BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, March 24, 2011 10:00 a.m.
William Green Building
30 West Spring Street, 2nd Floor (Mezzanine)
Columbus, Ohio 43215

Members Present:	Robert Smith, Chair Mark Palmer, Vice Chair David Caldwell Kenneth Haffey Larry Price Nicholas Zuk, ex officio
Other Members Present:	James Hummel, Stephen Lehecka, Jim Matesich, Thomas Pitts, Dewey Stokes
Members Absent:	None
Counsel Present:	Janyce Katz, Assistant Attorney General
Staff Present:	Stephen Buehrer, Administrator Bruce Dunn, Chief Investment Officer Lee Damsel, Director of Investments Donald Berno, Board Liaison
Consultants Present:	Kweku Obed, Principal, Mercer Consulting
Scribe:	Linda Byron, Staff Attorney, Legal Division, BWC

CALL TO ORDER
Mr. Smith called the meeting to order at 10:30 a.m.

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

APPROVE MINUTES OF THE FEBRUARY 23, 2011 MEETING
Upon motion of Mr. Haffey, seconded by Mr. Palmer, the minutes of the February 23, 2011 were approved as written. Roll call was taken and the motion passed 6-0.

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

NEW BUSINESS/ACTION ITEMS:

FULL SERVICE INVESTMENT CONSULTANT REQUEST FOR PROPOSALS SEARCH FINALIST SELECTION

Mr. Smith referred to the Full Service Investment Consultant RFP Search Process Summary and Finalist Recommendation Presentation dated March 24, 2011. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Smith discussed the steps in the Request for Proposals (RFP) process in the Bureau's search for a new full service investment consultant. The Board of Directors approved the issuance of a full service investment consultant RFP on October 22, 2010. That RFP was issued November 16, 2010. Each of the eight eligible respondent proposals were graded by Bruce Dunn, the Bureau's Chief Investment Officer (CIO) and Lee Damsel, the Bureau's Director of Investments. The Evaluation Committee which consisted of Robert Smith, the Investment Committee Chair, Mark Palmer, the Investment Committee Vice-Chair, as well as Bruce Dunn and Lee Damsel, then conducted four finalist interviews on February 24th and February 25th, 2011 at the William Green Building. The entire Evaluation Committee performed an on-site visit to the headquarters of the leading finalist candidate on March 10, 2011. Mr. Dunn indicated that the timetable of the RFP selection process had been amended somewhat in order to meet the goal of being ahead of the March 31, 2011 deadline for choosing a new full service investment consultant. Mr. Dunn added that he and Ms. Damsel had performed a separate on-site visit on March 17, 2011 to the leading finalist candidate's Chicago, Illinois office, where its real estate consulting team is located. He emphasized that all designated officers of the finalist's firm requested by Mr. Dunn to be present at the Evaluation Committee meeting in Portland, Oregon were available to be interviewed. The finalist recommendation is R.V. Kuhns & Associates, Inc., headquartered in Portland, Oregon. The firm also has offices in New York, Chicago and Seattle.

R.V. Kuhns & Associates (hereinafter RVK) has over 25 years of consulting experience. Mr. Dunn emphasized that the firm is an independent company where 100% of its revenue is derived from providing investment consulting services. There are no potential conflicts of interest because RVK does not provide any other fee-based services. The company is one of the top ten investment consulting firms globally in terms of client assets under advisement that are concentrated towards public fund clients. RVK currently has 12 state public funds as clients with over $10.0 billion in assets of which five of those clients have more than $50.0 billion in assets. The firm was founded by Russell Kuhns in 1985. All of the shareholders are employees of the firm. Guy Cooper, who has over 35 years of investment experience will serve as lead consultant and Robert Palmeri, the Director of East Coast Consulting Operations will act as a co-lead consultant to the Bureau. Jim Voytko will also advise the Bureau. Mr. Voytko was CEO/Executive Director of the large Oregon state pension plan prior to joining RVK. Mr. Dunn indicated that he was most impressed with the teamwork and collaboration shown by RVK, adding that the investment staff and the Board are encouraged to contact any investment professional of the firm at any time. The firm has a strong focus on client education and information. Mr. Dunn emphasized that this is an important component of the new relationship with RVK since the Bureau will be moving into new investment arenas such as real estate and active management. The firm also focuses on assisting clients in drafting RFPs. The consultant fee for RVK will be all-inclusive.

Mr. Dunn noted the services to be provided by the contract with RVK. It is the Bureau's intention that one significant asset/liability study is included in the contract, and will probably be conducted in fiscal year 2013. The contract termination options were discussed. The provision that allows an investment consultant to terminate the contract for convenience only after 180 days advance notice is a new contract provision. That provision was added to the new contract because of the previous consultant's abrupt termination of their contract. The annual retainer fee for RVK will be $538,000 for the first twenty-seven months of the contract from April 1, 2011 through June 30, 2013. The contract includes a 3.5% increase per year thereafter. The initial contract term will be for twenty-seven months through June 30, 2013. The contract allows for one year extensions from July 1 of 2013, 2014 and 2015. Mr. Smith added that the fee proposal was scored based on the entire length of the contract. Mr. Dunn noted that all finalists were required to provide an all-inclusive bid. Mr. Zuk pointed out the difference in the contract prices between the prior consultant and RVK. He asked how much the prior consultant had been paid to provide optional services. Mr. Dunn responded that no extra fees had been paid to the prior consultant because the Bureau had limited their service requests to those that were included in the contract price. He added that the contract with the prior consultant limited the number of investment manager searches and did not include a custodian review.

Ms. Damsel added that RVK has a very extensive performance reporting group. Mr. Palmer noted that the Evaluation Committee had been unanimous in choosing RVK as the top finalist. He noted that he was impressed with the on-site meeting that included all levels of personnel from senior level management to support staff. Mr. Smith added that a strong relationship with the investment consultant is very important. He noted that the investment consultants will be asked to provide independent evaluations of CIO recommendations and Board initiatives. Mr. Caldwell verified that the headquarters was in Portland and the satellite offices were located in New York, Chicago and Seattle.

At this point in the presentation, the representatives from RVK entered the room. Guy Cooper, Senior Consultant with RVK indicated that he considered it to be a high honor to be considered for the investment consultant position, especially for an agency of the Bureau's size. He indicated that RVK's headquarters has approximately 90 employees, in addition to having employees work from the other satellite offices. RVK has employees in Chicago, New York, Seattle, Dallas and Los Angeles. Mr. Cooper reiterated the business' longevity in the industry and ownership structure. He also reiterated their sole focus was on investment consulting. Mr. Cooper referred to the State of Ohio Bureau of Workers' Compensation Investing Consulting Services presentation, dated March 24, 2011, created by RVK. The report is incorporated into the minutes by reference and was provided to the Committee just prior to the presentation for confidentiality reasons. Mr. Cooper pointed out the diversity of the institutional investors that RVK advises. Ninety-three percent of the assets under advisement are from public funds. Mr. Cooper emphasized that the Bureau would be one of RVK's top five largest clients based on size. RVK also advises the large New York State workers' compensation fund. Mr. Cooper added that many of RVK's clients have the same decision-making complexities as the Bureau in that they have an investment division, a Board of Directors and an Investment Committee. Mr. Cooper pointed out RVK's representative public fund client list and firm overview. He noted that by the end of the contract, all employees in the firm will have worked on some aspect of Bureau representation.

Rob Palmeri, a Senior Consultant and Principal who is also Director of East Coast Consulting Operations for RVK, pointed out the primary service team who will be working directly with the Bureau. He emphasized that questions can be emailed to the entire service team which allows for significant internal and external collaboration. The inclusion of all members of the team allows for greater responsiveness, full access to firm resources and allows the Bureau to have multiple projects running concurrently. Mr. Palmeri pointed out the extensive investing experience of Guy Cooper, Jim Voytko and himself. He added that Anthony Johnson had previously initiated a Minority-Owned or Women-Owned Business Enterprise (MWBE) program for the city of Philadelphia. Additionally, he and Anthony Johnson had recently implemented a MWBE program for the New York State Insurance Fund. Mr. Palmeri noted RVK's hierarchy of institutional fund management, their list of available services and their client relationship philosophy. Mr. Palmeri emphasized that unlike their competition, RVK will be proactive in making investment recommendations. He pointed out that RVK's focus on investment consulting creates an independence that is important when interviewing and evaluating potential managers. He also pointed out the diverse specialization and expertise of the firm's senior level managers. Jim Voytko, President, Senior Consultant and Principal of RVK commended the Bureau on performing such extensive due diligence on their firm before choosing RVK as the Bureau's investment consultant. Mr. Smith added that he was impressed with the number and depth of the RVK employees who attended the meeting in Portland.

At this point, the representatives from RVK left the room. Mr. Price thanked Mr. Smith, Mr. Palmer, Mr. Dunn, Ms. Damsel and the entire investment division for the amount of work performed in choosing this investment consultant. He added that he was impressed with RVK's willingness to provide independent evaluation of the Bureau's investment recommendations. Mr. Smith added that Anthony Johnson had also been present at the meeting in Portland and had been invited to appear at the current meeting, but had been unable to attend due to a previous commitment.

Mr. Palmer made a motion of the BWC Investment Committee to Approve 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 approve and adopt the recommendation of the RFP Evaluation Committee to authorize the Administrator of the Bureau of Workers' Compensation to contract with R.V. Kuhns & Associates, Inc. to serve the Board of Directors and the BWC staff as a Full Service Investment Consultant, upon such terms as are outlined in the Request for Proposals issued November 16, 2010 by the Bureau of Workers' Compensation and in R.V Kuhns & Associates, Inc.'s response to the Request for Proposals issued November 16, 2010. Roll call was taken and the motion passed 6-0. Mr. Zuk asked if the investment consultant contract had already been signed. Mr. Dunn responded in the negative and added that the process was still in the blackout period until such contract is signed. He noted that the vote would be put before the Board on their March 25, 2011 meeting, the following day.

BWC TRANSITION MANAGERS OPTIONAL USE CONTRACTS RENEWAL

Mr. Kweku Obed, Principal with Mercer Consulting (Mercer), the Bureau's investment consulting firm entered the meeting at this point. No representatives from Mercer participated in the presentation, discussion or vote on the Bureau's new investment consultant. Mr. Smith indicated that this would be the final meeting with Mercer as the Bureau's investment consultant. He thanked Mr. Obed and his colleagues for their assistance and advice. Mr. Dunn referred to the BWC Transition Managers Optional Use Contracts-Contract Renewal Recommendations memo dated March 15, 2011. The memo is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn indicated that a RFP for transition managers had been issued February 19, 2009. Multiple transition managers had responded and three transition managers had been chosen. Since their approval, these three transition managers had been involved in executing transitions for the State Insurance Fund (SIF), the Disabled Workers' Relief Fund and the Coal Workers' Pneumoconiosis Fund. The contracts for all three transition managers are up for renewal on June 30, 2011. Mr. Dunn explained that an Optional Use Contract allows the Bureau to request information and proposals from all firms that are under contract and then choose one or more than one transition management firm to perform the transition. The Investment Division is recommending a two-year renewal of the contracts. The contract allows for one subsequent two-year renewal at the expiration of the current renewal on June 30, 2013. The three transition managers are: BlackRock Institutional Trust Company, N.A., Russell Implementation Services, Inc., and State Street Bank and Trust Company (State Street). Mr. Smith asked if there were any objections to the waiving of the second reading. There were no objections.

Mr. Palmer made a Motion of the BWC Investment Committee to Recommend the Renewal of the Respective Optional Use Contracts of the BWC Transition Managers, seconded by Mr. Caldwell as follows: I move that the Investment Committee of the Workers' Compensation Board of Directors recommend to the Board to renew the respective Optional Use Contracts of the BWC Transition Managers, for the reasons set forth in the memorandum of BWC's Chief Investment Officer dated March 15, 2011, for BlackRock Institutional Trust Company, N.A.; Russell Implementation Services, Inc.; and State Street Bank & Trust Company and to waive the second reading of the motion. Roll call was taken and the motion passed 6-0.

LONG DURATION CREDIT ACTIVE MANAGEMENT

Mr. Dunn referred to the Chief Investment Officer Investment Policy Recommendation, Long Duration Credit Fixed Income Active Management- State Insurance Fund memo, dated January 12, 2011. The memo is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn indicated that currently a targeted 28% of the SIF investment portfolio, or approximately $5.3 billion, is allocated to the passively managed long credit fixed income mandate. The CIO recommends that 20% of the total SIF invested assets, or approximately $3.75 billion become actively managed long credit fixed income. Mr. Dunn noted that active management would control risk and is expected to achieve higher investment returns net of management fees. The negative tracking error for passive management of long credit fixed income is currently approximately 20 basis points (bps) per year. Mr. Dunn noted that the Bureau had previously lost approximately $50 million from holding Lehman Brothers bonds that were passively managed. He pointed out that The Ohio Bureau of Workers' Compensation Statement of Investment Policy and Guidelines (IPS) is being changed currently only to accommodate management of long duration credit active fixed income. The statement will likely be amended later to include active management of equities. Section IV.C.i of the IPS has been amended to state that, with regard to actively managed fixed income, no investment firm can manage more than 50% of any specific investment mandate at the time of hiring under contract. The rule is intended to diversify managers. Mr. Dunn noted that in 2006 and early 2007, State Street managed 100% of the Bureau's assets. Recently, that amount was 44%. Due to this investment management percentage limitation, at least 3-4 active managers will be chosen for the long credit mandate. The amended IPS will remain general in order to encourage active managers of long credit fixed income to diversify holdings by issuer and industry/sector groups, but discourage recklessness. Mr. Dunn added that the specific active management contracts with each approved manager will have more specific guidelines. The IPS states that over a trailing three-year period, active managers of long duration fixed income are expected to outperform the benchmark by 25 bps net of fees and outperform the peer group. Passive managed indexed long duration fixed income was reduced from 28% to 8% in the amended IPS.

Mr. Obed indicated that he had submitted a memo to the Investment Committee and Board indicating Mercer's support to active management of long duration fixed income. He added that active management can increase returns and reduce risk. Mr. Zuk asked for the thought process behind choosing the 25 bps as the minimum amount for outperforming the benchmark. Mr. Dunn replied that the amount is highly achievable. Additionally, the amount is a minimum requirement and can be reassessed later. He added the amount was chosen after discussions with Mercer and other parties. It was chosen to discourage overly aggressive investing with outsized bets. Mercer's research has indicated that active managers should consistently beat the outperformance requirements. Mr. Pitts asked the Mercer representative if he felt that 25 bps was a reasonable expectation. Mr. Obed answered in the affirmative, emphasizing that the Bureau does not want to be too aggressive in its requirements. Mr. Zuk asked if the IPS should indicate outperformance of the benchmark at 25 bps or more. Mr. Obed responded that the amount can be revisited at a later time. Mr. Price pointed to the extreme gains and losses shown in the prior Mercer presentations on active management of fixed income. He noted that the prior educational sessions had charted extensive inconsistency in performance. Mr. Dunn added that the requirements would result in more consistency in performance. Mr. Obed emphasized that the Bureau portfolio is performing well. He added that the Bureau does not need to reach for excessive risk in order to achieve alpha.

Mr. Palmer made a motion of the BWC Investment Committee to Recommend Amendment of the Investment Policy Statement Regarding Long Duration Credit Active Management, seconded by Mr. Haffey as follows: I move that the Investment Committee of the Bureau of Workers' Compensation Board of Directors recommend to the Bureau of Workers' Compensation Board of Directors that it amend those provisions of the Statement of Investment Policy and Guidelines regarding Long Duration Credit active management, for the reasons set forth in the memorandum of BWC's Chief Investment Officer dated January 12, 2011. The recommended amendments to the IPS are shown in the red-lined version of the IPS prepared by BWC's Chief Investment Officer and Mercer Investment Consulting and the exact changes adopted as a result of this motion will be incorporated by reference in the minutes of this meeting of the Committee. Roll call was taken and the motion passed 6-0.

DISCUSSION ITEMS:

MONTHLY AND FISCAL YEAR TO DATE PORTFOLIO VALUE COMPARISONS

Mr. Dunn referred to the Invested Assets Market Value Comparison-Total Funds report, dated March 17, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr.

Dunn indicated that net investment income in February 2011 was $362 million, representing a positive 1.8% portfolio return. Bonds returned a positive 1.1% in the month of February 2011. Stocks returned over $200 million or positive 3.3%. The Long Credit fixed income portfolio had a positive return of 1.6%. The U.S. Aggregate portfolio returned positive 0.2% in February 2011. Mr. Dunn noted that there was a slight flattening of the yield curve during February 2011. With equities, the U.S. domestic equity portfolio returned positive 3.6% and international equity returned positive 2.6% in February 2011. The U.S. Dollar declined in February 2011. Of the 2.6% positive return on international equities, 1.0% was attributable to the decline of the U.S. Dollar. Mr. Dunn assured the Committee that although the international equities had been somewhat volatile recently due to the earthquake and the tsunami that hit Japan in March 2011, equities had declined less than 1% during this month to date. Japanese holdings in the MSCI ACWI ex-U.S. account for approximately 14% of the index. Mr. Dunn also mentioned the civil unrest in Egypt. He indicated that the Bureau had very few Egyptian holdings, but added that it is an emerging market. The Bureau has approximately $1.6 million invested in Egyptian equities or 0.02% of the ACWI index. He added that most are ADRs that do trade in the U.S. Net investment income increased over $1.8 billion in the current fiscal year through February 2011. That equates to a positive 9.8% return during that period. Bonds returned positive 1.9% and stocks returned positive 31.5% in the same period. U.S. equities outperformed international equities due to lagging emerging markets performance. The Price-Earnings ratio is currently lower for emerging markets compared to U.S. equities.

MONTH-END PORTFOLIO ASSET ALLOCATION VALUES
Ms. Damsel referred to the Investment Asset Allocation-Combining Schedule as of February 28, 2011, dated March 17, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. She also referred to the Investment Asset Allocation-Combining Schedule as of January 31, 2011 report, dated March 17, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Ms. Damsel noted that equities had increased fairly significantly in market value in February 2011. Stocks increased $197 million in February 2011 while bonds increased $138 million in the same period. Operating cash increased by $329 million in the same period. Ms. Damsel assured the Committee that all asset allocations were within IPS target ranges.

Mr. Dunn referred to the BWC Invested Assets as of March 23, 2011 chart. The chart is incorporated into the minutes by reference and was provided to the Investment Committee just prior to the March 24, 2011 Investment Committee meeting in order to reflect the most current portfolio valuations. Mr. Dunn noted that the market had performed fairly well despite issues in Africa and Japan. He indicated that the domestic economy has continued to improve. In the month to date March 2011, bonds increased by 0.5% and equities decreased by 2.1% in total return. Mr. Dunn noted that there was a flight to high quality bonds due to turmoil in Japan and Africa. The total portfolio of bonds and stocks decreased by $72 million in the month to date. Mr. Dunn noted that the Japanese Yen had appreciated compared to the U.S. Dollar since the earthquake. Mr. Smith observed that he had expected the Japanese Yen to depreciate because of the earthquake and tsunami and had been surprised when it had appreciated instead. Mr. Dunn explained that the Yen had appreciated because of speculation that its value would increase due to the anticipated repatriation of Japanese assets invested overseas to be converted back to Japanese Yen in order to support the rebuilding of infrastructure. Mr. Dunn added that Japan is a large holder of U.S. Treasuries.

CIO REPORT
Mr. Dunn referred to the CIO Report February 2011, dated March 16, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn noted that the CIO report included a RFP update on the Investment Consultant search.

COMMITTEE CALENDAR
Mr. Smith referred to the 12-month Investment Committee Calendar, dated March 16, 2011. The calendar is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn noted the Updated Recommended Phase I & Phase II Strategies-Investment Committee Estimated Timetable: State Insurance Fund report dated March 8, 2011. The timetable is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Smith indicated that a vote on the active long credit RFP would be included in the April 2011 Investment Committee meeting. The April 2011 meeting would also include a general presentation on investing in real estate, as well as a presentation on revising the IPS to allow investment in real estate. He added that investing in real estate would help to diversify the Bureau’s portfolio and increase income. Mr. Dunn indicated that he and Ms. Damsel had just recently met with personnel in RVK’s Chicago office, where the RVK real estate consulting group is located. He added that he would be ready to give a presentation on real estate and proposed changes to the IPS for real estate during the April 2011 Investment Committee meeting. Mr. Smith asked what percentage of the portfolio would be invested in real estate. Mr. Dunn replied it was being recommended that 5% of the SIF total portfolio be invested in real estate. Mr. Pitts thanked Kweku Obed, Jordan Nault and all of the other Mercer representatives for their hard work.

ADJOURN
A motion to adjourn the meeting at 12:00 p.m. was made by Mr. Haffey and seconded by Mr. Caldwell. Roll call was taken and the motion passed 6-0.