BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, October 21, 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
Other Members Present:	Jim Harris, James Hummel, Jim Matesich Thomas Pitts
Members Absent:	None
Counsel Present:	John Williams, Assistant Attorney General
Staff Present:	Marsha Ryan, Administrator Bruce Dunn, Chief Investment Officer Lee Damsel, Director, Investments
Consultants Present:	Guy Cooper, Partner, Mercer Consulting Jordan Nault, Principal, Mercer Consulting Kweku Obed, Senior Associate, Mercer Consulting
Scribe:	Linda Byron, Staff Attorney

CALL TO ORDER
Mr. Smith called the meeting to order at 9:48 a.m.

ROLL CALL
Roll call was taken. Mr. Caldwell was not present for roll call.

APPROVE MINUTES OF THE SEPTEMBER 23, 2010 MEETING
Mr. Price asked for an amendment on page 6 in the minutes where it states that he asked for an opinion from the Mercer representatives. Mr. Price indicated that

his question to the Mercer representatives inquired as to how the Bureau's proposed 1% investment directed towards minority-owned and women-owned business enterprise (MWBE) investment managers compared to other institutions. Upon request of Mr. Price, the prior statement was removed and the minutes were amended to read as follows: Mr. Price asked for an opinion from the Mercer representatives as to how the Bureau's 1% investment in MWBE investment managers compared to other institutions. Mr. Caldwell arrived during this agenda item. Upon motion of Mr. Haffey, seconded by Ms. Falls, the minutes of the September 23, 2010 meeting minutes were approved as amended. Roll call was taken and the motion passed 6-0.

AGENDA

Upon motion of Ms. Falls, seconded by Mr. Caldwell, the agenda was approved as written. Roll call was taken and the motion passed 6-0.

Before starting the first item on the agenda, Chairman Smith asked Guy Cooper, Partner with Mercer Consulting, the Bureau's investment consulting firm, (hereinafter referred to as Mercer or Mercer Consulting) to explain Mercer's recent announcement they were withdrawing from the public fund consulting business. Mr. Cooper emphasized that the decision was sudden and unexpected. There had been previous discussions in the firm on the need to minimize the risk of the public fund consulting aspect of their business, but there was no anticipation that this discussion would lead to a termination of that representation. Mercer currently has more than 20 public fund consulting clients that provide less than $10 million in annual revenues but create the risk of substantially more in liability being paid from Mercer, should a lawsuit occur. Mr. Cooper indicated that Mercer would continue to provide the same high level of services to the Bureau until March 31, 2011. He added that it had been an honor to be involved with the Committee for the last three years and emphasized that Mercer would do everything that it could to help facilitate a smooth transition. Jordan Nault, Principal of Mercer Consulting and Kweku Obed, Senior Associate with Mercer Consulting both reiterated that they agreed with Mr. Cooper's sentiments and appreciated the opportunity to work with the Committee. Ms. Nault added that she enjoyed working with a Committee that strongly emphasized due diligence and followed such high governance practices.

Mr. Smith commended the work that the individual Mercer consultants had done on the Bureau's behalf. He added that the Mercer team had provided excellent presentations and good insight that had allowed the Committee to move forward with decisions. On the other hand, he expressed extreme disappointment and frustration with the Mercer firm as a whole. He expressed frustration that this decision was made so suddenly, especially in light of the recent renewal of the contract with Mercer, that extended the contract through June 30, 2011. He indicated that he was very disappointed in the way that this termination of representation had been handled. He added that this action by Mercer Consulting will make the transition more difficult and will create additional pressures and time constraints. Mr. Lhota thanked the Mercer representatives for the education that they provided. He suggested that the Investment Committee Chair write a letter to Mercer commending Mr. Cooper, Ms. Nault and Mr. Obed on their excellent work. Mr. Smith agreed, noting that a letter would be sent. Mr. Caldwell thanked the Mercer representatives for assisting him in learning as much as possible. Mr. Price reiterated that he felt a letter to Mercer was a good idea. He added that he wanted to thank the Mercer representatives for including women and minority investment managers in the discussions about RFPs. He also thanked them for their teaching. Ms. Falls added that the Mercer representatives were outstanding professionals. She indicated that in spite of the decision of their parent firm, she thanked them for their continued commitment to the Bureau until their last day. The Mercer representatives left the Committee table at this time and did not participate in the following discussion on the full service investment consultant RFP.

NEW BUSINESS/ACTION ITEMS:

BWC FULL SERVICE INVESTMENT CONSULTANT

Mr. Dunn, the Bureau's Chief Investment Officer, referred the Committee to the BWC Full Service Investment Consultant-Request for Proposals Issuance Recommendation memo, dated October 13, 2010. The memo is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn noted that the Request for Proposals (hereinafter RFP) had been created because the current contract was to end on June 30, 2011. The final decision was to be made by the end of April 2011 in the prior RFP schedule drafted, but would now need to be made by the end of March 2011. He indicated that the timeframe for submission of proposals had not changed, but the review process has been accelerated. The Bureau should be under contract with a new firm by early April 2011. He added that back in 2008 when the Bureau changed investment consulting firms, there was only a one-month period where duplicate fees were paid. Mr. Dunn noted that the blackout period will officially begin once the Board takes action to approve the issuance of this RFP, but it has unofficially begun now, as contact must be limited with any firm that might offer a bid.

Mr. Dunn indicated that the proposed 5-1/4 year term in the contract is appropriate. He added that an asset/liability study will occur within the next two years, so this will be included in the new contract. Additionally, the contract allows the Bureau to terminate the contract on very short notice. In situations where there has been a default or a violation of a statute, the contract allows for termination with one day notice. Mr. Hummel pointed out that the current contract with Mercer ends on June 30, 2011, but that the Mercer representatives would be leaving on March 31, 2011. He asked if Mercer is able to terminate their services early based on the contract. Mr. Dunn responded that the contract is purposefully silent on their termination. Mr. Matesich asked if Mr. Dunn had seen similar practices of other consulting firms terminating their contracts early or getting out of the consulting business completely. Mr. Smith stated he had not really seen an increase in that practice, but added that the current economy does create more liability vulnerability for consulting firms with deep pockets. He added that he had intended to ask Mercer to honor their contract, but now believes the best course would be to bring in a new committed consulting firm, rather than continuing with one whose continued commitment would be questionable. Mr. Dunn added that he has already gotten calls from other firms who want to fill the void that Mercer's termination has created. He added that additional scrutiny will be required for any respondent firm that has the same parent company structure as Mercer.

Ms. Falls made a Motion of the Investment Committee to Recommend Issuance of an RFP for a Full Service Investment Consultant, seconded by Mr. Haffey as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors Recommend to the Board that it authorize the Administrator to issue a Request for Proposals ("RFP") for the services of a full service investment consultant to advise the Investment Committee and the Board, and further recommend that the Board direct the Administrator to consult with the Chief Investment Officer regarding the scope of services to be defined in the RFP and that the RFP describe the term of the consultant's engagement as outlined in the memorandum of BWC's Chief Investment Officer dated October 13, 2010. Roll call was taken. The motion passed 6-0. Mr. Lhota requested the record reflect the Mercer representatives had not remained at the Committee table nor had they participated in the RFP discussion. At this time, the Mercer representatives rejoined the Investment Committee at the Committee table.

ANNUAL REPORT DRAFT (FISCAL 2010) ON THE PERFORMANCE AND VALUE OF EACH INVESTMENT CLASS

Mr. Dunn referred to the Asset Class Annual Report Draft for Fiscal Year 2010, dated October 13, 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 the report was created in order to satisfy the requirements of RC 4121.12(F)(12), but that it contained additional information at the suggestion of Ms. Falls. Mr. Dunn emphasized that the Bureau had transitioned a significant amount of money from fixed income to equities. Column D is largely reflective of the transition from 20% equity to 30% equity for the State Insurance Fund which began and ended during fiscal year 2010. Bonds were reduced by $1,274 million. That amount was redirected to stocks. Mr. Dunn noted that this major transition should be taken into consideration when reviewing the adjusted fair market value change. U.S. Equities had a fair value increase of $552 million in fiscal year 2010 after the adjustment. Mr. Smith commended the report and commended Ms. Falls for suggesting that the schedule should contain more information than required by the Ohio Revised Code. Ms. Falls indicated that the narrative of this report enforces the Bureau's commitment to transparency to its many constituents and commitment to oversight in all areas. She commended Mr. Dunn for the information provided in the report.

Ms. Falls made a Motion of the Investment Committee to Recommend Approval of the Draft Annual Report on the Performance and Value of each Investment Class, seconded by Mr. Haffey as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board that it approve the draft annual report on the performance and value of each investment class, as prepared by the Chief Investment Officer and submitted October 13, 2010, and that it thereafter submit the report to the Governor and Legislative Leaders in fulfillment of the Board's obligation under Revised Code section 4121.12(F)(12). Roll call was taken and the motion passed 6-0.

DISCUSSION ITEMS:
INVESTMENT COMMITTEE CHARTER ANNUAL REVIEW
Mr. Don Berno, Board Liaison for the Bureau and Ms. Ann Shannon, Bureau Legal Counsel referred the Committee to the OBWC Board of Directors Investment Committee Charter, dated October 12, 2010. The charter is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Berno indicated that the charter had been reviewed by the Governance Committee and includes its recommended changes. When the Investment Committee completes its review, the charter is sent back to the Governance Committee for final review and then to the Investment Committee and then the Board for final approval. The language about fixing and maintaining the lowest possible rates of premium consistent with the maintenance of a solvent state insurance fund has been added based on a recommendation of the Governance Committee. The ellipses in the charter will be removed based on a recommendation from legal counsel. Mr. Lhota asked that the first sentence of the charter be amended to state "[t]he Investment Committee ensures that the assets…."

Mr. Haffey made a Motion of the Investment Committee to Refer the Investment Committee Charter to the Governance Committee for Review, seconded by Mr. Caldwell as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors refer the Investment Committee Charter to the Governance Committee to consider the recommended changes as discussed here today. Roll call was taken and the motion passed 6-0.

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS
Mr. Dunn referred to the Invested Assets Market Value Comparison-Total Funds chart, dated October 15, 2010. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Net investment income in September 2010 returned a positive 2.5%. The bond portfolio return was negative 0.1% in September 2010 while equity returned a positive 9.6% during the same period. International stocks had a positive return of

9.9% while the Russell 3000 had a positive return of 9.4%. Approximately half of the non-U.S. equity positive return was a result of a weakening dollar. Net cash balances decreased in September 2010, largely due to decreased operating cash balances of $151 million. Net investment income for the three-month period July-September of fiscal year 2011 was $1,262 million representing a net portfolio return of positive 6.6%. For this period, the equity portfolio returned positive 13.5% and the bond portfolio returned positive 4.2%. Mr. Smith pointed out that interest rates were likely to increase since they are not able to go much lower. Mr. Dunn indicated that spreads between long credit and long government bonds may tighten a little more, but not much more. Mr. Dunn indicated that the types of non-financial corporate credits in the bond portfolio generally have very strong balance sheets.

MONTH-END PORTFOLIO ASSET ALLOCATIONS VALUE

Mr. Dunn referred the Committee to the Investment Asset Allocation- Combining Schedule as of August 31, 2010, dated September 16, 2010 and the Investment Asset Allocation-Combining Schedule as of September 30, 2010, dated October 15, 2010. The reports are incorporated into the minutes by reference and were provided to the Committee in advance of the meeting. Bonds decreased from 70.0% to 68.7%, a total of negative 1.3% from the end of August 2010 through the end of September 2010. Stocks increased from 27.1% to 29.2% and cash declined from 2.9% to 2.1% in the same period.

QUARTER-END PORTFOLIO TARGET ASSET ALLOCATION RESULTS AND VARIANCES

Mr. Dunn referred to the Investment Asset Allocation Fund-Target Variance as of September 30, 2010 chart, dated October 14, 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 there was no need to rebalance any of the portfolios at the end of September, 2010. All of the respective asset class funds are within the target range reflected in the investment policy. Long credit is 2.3% higher than its target, but is still within the target range. The cash allocation amount varies among the funds. The cash amount for the Disabled Workers' Relief Fund and the Coal Workers' Pneumoconiosis Fund is currently low. Mr. Haffey commended the report.

Mr. Dunn referred to the BWC Invested Assets as of October 20, 2010 report, prepared by the Chief Investment Officer. The chart is incorporated into the minutes by reference and was provided to the Investment Committee just prior to the October 21, 2010 Investment Committee meeting in order to reflect the most current portfolio valuations. The total Bureau portfolio had a positive return of 1.1% in the month to date ending October 20, 2010, for a total portfolio value of $20,499 million. Equities had a positive return of 3.4% and bonds had a positive return of 0.2% in the same period.

CIO REPORT

Mr. Dunn referred to the CIO Report for September 2010, dated October 13, 2010. The report is incorporated into the minutes by reference and was provided to the Investment Committee in advance of the meeting. Mr. Dunn indicated that the report included a summary of the quarterly investment manager meetings for the second quarter 2010. The meetings with BlackRock and Mellon Capital Management were held at the San Francisco headquarters of each. The meetings with State Street Global Advisors and Northern Trust took place in the Bureau Investment Division offices in Columbus, Ohio. Mr. Bruce Dunn, the Bureau's Chief Investment Officer along with Ms. Lee Damsel, the Bureau's Director of Investments and Ms. Alison Falls, Vice Chair of the Investment Committee will be attending respective on-site meetings with representatives from State Street Global Advisors and Northern Trust in early November 2010.

MERCER PRESENTATION ON REAL ESTATE AS AN ASSET CLASS

Kweku Obed, Senior Associate with Mercer Consulting, referred to the Asset Allocation in Real Estate by Plan Type presentation, created by Mercer and dated September 23, 2010. The presentation is incorporated in the minutes by reference and was provided to the Investment Committee in advance of the meeting. Mr. Obed noted that the purpose of this presentation was to answer questions that the Investment Committee members had asked during the August 2010 presentation by Allison Yager, the Global Business and Investment Leader of Mercer's Real Estate Boutique. At the time, it was recommended that the Bureau initially invest 3% of its portfolio in real estate. One of the questions asked at the time was whether this allocation was in line with other funds. Mr. Obed pointed out that of the total 59 participating funds that were reviewed, the percentage of assets represented by real estate was between 6-8% in real estate in both 2008 and 2009. Ms. Falls inquired if the funds were all pension funds. Mr. Obed answered that the majority were pension funds, but that they had also included union and corporate funds in the study. Mr. Cooper added that the study did not include insurance company funds. Mr. Smith asked how much exposure a typical insurance company would have in real estate. Mr. Cooper indicated that insurance companies usually invest around 10% in real estate since the remainder of their investments is primarily in bonds. In response to a question from Mr. Price, Mr. Obed answered that the information came from the Council of Institutional Investors Asset Allocation Survey 2009. Mr. Price indicated that the 2.0-3.0% allocation seemed low in comparison to other entities. Mr. Harris asked if all of the plans included in the presentation were defined-benefit plans. Mr. Obed responded that all of the plans in the presentation were pension plans and were defined-benefit plans. Mr. Smith added that defined-plans include corporate. Mr. Smith indicated that the case for the Bureau investing in real estate is made stronger since the investment in real estate varies the portfolio, which is currently primarily invested in bonds. Ms. Falls pointed out that she had gotten a "what if…" chart when she first joined the Board. She indicated that she would like an updated version of that chart, dealing with issues such as: What if bond interest rates increase? What if credit spreads increase?

Mr. Obed pointed out Mercer's presentation included a comparison of the Bureau's asset mix to other corporate, public and union funds. Mr. Price indicated that the recommended 2.5-3.0% to be allocated to real estate seemed very conservative. Mr. Cooper replied that the percentage was a starter allocation. Mr. Haffey added that he personally has clients in many different sectors that are now looking at the availability of different types of assets, including real estate. They are starting to see prices firm, if not rise. Mr. Pitts mentioned that the discussion had centered on reallocating money to real estate, but had not specified where the source of the money. Mr. Cooper replied that the specifics had not been discussed, but that the money would likely come from bonds. The Teacher Retirement System of Texas was mentioned. The retirement system's minimum and maximum allocations to real estate, total real estate investment amount and mixture of strategies were reviewed. Mr. Smith noted that private equity cannot be rebalanced. He asked if the Texas system used such comprehensive guidelines in order to stay within those guidelines. Mr. Obed replied that the guidelines were comprehensive due to their wide range of assets. Mr. Smith clarified that the Texas system was not being recommended for the Bureau. Mr. Obed emphasized that Mercer Consulting was not recommending that the Bureau use all of the same investments as Texas. He added that the purpose of the presentation was to present an overview of other public funds and their strategies. Mr. Price asked for the actual percentage that each fund had invested in real estate. Mr. Obed responded that the actual investment allocation was shown toward the end of the report. Ms. Nault added that global reallocation is more liquid.

Mr. Obed pointed out that the Ohio Public Employees Retirement System plans to allocate $1.6 billion to real estate in 2010, but has a real estate ownership weight range of between 0-14% of total invested assets with a target weight of 10% based on its investment policy statement. The weights and portfolio compositions for the California State Teachers' Retirement System, the California Public Employees' Retirement System (CalPERS), the New York State Common Retirement Fund and the Colorado Public Employees' Retirement Association were discussed. Mr. Obed indicated that the CalPERS plan invests in real estate locally. This strategy is not recommended for the Bureau. Mr. Lhota asked what tactical real estate investment was. Mr. Obed responded that a tactical real estate investment allows a fund to use opportunities to make money short term by looking at the current market and taking advantage of a slight dislocation in the market. Tactical investing is done with a view toward the short term in opposition to strategic which emphasizes long term investing. Mr. Obed noted that the Recent Allocations in Real Estate chart was based on public information, accounting for the differences in dates.

Mr. Obed noted that a slight change in the mean-variance assumptions causes a slight change in the return. Standard deviation refers to risk. Ms. Falls added that real estate is less risky than the S&P 500. Mr. Cooper noted that REITS (Real Estate Investment Trusts) are almost as risky as the S&P 500. Mr. Price indicated that he would like to know the time frame involved in real estate for other pensions. Mr. Cooper responded that real estate investments had been hit hard in 2008 and 2009, but not as badly as equities. Prior to 2007, returns were in the double digits. He added that this type of investment is cyclical. Mr. Price indicated that this provided him with a good comparison, as real estate was not as bad as equity when compared to other investments. Mr. Lhota pointed out that new commercial real estate continues to be depressed. Mr. Obed noted that Mercer was working on a paper that would discuss real estate and their predictions for it. Mr. Cooper added that real estate was at or near the bottom of its valuation cycle in the aggregate. He emphasized that the Bureau must be selective, but added that the Bureau should enter the real estate market before it significantly increases in property valuations.

CONSIDERATION OF CIO INVESTMENT STRATEGY PRIORITIES PROPOSED FOR CALENDAR YEARS 2011 AND 2012

Mr. Smith referred to the CIO Recommendations-BWC New Investment Strategy Considerations-State Insurance Fund Memo, dated September 14, 2010. The memo is incorporated into the minutes and was provided to the Investment Committee in advance of the meeting. Mr. Smith noted each individual recommendation would be discussed and acted upon separately. He added that the individual recommendations might require changes to the Investment Policy Statement. Mr. Dunn replied that the recommendations should be considered in priority order. Mr. Haffey agreed that this strategy seemed sensible. Mr. Cooper noted the self-insured asset study still needed to be performed. He emphasized that until that study is finished, it will remain as a priority although it is not listed as one in the CIO memo.

COMMITTEE CALENDAR

Mr. Smith referred to the 12-month Investment Committee Calendar, dated October 6, 2010. The calendar is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Cooper pointed out that Mercer was prepared to make a presentation on long credit. This item was added to the calendar for the November 2010 meeting.

ADJOURN

A motion to adjourn the meeting at 11:18 a.m. was made by Mr. Caldwell and seconded by Mr. Haffey. Roll call was taken and the motion passed 6-0.