MWBE is a company where a female or minority is a majority stakeholder. Emerging managers are generally companies that have $2.0 billion or less in assets under management. This definition is standard in the industry, but can be changed by state laws or regulations. Since 70% of the MWBE in Mercer's database have less than $2.0 billion in assets under management (AUM), the majority of MWBE companies also qualify as emerging managers. For purposes of this presentation, the term "emerging managers" would be used to describe both MWBE and firms with fewer than $2.0 billion in AUM. Mr. Obed added that 60% of the emerging managers in the United States are minority owned, while the percentage decreases to 30% worldwide. Mercer's clients have begun hiring more MWBE managers in the last one to three years. He indicated that the Bureau was unique with a portfolio that was 100% passively managed and had a strong bias toward fixed income. Mr. Obed noted that a question had arisen at a prior meeting with regard to how many states had mandated the use of MWBE managers. He responded that three states used a mandate: California, Illinois and New York. He also indicated that almost half of the institutional investors listed in the presentation who used MWBE were located in a state with a mandate.

Mr. Price pointed out that the Ohio EDGE (Encouraging Diversity, Growth and Equity) program had originally been designed to give higher consideration to MWBE, but later was expanded to also include traditional emerging businesses. He added that H.B. 584 (also known as the EDGE

Program) now includes small and economically disadvantaged small businesses without regard to race, such as businesses from Appalachia. He indicated that his hope for the Bureau was to include more MWBE managers, as the EDGE program had intended. Mr. Smith commented that the EDGE program seemed to be more inclusive. Mr. Price responded that the EDGE program can be exclusive, especially when small businesses merge or grow and lose the benefits of the program. He added that the Bureau should give MWBE firms the opportunity to participate in the program despite having small AUM or being identified as an emerging firm. He stated that the Bureau needed to allow the emerging MWBE firms to grow, while continuing to allow them to manage Bureau funds. Mr. Obed indicated that with a MoM (manager of managers) program, the Bureau could hire out the due diligence, performance monitoring and the search for managers. Whether to directly hire a manager or use a MoM is dependent on internal capabilities, appetite for risk and the staff to monitor the investments. Legal restrictions could require the use of a FoF (fund of funds) or MoM. Mr. Price asked which program was less costly. Mr. Obed replied that the MoM had lower costs if the Bureau was using an emerging manager. He assured the Committee that a MoM was still efficient despite the lower costs. He added that the Bureau was not prepared to use a FoF. A MoM is recommended for the Bureau.

The California Public Employees Retirement System (CalPERS) is the nation's largest public pension fund. It's MWBE and emerging manager program uses a direct investment strategy as well as utilizing MoMs. New York's MWBE and emerging manager program uses MoM exclusively, due to limited funds to monitor its managers. Mr. Obed cautioned that despite the strength of any MWBE, risks are still inherent. CalPERS has assets totaling $200 billion. In addition to using MoMs, CalPERS uses manager development programs, regional development and FoFs. Mr. Obed noted that the Bureau might not want to use the programs used by California, Illinois and New York since the Bureau was just entering the MWBE, emerging manager and active management arenas. Mr. Obed pointed out the approaches used by the Illinois Municipal Retirement Fund, the Illinois State Teachers Retirement System and Los Angeles County Employees Retirement System. Ms. Falls asked if the states with longstanding MWBE programs began by using a MoM or in the public market. Mr. Obed responded that the MoM was a catalyst. Mr. Obed also pointed out the MWBE and emerging manager programs used by Maryland, New York, Pennsylvania and Texas.

Mr. Obed pointed to the Ohio Public Employees Retirement System (OPERS). The policy for OPERS emphasizes that investment managers must be hired in a manner that is consistent with their fiduciary duty. Mr. Smith indicated that OPERS' policy focuses on two goals that the Bureau should consider: being committed to increasing utilization of Ohio and minority investment managers who offer quality, services and safety comparable to other investment managers as well as hiring investment managers in a manner that is consistent with its fiduciary duty. Mr. Obed added that the Bureau can benefit by using a MoM to outsource its investment to someone who has strong relationships with other managers and the Bureau's goals can be directed to that MoM. Mr. Price reiterated that the intent of the Bureau's fiduciary duty was to get the best manager. He pointed out that managers from other states can be utilized if they are the best managers. He reiterated his belief that a MWBE or Ohio emerging manager should be used if all other factors are equal. He also indicated that the majority of programs reviewed rely on MWBE and emerging manager program for some of their private equity investments.. Mr. Obed replied that the use of private equity is not required to begin a MWBE program. He added that if private equity was used as part of the program; it was done purposefully. Additionally, if private equity was not part of the investment allocation then other types of investments could be used. Mr. Smith noted that in his experience, the asset allocation is chosen first and then the MWBE mandate. Ms. Falls pointed out that the Bureau's asset allocation did not include hedge funds or private equity. She asked if that would restrict the Bureau's goal of adding MWBE managers. Mr. Obed pointed out that the presentation contained a significant number of emerging managers while a MoM would also have a good number to choose from.

Mr. Smith indicated that Mr. Dunn and Mr. Cooper would need to outline a plan with the next steps after looking at the size of Bureau's assets, its policy, asset allocation, infrastructure, the costs, risks and determining whether a FoF or MoM is appropriate. Mr. Dunn said that they would need to rely on Mercer Consulting to provide expense information. Mr. Haffey asked for a time line for research. Mr. Smith answered that the August 2010 meeting would discuss the time needed. Mr. Haffey indicated that knowing the costs and amount of oversight needed was very important. Mr. Cooper replied that Mercer could only provide the amount of costs generally. Ms. Falls added that the discussion during the August 2010 meeting would show how to move forward.

LOOKING BACKWARDS/LOOKING FORWARD PRESENTATION

Mr. Smith referred to the Looking Backwards-Looking Forward presentation created by Mercer Consulting and dated July 28, 2010. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Cooper noted that the presentation included a work plan for the next eighteen months. It also illustrated the strides made in the last three years by the Bureau's Investment Division and Board of Directors. The presentation showed a list of four principal questions (our objective, asset mix, design details of the portfolios, and investment manager selection) that had been asked by the Bureau, in order, before the investment plan was determined. The objective and asset mix has been set, but the portfolio details and the investment managers continue to be reviewed and revised. From 2007-2010, the Bureau has raised a significant number of questions about the portfolio, and specifically its asset allocation. The responses to date have included decisions to remain 100% passive with the investing and to invest 20% of the portfolio in U.S. stocks and 10% in non-U.S. stocks. This amount is underweight when compared with the whole market. Other Bureau portfolio weights mirror the capital market, such as with U.S. large, mid and small capitalizations and non-U.S. developed markets. The Bureau portfolio bond duration is longer than most institutional funds and it does not allow securities lending. Mr. Price pointed out that investors are moving more toward international investing. He also indicated that the discussion had been to give more consideration to local MWBE and emerging managers, but the committee hadn't discussed international managers. Mr. Cooper responded that those issues would be reviewed later. Mr. Smith added that 10 years ago, most investors would have 10% invested in international stocks. Currently, many have around 33%. Mr. Cooper added that the term "emerging markets" now represents a distinct target allocation for equity investments by many institutional investors.

The presentation also lists asset classes and investments to which the Bureau has made no commitment. Mr. Cooper indicated that Mercer Consulting agrees with this list for now for the Bureau with the exception of investing in real estate. Mercer supports investing in real estate and has committed to discuss real estate next month. Mr. Cooper also emphasized that the Bureau may choose to invest in other areas on the list such as private equity or other alternative investments at a later time. The Bureau used the Deloitte study as a basis for determining the funding ratio. An asset and liability study was performed to determine a mix of 70% bonds and 30% stocks for which should provide an acceptable funding ratio of 1.25 within 10 years. Other discussions led to decisions such as: to increase equity investments, reduce government bonds in order to increase investment in corporate bonds, avoid alternative investments and continue with passive investment. The presentation also includes a timeline of actions taken from early 2008 through 2010 to date. Mr. Cooper indicated that the Phase 1 and Phase 2 policies have been completed. Phase 3 has been partially completed. Phase 3 will become a priority and then two more phases are to be added for future considerations.

Mr. Cooper noted that the decision-making process of the Investment Committee has been very important to its success. He applauds the Directors' steady, measured, disciplined and flexible approach to the process. He indicated that he was impressed that all of the members of the Board of Directors attended the meetings and participated in the discussions. He added that in other organizations some members of other committees will pressure other members or succumb to arguments from outside parties with conflicting agendas or motives. Mr. Cooper was impressed that the members of the Bureau's Investment Committee have never shown any of those tendencies. The Mercer presentation mentioned priorities for the investment agenda for the remainder of 2010 as well as other considerations that are being reserved for the future. Mr. Price asked for Mr. Dunn's thoughts on the agenda priorities for 2010 and the other issues being considered for future discussions. Mr. Dunn responded that he agreed with the listed priorities, if they were limited to three. He added that MWBE are not very active in the long credit fixed income arena. He also indicated that he considered the discussion of real estate to be important. Mr. Cooper added that he felt that the discussions on adding MWBE managers and active management should be among the first priorities. Later discussions should include the potential of adding other asset classes.

Ms. Fall noted the geographic distinctions of "U.S. equity" and "non-U.S. equity" may not fully reflect international trade patterns and the global integrated economy. Mr. Cooper agreed the nomenclature is outdated. For example, Samsung has a major U.S. presence, but is listed in the international/emerging markets indices.

Mr. Lhota asked why Mr. Cooper and Mr. Dunn both supported discussing investing in real estate in light of the depressed market. He pointed out the problems that many banks had experienced due to investment in real estate. Mr. Dunn replied that long term liabilities are susceptible to rising inflation and real estate can address this risk. He added that investment in TIPS will assist with rising inflation, but cannot fully keep up with rising medical inflation liabilities of the Bureau. The Investment Committee is scheduled to have an educational presentation on real estate during the August and September 2010 Investment Committee meetings. Mr. Dunn pointed out that real estate will provide income for the early years of ownership, and appreciation should accrue over the longer term. Private equity requires a long term commitment that may provide no return during the early years of investment. He recommended that the Investment Committee begin by discussing active management for long credit while leaving the discussions on international, small cap and other proposed asset classes for later. He proposed inviting some of the best managers to Ohio to meet with members of the Investment Committee and Mercer Consulting to discuss the feasibility. Mr. Cooper pointed out the potential future issues with active management and the new risk involved. He also pointed out the areas where the Investment Committee has discretion, but noted the added fiduciary and legal issues. Mr. Smith indicated support for the recommendation of new active managers and continued movement toward Committee and Board approval. He added that the Committee should consider asset allocation and the new asset classes in the future. Currently there is no action item for the new steps since they were just presented at the July 26, 2010 meeting, but the calendar would be updated. Ms. Falls indicated that the next steps should begin at the August 2010 meeting.

COMMITTEE CALENDAR

Mr. Smith directed the Committee to the 12—month Investment Committee Calendar, dated July 19, 2010. The calendar is incorporated into the minutes by reference and was given to the Committee prior to the meeting. Mr. Dunn indicated that the August 2010 meeting would include a discussion on real estate. He added that both he and Mr. Cooper support adding real estate as an investment, but they would like to hear the presentation before deciding on priorities. Mr. Cooper indicated that Mr. Dunn would be addressing the Bureau's priorities. Ms. Falls asked why an educational session was being presented on real estate when it had not been decided on as one of the priorities. Mr. Smith indicated that the August 2010 meeting would discuss Investment Committee priorities. Mr. Price added that he would like to hear Mr. Dunn's comments on active management and other investment classes at a future meeting. Mr. Smith pointed out that the August 2010 meeting would include a presentation on the investment goals for 2011 after they had been discussed with the Administrator privately. The August 2010 meeting would also contain a presentation from Mercer Consulting on the second quarter 2010 investment performance and a continued discussion on MWBE.

ADJOURN

A motion was made by Ms. Falls, seconded by Mr. Haffey to adjourn the meeting at 12:34 p.m. Roll call was taken and the motion passed 6-0.