

**WORKERS' COMPENSATION BOARD OF DIRECTORS  
INVESTMENT COMMITTEE**

**DRAFT**

**WEDNESDAY DECEMBER 19, 2007, 12:00 PM  
WILLIAM GREEN BUILDING  
THE NEIL SCHULTZ CONFERENCE CENTER  
30 WEST SPRING ST., 2<sup>ND</sup> FLOOR (MEZZANINE)  
COLUMBUS OH 43215**

Members Present: Robert Smith, Chair  
Alison Falls, Vice Chair  
David Caldwell  
James Harris  
Larry Price  
William Lhota

Other Members Present:

James Hummel  
Jim Matesich  
Philip Fulton  
Charles Bryan  
Kenneth Haffey

**CALL TO ORDER**

Mr. Smith called the meeting to order at 12:00 PM and the roll call was taken.

**MINUTES OF NOVEMBER 20, 2007**

Upon a motion made by Mr. Harris and seconded by Mr. Caldwell, the minutes were approved.

**CHARTER REVIEW**

The review of the committee charter was moved to the meeting for next month.

**NEW BUSINESS / ACTION ITEMS**

**Securities Lending**

Lee Damsel, Director of Investments, and Bruce Dunn, Chief Investment Officer, presented an overview of securities lending. Ms. Damsel discussed securities lending as an overlay strategy. Ms. Damsel described securities lending as short term loans of securities that generate income. Securities lending involves specific longer-term held securities such as bonds and stocks that are loaned to entities that need them for a short period of time. These entities pay a borrowing fee for the security, thus providing additional incremental revenue to the owner and lender of the security. Mr. Matesich

inquired about the nature of the collateral utilized to secure the return of the security. Ms. Damsel indicated that securities on loan are collateralized from 102% to 105% of their value. Securities lending will impact the financial statements. Securities lending will enhance revenue and provide additional funds to meet operating expenses. It is estimated that a securities lending program for BWC may increase revenue by five to ten million dollars per year.

Mr. Fulton inquired as to why the practice of securities lending was originally stopped. Mr. Dunn indicated that it was stopped approximately one year ago, as a consequence of the seventeen billion dollar asset transition. It is important that all securities involved in an asset transition strategy be free from being on loan so that the assigned transition manager can effectively execute the transition strategy. The Investment Division and its selected securities lenders will be very diligent in evaluating the credit worthiness of the borrowers. Ms. Damsel emphasized the importance of having appropriate securities lending policies and procedures in place prior to exercising a securities lending program. There was discussion on the issue of securities lending with Board members. Emphasis was placed on following industry standards with regard to securities lending.

A motion was made by Ms. Falls, and seconded by Mr. Price, as follows: that the Investment Committee recommend that Workers' Compensation Board of Directors authorize the Bureau's Chief Investment Officer to implement a securities lending program, for the reasons set forth in the securities lending presentation dated December 19, 2007, and that section IV. C. vi of the current Bureau Investment Policy Statement be amended or deleted as necessary to implement the securities lending program. Roll call was taken and the recommendation passed 6-0.

### **Commingled Index Managers Request for Proposal**

Mr. Dunn discussed a proposal for the issuance of a Request for Proposals for passive indexed investment managers managing assets under a pooled commingled custodian account structure, as described in his memorandum dated December 10, 2007. Such RFP would apply for each of the three largest trust funds of BWC which are the State Insurance Fund, Disabled Workers Fund and Coal Workers Fund. This RFP document to be issued would involve separate passive indexed manager searches for each of the three current passive index mandates of these three trust funds: Long Duration Fixed Income, U.S. Treasury Inflation Protected Securities (TIPS) and Large Cap U.S. Equity. Mr. Dunn stated that the Investment Division is very satisfied with the current group of three passive indexed investment managers of BWC. However, a new RFP is required to be issued for these searches with the desired conversion preference of the Board to a commingled pooled custodian management structure from the current separate account management structure for all BWC passive indexed managed assets.

Mr. Dunn discussed the recommended level of experience and minimum assets under management suggested of each eligible respondent to the proposed RFP, as reflected in his memorandum. Mr. Dunn discussed proposed scoring weighting subject matter criteria

for the proposed RFP, as also presented in his memorandum. It was emphasized by Mr. Dunn that, given the large size of each of the three asset class mandates, it is important that each potential investment manager respondent to this RFP be large and experienced managers who can achieve economies of scale in the management of a large pool of assets to the benefit of the Bureau. Mark Brubaker of Wilshire Consulting indicated that he supported this RFP approach presented and the importance of large and experienced investment managers offering low competitive fees in the management of the large size of Bureau assets in each of the three asset classes.

Mr. Dunn also discussed the need to consider a change in the long duration fixed income (LDFI) benchmark applied to such long duration fixed income assets of BWC. Mr. Dunn pointed out that the existing customized benchmark index utilized by BWC is not a widely recognized and accepted benchmark index for this asset class, as it includes restrictions prohibiting investments in foreign government related debt. Mr. Dunn stated that BWC will not be able to convert management of its passive indexed long duration fixed income assets to a pooled commingled account structure combining other client assets of an investment manager unless the widely accepted Lehman U.S. Long Government/Credit Index benchmark becomes the new benchmark for BWC for such assets. This widely recognized index serves as the reference benchmark index used in the creation of the current BWC customized benchmark for this fixed income asset class. Mr. Dunn also mentioned that a comparison of past performance of the returns of the BWC customized LDFI benchmarks with the standard reference Lehman LDFI index over the past ten-year period reflects the consistent higher returns provided by the standard benchmark, as provided in his memorandum. Mr. Brubaker indicated that he supported having the standard Lehman long duration bond index becoming the new benchmark for this asset class. Mr. Brubaker stated that the fewer restrictions placed upon investment managers will generally result in greater returns on investments over the long-term.

Motion was made by Ms. Falls, and seconded by Mr. Price, as follows: that the Investment Committee recommend that the Workers' Compensation Board of Directors authorize the Administrator to issue separate new requests for proposals for passive indexed investment managers for three large asset class mandates within the state insurance fund, and the pneumoconiosis fund, for reasons set forth in the memorandum of the Bureau's Chief Investment Officer dated December 10, 2007. The separate requests for proposal would be for the Long Duration Fixed Income, U.S. TIPS, and Large Cap U.S. Equity asset classes. Roll call was taken and the recommendation passed 6-0.

There was discussion with regard to the long duration fixed income benchmark, and whether it should be altered to permit the Bureau to invest in Non-U.S. government-related debt. Motion was made by Ms. Falls and seconded by Mr. Price as follows: that the Investment Committee recommend that the Workers' Compensation Board of Directors adopt and approve the recommendation of the Investment Committee to adopt the Lehman U.S. Long Government/Credit Index as the long duration fixed income benchmark, replacing the existing Lehman customized U.S. Long Government/Credit Index benchmark, for the reasons set forth in the memorandum of the Bureau's Chief

Investment Officer dated December 10, 2007, and to amend section V.A of the Investment Policy Statement to reflect the change to the Lehman U.S. Long Government/Credit Index as the long duration fixed income benchmark. Roll call was taken and the vote was as follows:

SMITH	YES
FALLS	YES
PRICE	YES
CALDWELL	NO
HARRIS	NO
LHOTA	YES

The recommendation passed by a vote of 4-2.

#### **Investment Policy Statement Review**

Mark Brubaker discussed the critical elements of an Investment Policy Statement. Mr. Brubaker wants to reduce the ministerial, prescriptive nature of the statement, and make it an "all weather" document. Mr. Brubaker discussed the template of the document in detail. The first part of the document clearly defines the mission of the fund. Mr. Smith emphasized the importance of this. The document further states the investment objectives (i.e. pay claims when due, maintain liquidity and solvency, maintain adequate surplus, manage asset allocation for a stable and competitive premium). The document further defines roles and responsibilities. Wilshire Consulting recommends doing a formal asset / liability study every three years. In sum, the Investment Policy Statement is the governing document for investments. Mr. Fulton inquired as to whether or not the investment policy of the Bureau will be consistent with legislative proposals made by State Representative William Batchelder. Because the outcome of the pending legislation is still unknown, Mr. Smith and Mr. Price commented that the Board should not base its decisions on what action the legislature might take on any issue.

A motion was made by Mr. Price and seconded by Mr. Harris as follows: that the Investment Committee recommends that the Workers' Compensation Board of Directors adopt and approve the recommendation of the Investment Committee to amend the Bureau Statement of Investment Policy and Guidelines to replace references to the former Workers' Compensation Oversight Commission and various statutory citations to reflect changes adopted in Amended Substitute House Bill 100 of the 127<sup>th</sup> General Assembly, as set forth in the red-lined version of the Investment Policy Statement presented to the Board on December 20, 2007. Roll call was taken and the motion passed 6-0.

#### **DISCUSSION ITEMS**

##### **CIO Report – December 2007**

According to Mr. Dunn, the investment rate of return on the BWC total investment portfolio increased by 1.5% in October of 2007. The rate of return increased in November of 2007, as well.

### **Calendar of Events**

Ms. Damsel indicated that the Board needed to select dates for the interviewing of finalist candidates in Columbus, Ohio for the full service investment consultant RFP. Ms. Damsel stated these interviews could be performed in one day. After discussion, it was determined that interviews of the finalist candidates shall be conducted at 9:00 AM, on January 9, 2008. Ms. Damsel and Mr. Dunn will grade and score RFP proposals submitted by the twelve eligible respondents. December 28, 2007 is the anticipated date for Mr. Dunn to provide the Board Members with the results of the grading.

### **ADJOURNMENT**

Motion was made by Mr. Caldwell and seconded by Mr. Price, to adjourn the meeting at 2:15 PM.

Prepared by Tom Woodruff, BWC Staff Counsel