



Sub. H.B. 79

127th General Assembly

(As Reported by H. Commerce and Labor)

**Reps. Batchelder, J. McGregor, Fessler, Latta, Stebelton, Webster,
Uecker**

BILL SUMMARY

- Removes the requirement that the Administrator of Workers' Compensation make investments based on the prudent person standard and requires the Administrator to invest only in the types of investments specified in the bill.
- Specifies limitations regarding the percentage of funds that the Administrator may invest in certain types of permitted investments.
- Requires the Bureau of Workers' Compensation Board of Directors to approve a new investment policy within 90 days after the bill's effective date that satisfies the bill's requirements.
- Removes the list describing the types of investments that are prohibited under current law.
- Specifies that all of the Bureau of Workers' Compensation (BWC) custodial funds, as defined in the bill, must be invested in accordance with the bill's requirements.
- Requires criminal records checks for investment consultants who provide advice and opinions about investing the BWC custodial funds.
- Removes the requirements that the Board (1) vote to open an investment class, (2) adopt due diligence standards for investing in that class, and (3) report to the leaders of the General Assembly about those investments.

TABLE OF CONTENTS

Changes to the investment authority of the Administrator of Workers' Compensation	2
Investment authority under current law	2
Investment authority under the bill	3
Permitted investments	4
Limitations on permitted investments	8
Changes to the investment policy	10
Current law	10
The bill	11
Contracting with outside investment managers and consultants	11
Current law	11
The bill	12
Reorganization of laws governing BWC custodial fund investments	13

CONTENT AND OPERATION

Changes to the investment authority of the Administrator of Workers' Compensation

Investment authority under current law

Continuing law allows the Administrator of Workers' Compensation to invest the surplus and reserve of the State Insurance Fund (hereafter SIF). The Administrator must make those investments (1) in accordance with statutorily specified fiduciary requirements and conflict of interest prohibitions (secs. 4121.126 and 4121.127, not in the bill), (2) in accordance with the investment policy approved by the Bureau of Workers' Compensation Board of Directors (hereafter "Board"), and (3) in consultation with the Bureau of Workers' Compensation Chief Investment Officer. Under current law, the Administrator must not engage in any prohibited investment activity specified by the Board and must not invest in certain types of investments specified under current law. (Secs. 4121.121 and 4123.44.)

The Workers' Compensation Law includes other custodial funds in addition to the SIF that the Administrator administers. Current law specifically states that the Administrator has the same powers to invest any of the surplus or reserve belonging to the Self-Insuring Employer Guaranty Fund, the Coal-Workers Pneumoconiosis Fund, and the Marine Industry Fund as the Administrator has with respect to the SIF (secs. 4123.351, 4131.03, and 4131.13). The Administrator also oversees the Premium Payment Security Fund, the Disabled

Worker Relief Fund, and the Public Work-Relief Employees' Compensation Fund, all of which are considered custodial funds. However, current law does not specifically state that the Administrator has the authority to invest the money in these funds (secs. 4123.34, 4123.412, and 4127.05). Additionally, current law defines "Bureau of Workers' Compensation funds" as each of the funds specified in the Workers' Compensation Law (R.C. Chapters 4121., 4123., 4127., and 4131.) that the Administrator has the authority to invest in accordance the Administrator's authority to invest the SIF (sec. 4123.444(A)(1)).

Under current law, the members of the Board, the Administrator, and the BWC Chief Investment Officer are the trustees of the SIF. Current law requires the Administrator and other fiduciaries to discharge their duties with respect to the funds with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, and by diversifying the investments of the assets of the funds so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. To facilitate investment of the funds, current law permits the Administrator to establish a partnership, trust, limited liability company, corporation, including a corporation exempt from taxation under the Internal Revenue Code, 26 U.S.C. 1, as amended, or any other legal entity authorized to transact business in Ohio. Continuing law specifies requirements for purchasing and reporting on investments. (Sec. 4123.44.)

Investment authority under the bill

The bill names the members of the Board, the Administrator, and the BWC Chief Investment Officer the trustees of the Bureau of Workers' Compensation Custodial Funds (hereafter "BWC custodial funds"). The bill defines "BWC custodial funds" as the SIF, the Premium Payment Security Fund, the Self-Insuring Employer Guaranty Fund, the Disabled Worker Relief Fund, the Public Work-Relief Employees' Compensation Fund, the Coal-Workers Pneumoconiosis Fund, and the Marine Industry Fund. The bill also expressly grants the Administrator the authority to invest the surplus and reserve belonging to each fund in accordance with the bill. Additionally, the bill removes the definition of BWC funds used in current law and instead refers to BWC custodial funds (see "**Contracting with investment managers and consultants**" below). (Secs. 4123.01, 4123.34, 4123.351, 4123.412, 4123.44, 4123.444 (renumbered 4123.445 by the bill), 4127.05, 4131.03, and 4131.13.)

The bill removes the requirement that the Administrator make investments in accordance with the prudent person standard described above and removes the prohibition against investing in certain types of investments that are not commonly part of an institutional portfolio, lack liquidity, and lack readily determinable

valuation. Instead, the Administrator must invest the surplus and reserve belonging to each of the BWC custodial funds in the classes of investments specified in the bill (see "**Permitted investments**," below). The bill also removes the ability of the Administrator to establish a partnership, trust, limited liability company, corporation, or other type of legal entity to facilitate the investment of the assets of the SIF. (Secs. 4121.121 and 4123.44.)

Permitted investments

The bill permits the Administrator, in accordance with the requirements described under "**Changes to the investment authority of the Administrator of Workers' Compensation**," above, to invest the surplus and reserve of each of the BWC custodial funds in any of the following classes of investments:

(1) Bonds and mortgages on unencumbered real estate within Ohio or any other state worth 25% more than the sum loaned thereon, exclusive of buildings, unless such buildings are insured by some company authorized to do business in Ohio;

(2) Bonds, notes, debentures, and other such obligations secured by mortgages insured by the Federal Housing Administrator or the United States Secretary of Agriculture under Title I of "The Bankhead-Jones Farm Tenant Act" as amended;

(3) Loans to veterans guaranteed in whole or in part by the United States pursuant to Title III of the "Servicemen's Readjustment Act of 1944," 38 U.S.C. 693, as amended, provided such guaranteed loans are liens upon real estate;

(4) Legally authorized and executed bonds, notes, warrants, and securities that are the direct obligation of or are guaranteed as to both principal and interest by Canada, that are the direct obligation of or are guaranteed as to both principal and interest by any province of Canada, that are the direct obligation of or are guaranteed as to both principal and interest by any municipal corporation of Canada having a population of 100,000 or more by the latest official census, and that are not in default as to principal or interest;

(5) Obligations issued, assumed, or guaranteed by the International Finance Corporation or by the International Bank for Reconstruction and Development, the Asian Development Bank, the Inter-American Development Bank, the African Development Bank, or similar development bank in which the President, as authorized by Congress and on behalf of the United States, has accepted membership;

(6) Specified bonds or other evidences of indebtedness that are issued by certain federal, state, or local governmental entities and are valid obligations of the governmental entity, if the governmental entity satisfies specified requirements relative to guarantees for payment of principal and interest and have a good payment history;

(7) Any bonds issued by or for federal land banks and any debentures issued by or for federal intermediate credit banks under the "Federal Farm Loan Act of 1916," 12 U.S.C.A. 641 and amendment thereto;

(8) Any debentures issued by or for banks for cooperatives under the "Farm Credit Act of 1933," 12 U.S.C.A. 131 and amendments thereto;

(9) Bonds issued under the "Home Owners' Loan Act of 1933," 12 U.S.C.A. 1461;

(10) The stock of a national bank located in Ohio, organized under the act entitled "An act to provide a national currency, secured by the pledge of United States stocks, and to provide for the circulation and redemption thereof," approved February 25, 1863, and acts amendatory thereof and supplementary thereto;

(11) First mortgage bonds of railroads upon which default in the payment of the interest coupons has not been made within three years prior to the purchase thereof by the Administrator;

(12) Legally authorized and executed bonds, notes, warrants, and other interest-bearing securities of any school district, water district, road district; or any special district of any state or of the District of Columbia if the district satisfies specified conditions relative to taxing authority and good payment history;

(13) Any securities described in section 77r-1 of the "Secondary Mortgage Market Enhancement Act of 1984," 15 U.S.C.A. 77r-1, subject to all of the limitations prescribed for (6) above for investments not guaranteed by the full faith and credit of the United States;

(14) Notwithstanding (13) immediately above, any of the following securities: (a) securities offered and sold pursuant to 15 U.S.C.A. section 77d(5), (b) mortgage related securities described in 15 U.S.C.A. section 78c(a)(41), or (c) securities issued or guaranteed by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association;

(15) Bonds or other evidences of indebtedness, bearing or accruing interest, issued, assumed, or guaranteed by any solvent corporation, trust, partnership, or similar business entity organized and existing under the laws of Ohio or any other state, or of the United States, the Commonwealth of Puerto

Rico, or of the District of Columbia, or of Canada or any province of Canada, upon which there is no existing interest or principal default, provided that the bonds or other evidences of indebtedness are rated by Moody's, Standard and Poor's, or Fitch ratings;

(16) Stocks or limited liability company membership interests of any insurance, financial, investment, or investment management companies if the investment management companies are registered with the Securities and Exchange Commission under the "Investment Company Act of 1940," 15 U.S.C. 80a-1, as amended;

(17) Other stocks of any solvent corporation organized under the laws of Ohio or any other state, or of the United States, the District of Columbia, Canada, or any province of Canada;

(18) Tangible personal property or interests in that property for the production of income, provided that the amount of assets of the BWC custodial fund that is invested in such property or interest does not exceed 2% of the admitted assets of that fund;

(19) In equipment trust obligations or certificates, security agreements, or other evidences of indebtedness entered into or guaranteed by any company operating wholly or partly within the United States or Canada, if that debt obligation is secured by a first lien on tangible personal property that is purchased or secured for payment thereof and that debt obligation is repayable within 20 years from the date of issue in annual, semiannual, or more frequent installments beginning not later than the first year after that date;

(20) Government money market funds¹ and money market funds that have received the highest credit rating for money market funds offered by either Standard and Poor's or Moody's services;

(21) Negotiable promissory notes maturing in not more than six months from the date the note is issued, secured by collateral security through the transfer of any of the classes of securities described in the bill, with absolute power of sale within 20 days after default in payment at maturity;

¹ The bill defines "government money market fund" as a fund that at all times invests in obligations issued, guaranteed, or insured by the federal government of the United States or collateralized repurchase agreements comprised of such obligations, and that qualifies for investment without a reserve pursuant to the purposes and procedures of the Securities Valuation Office of the National Association of Insurance Commissioners (sec. 4123.443(B)(3)).

(22) Repurchase agreements with and interest-bearing obligations of, including savings accounts and time certificates of deposit of a national bank of the United States, a commonwealth bank of Puerto Rico, a chartered bank of Canada, or a state bank, provided such bank is either a member of the federal deposit insurance corporation created pursuant to the "Banking Act of 1933," as amended, or the Canada deposit insurance corporation created pursuant to the act of Parliament known as the "Canada Deposit Insurance Corporation Act," as amended;

(23) Certificates of deposit, savings share accounts, investment share accounts, stock deposits, stock certificates, or other evidences of indebtedness of a savings and loan association, provided all such evidences of indebtedness are insured pursuant to the "Financial Institutions Reform, Recovery, and Enforcement Act of 1989," 12 U.S.C.A. 1811, as amended;

(24) Bankers' acceptances and bills of exchange of the kinds and maturities made eligible by law for rediscount with the federal reserve banks, provided that the same are accepted by a bank or trust company incorporated under the laws of the United States or of this state or any other bank or trust company which is a member of the federal reserve system;

(25) Specified investments in business entities formed under the laws of a foreign jurisdiction² and specified investments issued by a foreign jurisdiction, subject to the limitations described under "**Limitations on permitted investments,**" below;

(26) Investments denominated in foreign currency regardless of whether they are foreign investments, subject to the limitations described under "**Limitations on permitted investments,**" below;

(27) Any securities or other property not otherwise permitted under the bill provided that the total amount of the assets of an individual BWC custodial fund that is invested in those investments does not exceed, in the aggregate, 6% of the total admitted assets of that fund and provided that those investments are made within the limitations prescribed under "**Limitations on permitted investments,**" below;

² The bill defines "foreign jurisdiction" as a jurisdiction outside the United States, Puerto Rico, or Canada whose bonds are rated 1 by the Securities Valuation Office of the National Association of Insurance Commissioners (sec. 4123.443(C)).

(28) Within the limitations prescribed under "*Limitations on permitted investments*," below, loans or investments³ in small businesses⁴ having more than half of their assets or employees in Ohio and venture capital firms⁵ that meet specified requirements, provided that the amount of assets of a BWC custodial fund that is invested in such investments does not exceed 5% of the total admitted assets of that fund (sec. 4123.443(A)).

The bill specifies that the admitted assets of an individual BWC custodial fund must be calculated as of the December 31 immediately preceding the date the value of the applicable fund is determined (sec. 4123.443(B)).

Limitations on permitted investments

For the purposes of investing in foreign investments described under (25) above and including investments denominated in foreign currency, the bill prohibits the Administrator from investing the assets of an individual BWC custodial fund in a sum exceeding in the aggregate 15% of the admitted assets of that fund. The aggregate amount of the assets of a BWC custodial fund that is invested in a single foreign jurisdiction must not exceed 3% of the admitted assets of the surplus and reserve of that fund. The bill also prohibits the Administrator from investing the assets of an individual BWC custodial fund in investments denominated in foreign currency in a sum exceeding in the aggregate 10% of the admitted assets of that fund. The aggregate amount of the assets of a BWC custodial fund that is invested in investments denominated in a single foreign currency cannot exceed 3% of the admitted assets of that fund. (Sec. 4123.444(A) and (B).)

Under the bill, the Administrator must not do any of the following:

³ For the purposes of (28) above, the bill defines "investments" as any equity investment, including limited partnership interests and other equity interests in which liability is limited to the amount of the investment, but does not include general partnership interests or other interests involving general liability (sec. 4123.443(D)).

⁴ "Small business," under the bill, means any corporation, partnership, proprietorship, or other entity that either does not have more than 400 employees, or would qualify as a small business for the purpose of receiving financial assistance from small business investment companies licensed under the "Small Business Investment Act of 1958," 15 U.S.C.A. 661, as amended, and rules of the Small Business Administration (sec. 4123.443(C)).

⁵ "Venture capital firm," under the bill, means any corporation, partnership, proprietorship, or other entity, the principal business of which is or will be the making of investments in small businesses (sec. 4123.443(C)).

(1) At any time invest the assets of an individual BWC custodial fund in a sum exceeding 5% of the admitted assets of that fund in the bonds, notes, debentures, other evidences of indebtedness, and stocks of a particular corporation, trust, partnership, or similar business entity;

(2) At any time, own directly or indirectly more than 25% of the outstanding bonds, notes, debentures, other evidences of indebtedness, and stocks of any corporation;

(3) Own more than one-fourth of the capital stock of a national bank;

(4) Invest the assets of an individual BWC custodial fund in the stocks and bonds of any railroad company or loan on any such stocks and bonds held in that fund in an amount that exceeds one-fifth of the surplus and reserve of that fund;

(5) Invest the assets of an individual BWC custodial fund in railroad property or loan on such property held in that fund in an amount that exceeds, in the aggregate, one-fourth of the surplus and reserve of that fund;

(6) At any one time, have the amount of assets of a BWC custodial fund invested in real estate exceed 10% of the assets of the surplus and reserve of that fund;

(7) At any one time, have the amount of assets of a BWC custodial fund invested in any one real estate investment exceed 2% of the assets of the surplus and reserve of that fund.

The bill expressly states that nothing in the provisions described immediately above authorizes the Administrator to use an investment in real estate primarily for recreational, agricultural, or mining purposes. (Sec. 4123.444(C) and (E).)

In the event that, subsequent to an investment in a small business or venture capital firm being made as described in (28) under "Permitted investments," above, a loan or investment is determined to have become qualified as a loan or investment described in (1) through (22) under "Permitted investments," above, the Administrator may consider such loan or investment as held under those investments and such loan or investment is no longer considered as having been made in accordance with (28) under "Permitted investments," above (sec. 4123.444(D)).

Changes to the investment policy

Current law

Under current law the Workers' Compensation Investment Committee must develop the investment policy for the administration of the investment program for the Workers' Compensation System that specifies asset allocation targets and ranges, risk factors, asset class benchmarks, time horizons, total return objectives, and performance evaluation guidelines. The policy must be approved by the Board. The Investment Committee also must monitor the Administrator's and BWC Chief Investment Officer's implementation of the policy (secs. 4121.12(F)(7) and 4123.442 and sec. 4121.129, not in the bill). The Investment Committee cannot specify in the objectives, policies, and criteria that the Administrator or employees of the Bureau of Workers' Compensation (BWC) are prohibited from conducting business with an investment management firm, any investment management professional associated with that firm, any third party solicitor associated with that firm, or any political action committee controlled by that firm or controlled by an investment management professional of that firm based on criteria that are more restrictive than the restrictions described in the Campaign Finance Law (R.C. Chapter 3517.) (sec. 4123.442). Current law requires the Oversight Commission to review and publish the objectives, policies, and criteria no less than annually and make copies available to interested parties (sec. 4121.12(F)(8)).

The Board must prohibit on a prospective basis, any specific investment it finds to be contrary to the investment policy approved by the Board. When developing the investment policy, the Investment Committee must prohibit investing assets of funds, directly or indirectly, in vehicles that target any of the following: coins, artwork, horses, jewelry or gems, stamps, antiques, artifacts, collectibles, memorabilia, or similar unregulated investments that are not commonly part of an institutional portfolio, that lack liquidity, and that lack readily determinable valuation. (Secs. 4121.12(F)(9) and 4123.442(B).)

Current law requires the Investment Committee to specify in the investment policy that the Administrator is permitted to invest in an investment class only if the Board, by a majority vote, opens that class. After the Board opens a class but prior to the Administrator investing in that class, the Board must adopt rules establishing due diligence standards for BWC employees to follow when investing in that class and must establish policies and procedures to review and monitor the performance and value of each investment class. The Board must submit a report annually on the performance and value of each investment class to the Governor, the President and Minority Leader of the Senate, and the Speaker and Minority Leader of the House of Representatives. Current law allows the Board to vote to

close any investment class. (Secs. 4121.12(F)(10) to (12) and (G)(1) and 4123.442.)

The bill

The bill requires the Investment Committee to develop an investment policy using only the classes of investments specified in the bill (see "**Permitted Investments**," above) for the Administrator to implement that specifies the asset allocation targets and ranges, risk factors, asset class benchmarks, time horizons, total return objectives, and performance evaluation guidelines. Continuing law requires the Investment Committee to monitor the Administrator's and BWC Chief Investment Officer's implementation of the investment policy. (Sec. 4123.442(A) and sec. 4121.129, not in the bill.) Additionally, similar to current law, the Board must review and publish the investment policy no less than annually and make copies available to interested parties and must prohibit, on a prospective basis, any specific investment it finds to be contrary to the investment policy approved by the Board (sec. 4121.12(F)(8) and (9)).

The bill eliminates the list of prohibited investments contained in current law. The bill also eliminates the requirements that the Board (1) vote to open a class, (2) adopt rules specifying due diligence standards, and (3) submit an annual report to the Governor and the leaders of the General Assembly. Additionally, the bill removes the statement specifying that the Board may vote to close a class. (Secs. 4121.12(F)(10) to (12) and (G)(1) and 4123.442(B) to (D).)

The bill requires the Board to approve an investment policy that meets the requirements described immediately above no later than 90 days after the bill's effective date. Under the bill, the investment policy in existence on the bill's effective date remains in effect until the Board approves the new investment policy. Additionally, the bill specifies that it applies to investments made on or after the effective date of the investment policy approved by the Board pursuant to the bill (Sections 3 and 4).

Contracting with outside investment managers and consultants

Current law

Current law allows the Administrator to secure investment information services, consulting services, and other like services to facilitate investment of the surplus and reserve belonging to the SIF. If the Administrator elects to secure such services, the Administrator must pay the expense of securing such services from the SIF. (Sec. 4123.44.)

Current law prohibits the Administrator from entering into a contract with an investment manager for the investment of assets of BWC funds (renamed "BWC custodial funds" under the bill) if any employee of that investment manager who will be investing assets of BWC funds has been convicted of or pleaded guilty to a financial or investment crime, as defined under current law.⁶ Current law specifies procedures the Administrator, an investment manager, and employees of an investment manager who will be investing assets of BWC custodial funds must follow regarding obtaining criminal records checks. (Secs. 109.579, 4123.444, and 4123.445.)

The bill

The bill permits the Administrator, subject to the Board's approval, to secure investment information services, consulting services, or other like services to facilitate investment of the surplus and reserve belonging to each of the BWC custodial funds and to enter into a contract with an investment manager to have that manager invest the assets of the BWC custodial funds (sec. 4123.44). The bill prohibits the Administrator from entering into a contract with an investment consultant⁷ if any employee of that investment consultant who will be providing advice and opinions regarding the investment of the assets of BWC custodial funds has been convicted of or pleaded guilty to a financial or investment crime as defined under continuing law. The bill requires that the Administrator have criminal records checks conducted on those employees before the Administrator enters into a contract with the investment consultant and specifies requirements and procedures for those checks that are similar to those specified for employees of investment managers under continuing law. For example, the bill requires the Administrator to have the Superintendent of the Bureau of Criminal Investigation and Identification conduct those checks and requires the Administrator to pay a fee

⁶ A "financial or investment crime" means any of the following offenses: (1) any criminal offense involving theft, (2) receiving stolen property, (3) embezzlement, (4) forgery, (5) fraud, (6) passing bad checks, (7) money laundering, (8) drug trafficking, or (9) any criminal offense involving money or securities, as set forth under specified chapters in Title 29 of the Revised Code that govern the following offenses: (a) arson and related offenses, (b) robbery, burglary, trespass, and safecracking, (c) theft and fraud, (d) gambling, (e) offenses against justice and public administration, (f) conspiracy, attempt, complicity, weapons control, and corrupt activity, (g) drug offenses, or (h) any other law of this state, or the laws of any other state or of the United States that are substantially equivalent to the offenses listed directly above.

⁷ The bill defines an "investment consultant" as any person with whom the Administrator contracts pursuant to the Workers' Compensation Law to obtain the person's advice and opinions in order to facilitate the investment of assets of BWC custodial funds (sec. 4123.445 (renumbered from 4123.444 by the bill)).

for those checks as determined by the Superintendent. The bill also specifies procedures for obtaining and submitting employee fingerprints. (Sec. 109.579, 4123.445 (renumbered from 4123.444 by the bill), and 4123.446 (renumbered from 4123.445 by the bill).)

The bill also prohibits the Investment Committee from specifying in the investment policy that the Administrator or BWC employees are prohibited from conducting business with an investment consulting firm, any investment consulting professional associated with that firm, any third party solicitor associated with that firm, or any political action committee controlled by that firm or controlled by an investment consultant professional of that firm based on criteria that are more restrictive than the restrictions described in the Campaign Finance Law (R.C. Chapter 3517.), similar to the limitation specified in current law regarding investment managers (see "Current law" under "Changes to investment policy," above) (sec. 4123.442(D)).

Reorganization of laws governing BWC custodial fund investments

The bill reorganizes and renumbers several provisions in the law concerning BWC custodial funds investments (secs. 4123.44 (moved, in part, to 4123.447 by the bill), 4123.443 (renumbered 4123.448 by the bill), 4123.444 (renumbered 4123.445 by the bill), and 4123.445 (renumbered 4123.446 by the bill)).

HISTORY

ACTION	DATE
Introduced	02-27-07
Reported, H. Commerce & Labor	10-18-07

h0079-rh-127.doc/kl