BWC Board of Directors

INVESTMENT COMMITTEE

Thursday, April 28, 2011 9:30 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:	Bruce Dunn, Chief Investment Officer Lee Damsel, Director of Investments Donald Berno, Board Liaison
Consultants Present:	Guy Cooper, Senior Consultant, R.V. Kuhns Anthony Johnson, Principal, R.V. Kuhns Dan Krivinskas, Principal, R.V. Kuhns Roman Nemtsov, Consultant, R.V. Kuhns
Scribe:	Linda Byron, Staff Attorney, Legal Division, BWC

CALL TO ORDER
Mr. Smith called the meeting to order at 9:28 a.m.

ROLL CALL
Roll call was taken. All members were present except Mr. Caldwell, who joined the meeting later as noted.

APPROVE MINUTES OF THE MARCH 24, 2011 MEETING

Upon motion of Mr. Haffey, seconded by Mr. Palmer, the minutes of the March 24, 2011 meeting were approved as written. Roll call was taken and the motion passed 5-0.

AGENDA

Upon motion of Mr. Price, seconded by Mr. Haffey, the agenda was approved as written. Roll call was taken and the motion passed 5-0.

NEW BUSINESS/ACTION ITEMS:

BWC ACTIVE LONG DURATION INVESTMENT GRADE CREDIT ONLY FIXED INCOME MANAGERS SEARCH

Bruce Dunn, the Bureau's Chief Investment Officer (CIO), referred to the BWC Active Fixed Income Management Long Duration Investment Grade Credit Request for Proposals Issuance Recommendation Memo for the State Insurance Fund dated April 19, 2011. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn noted that the current SIF portfolio is $19.0 billion. Approximately $3.8 billion would be allocated to active long duration credit fixed income managers. Mr. Dunn emphasized that the Request for Proposals (RFP) would be for the services of qualified Active Long Duration Investment Grade Only Fixed Income managers. He pointed out the RFP timeline. The RFP is expected to be issued on May 26, 2011. Mr. Dunn indicated that R.V. Kuhns & Associates, Inc. (hereinafter RVK), the Bureau's investment consulting firm had already included feedback and recommendations for portions of the RFP. He added that he and Lee Damsel, the Bureau's Director of Investments, had met with Amy Hsiang, Manager Research Consultant of RVK, during the on-site meeting in March 2010. The Bureau's RFP Evaluation Committee, which includes RVK, will grade the responses to the RFP and then conduct on-site interviews with the finalist candidates. It is anticipated that 3-5 firms will be selected as finalists recommended for Board presentation and consideration to allow for some diversity in the management style and firm size.

Mr. Dunn pointed out that the RFP questionnaire will ask about the potential use of derivatives. Mr. Smith asked that the May 2011 Investment Committee meeting contain a discussion on derivatives and investment policy limitations. Mr. Haffey pointed out that many high quality investment firms are located in Ohio and asked how the Bureau could ensure that those firms were considered. Mr. Dunn cautioned that the mandate is a very large mandate and added that the investment policy limits the amount of the funds' assets managed for the Bureau by any one firm or General Partner to 5% of the total assets managed by the firm or the General Partner for all clients in that asset class at the time it is hired. Mr. Smith asked if the 5% limitation was typical in other funds. Guy Cooper, Senior Consultant with RVK, indicated that the amount varies and that previous discussions had centered on whether 5% was too restrictive. Mr. Smith stated that he wanted to discuss the 5% threshold at a later date because it might be too restrictive and might disqualify some smaller or minority firms. Mr. Cooper responded that 100% would obviously be unreasonable, but an amount around 20% might be feasible. Mr. Dunn added that assets under management are very liberally defined in the BWC investment policy statement and include all bond assets. He noted that this RFP deals with very specialized instruments in the U.S. bond market where a rigorous credit analysis would be required and pointed out that having more managers or small managers increase transaction costs, which undermines performance.

Mr. Palmer made a Motion of the Investment Committee to Recommend Issuance of a RFP for Qualified Active Long Duration Investment Grade Credit Only Fixed Income Managers, seconded by Mr. Zuk 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 for the services of qualified Active Long Duration Investment Grade Credit Only Fixed Income Managers to provide active management of a targeted twenty (20) percent of the State Insurance Fund invested assets as approved by the Board at its March 25, 2011 meeting, and as outlined in the memorandum of BWC's Chief Investment Officer dated April 19, 2011. Roll call was taken and the motion passed 5-0.

DISCUSSION ITEMS

MONTHLY AND FISCAL YEAR-TO-DATE PORTFOLIO VALUE COMPARISONS

Mr. Dunn referred to the Invested Assets Market Value Comparison-Total Funds chart, dated April 21, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. For March 2011, the total portfolio had a positive return of 0.2%. In the same month, both stocks and bonds returned positive 0.2%. Net investment income in March 2011 was $42.0 million. Mr. Dunn indicated that TIPS was the best performer for the month with a positive return of just over 1.0%. Long Credit lagged at negative 0.25% in the same period. U.S. equities had a positive return of 0.45% while non-U.S. equities lost 0.25% in the same period. The Developed country international equities in the aggregate lost 2.0% and emerging country equity markets gained over 4.0% in March 2011. Mr. Dunn noted that Japan was a drag on the portfolio for the month, with Japanese equities decreasing over 9.0%. The U.S. Dollar declined and foreign currency gained 0.8% versus the U.S. Dollar.

Net investment income in the fiscal year to date ending March 2011 was $1.91 billion with a positive return of 10.0%. Bonds returned positive 2.1% and equities returned positive 31.8% in the same period. TIPS returned positive 3.7% while Long Government bonds returned negative 3.9%. U.S. stocks returned positive 33.0% in the fiscal year to date and non-U.S. stocks returned positive 29.3%. The non-U.S. stock portfolio returns were boosted by the weaker U.S. dollar which declined in value versus most foreign currencies and accounted for 11.7% of this 29.3% positive return over this period for the non-U.S. stock portfolio commingled fund owned by the Bureau. Mr. Dunn noted that Fed quantitative easing continues to weaken the U.S. Dollar while keeping interest rates low in the U.S. Mr. Dunn pointed out that changes might occur once QE2 terminates at the end of June 2011. He added that the current policy improves multinational corporation earnings and non-U.S. equity returns when translated in U.S. dollars.

Mr. Dunn referred to the BWC Invested Assets as of April 27, 2011 chart. The chart is incorporated into the minutes by reference and was provided to the Investment Committee just prior to the April 28, 2011 Investment Committee meeting in order to reflect the most current portfolio valuations. The month to date total portfolio returned positive 1.7% in April 2011, putting the Bureau's total invested assets over $21.0 billion. Mr. Dunn noted the equities outperformed bonds. Bonds returned positive 1.3% in the month-to-date April 2011 and equities returned positive 2.6% in the same period.

MONTH-END PORFOLIO ASSET ALLOCATION VALUES

Ms. Damsel indicated that the Bureau did not have to rebalance at the end of March 2011, but noted that the results were close. The Committee was provided the Investment Asset Allocation-Combining Schedules as of March 31, 2011, dated April 21, 2011 and the Investment Asset Allocation-Combining Schedules as of February 28, 2011, dated April 21, 2011 charts. The charts are incorporated into the minutes by reference and were provided to the Committee in advance of the meeting.

QUARTER –END PORTFOLIO ASSET ALLOCATION VALUES

Ms. Damsel referred the Committee to the Invested Asset Allocation by Fund-Target Variance chart, dated April 20, 2011. The chart is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Ms. Damsel indicated that the value of equities is continuing to rise which will likely force a rebalancing of the Russell 3000 in the near future. Mr. Smith asked for a list of members on the rebalancing committee. Ms. Damsel responded that she and Mr. Dunn were members, as well as Stephen Buehrer, the Bureau's Administrator, Ray Mazzotta, the Bureau's Chief Operating Officer and Tracy Valentino, the Bureau's Chief of Fiscal and Planning.

CIO REPORT

Mr. Dunn referred to the CIO Report for March 2011, dated April 18, 2011. The report is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn pointed out that Mercer Consulting is obligated under the prior contract to provide, before a mid-May 2011 deadline, the Bureau with a quarterly investment performance report for the period ended March 31, 2011. The cost for that report will be $30,000. Mr. Dunn pointed out he will present this quarterly performance report at the May 2011 Investment Committee meeting. Mr. Dunn indicated that the CIO Report provides detailed summaries of each of the four quarterly investment manager meetings held in February, 2011. He noted that the Bureau will likely reduce the number of face-to-face meetings each year with its passive indexed managers after the active managers are added due to time constraints.

Mr. Dunn indicated that there had been a meeting on March 17, 2011 with RVK consultants at their Chicago office where interviews with the RVK real estate group were led by him and Ms. Damsel. This was a necessary precondition before recommending RVK as the new Bureau investment consulting firm.

INTRODUCTION OF R.V. KUHNS BWC EXTENDED CONSULTING TEAM MEMBER
Mr. Dunn introduced Anthony Johnson, a Senior Consultant with RVK. Mr. Johnson is a Principal with RVK. Prior to joining the firm in 2008, he was the Chief Investment Officer for the City of Philadelphia's $4.3 billion public retirement system. He has also provided specialized services to the New York State Insurance Fund including helping to implement a minority manager program and a MoM (Manager-of-Managers) program. Mr. Johnson emphasized that he has been an investment consultant for approximately sixteen years.

R.V. KUHNS REAL ESTATE CONSULTING SERVICE INTRODUCTION
Mr. Dunn introduced Dan Krivinskas, Director of Real Estate Consulting and a Principal with RVK. Mr. Krivinskas is located in RVK's Chicago office. He previously worked as an Attorney for the law firm Jones Day and also previously for Courtland Partners, a real estate advisory firm in Cleveland. He has extensive experience with advising governmental groups and corporations. Mr. Dunn also introduced Roman Nemtsov, Consultant with RVK, who works closely with Mr. Krivinskas in the RVK Chicago office on real estate consulting and who previously worked with Mr. Krivinskas at Courtland Partners.

As the presentation began, Mr. Smith noted that real estate investments present the opportunity for enhanced income, more diversification of the BWC portfolio, and the expectation for higher returns.

R.V. KUHNS PRESENTATION ON REAL ESTATE AS AN ASSET CLASS
Mr. Krivinskas referred to the State of Ohio Bureau of Workers' Compensation Real Estate Educational Presentation, dated April 28, 2011 and prepared by RVK. The presentation is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Krivinskas mentioned the Proprietary "RVK Corporate Governance Rating System" and RVK's downside scenario focus. Mr. Krivinskas emphasized that RVK's philosophy is that it is better for a client to miss a deal rather than entering into a bad one. He pointed out that RVK looks at client specific options to evaluate the best real estate strategies. RVK also proactively seeks investment opportunities. Mr. Smith asked for an opinion on the state of the publicly-traded real estate markets and its recovery. Mr. Krivinskas indicated that we are a little over halfway through the recovery cycle for the publicly-traded real estate market. He added that the value

of public real estate equities usually leads private real estate values. Mr. Smith asked how real estate investing has changed since the economic downturn. Mr. Krivinskas responded that more investors are now focused on the downside. There is more focus on corporate governance and a view toward balancing risk with reward. Mr. Smith asked what changes had been noticed with insurance company or public funds investing. Mr. Krivinskas replied that there is a movement back from risk to core real estate. He added that too much risk was being taken between 2005 and 2007 and many institutions have legacy portfolios. Some of those investors are currently buying the most expensive part of core real estate. Mr. Smith asked if insurance companies or public funds were getting out of real estate completely. Mr. Krivinskas replied that they are still proceeding with real estate investments, but diversifying by buying less risky investments. Mr. Palmer added that the Bureau needed to be careful about buying in when real estate values were highest. Mr. Krivinskas responded that there is currently an increase in real estate values and while core real estate values are increasing; there are long cycles for real estate. He added that real estate is a long term investment and noted that this is a good time to get into real estate investing if you split your investments between core and non-core. Mr. Smith asked how long remains in this current real estate investing cycle. Mr. Krivinskas answered that since private real estate lags public real estate equities for a year or two, he predicted that the current cycle would end around 2016 or 2017.

Mr. Krivinskas pointed out that RVK has implemented several Minority and Women-Owned Real Estate Manager and Green investment initiatives. Mr. Krivinskas discussed specific examples of what can be reviewed as part of the Proprietary RVK Corporate Governance Rating System. Mr. Roman Nemtsov, a Consultant with RVK's real estate division added that the illiquidity of real estate should be considered and he emphasized that the focus needed to be on the long term. Mr. Nemtsov stated that he thought that the real estate recovery was earlier in the cycle than had been previously described by Mr. Krivinskas in the meeting. Mr. Caldwell arrived at this point during the discussion item. Mr. Nemtsov discussed RVK's real estate investment philosophy, emphasizing that a bottom-up fundamental analysis is the key to long-term success. Mr. Smith inquired as to what types of investments were being recommended for the Bureau. Mr. Nemtsov replied that the Bureau's investments would not include direct individual property ownership, but would include both core and non-core real estate investments. Mr. Smith asked if real estate had a J-curve effect. Mr. Nemtsov responded in the affirmative, adding that the effect is mitigated by some funds, but diversity is needed. Mr. Pitts expressed concern that the real estate class has repeatedly been described as illiquid. Mr. Krivinskas agreed that selling at the right time can be an issue. Mr. Smith added that his concern was reducing real estate to meet rebalancing requirements, after the value had increased. Mr. Krivinskas responded that most of the returns from real estate comes from the income returns it provides and added that the illiquidity risk can provide greater returns compared to publicly-traded investments.

Mr. Smith asked if the funds were income producing. Mr. Krivinskas responded in the affirmative and emphasized that 80% of the returns come from income over time. Mr. Smith asked the amount of projected returns. Mr. Dunn replied that there is a 3.1% expected returns yield spread projected based on the selling of long government bonds with a 3.5% estimated return over 10 years and TIPS with a 4.25% estimated return over 10 years. Mr. Smith asked if real estate was primarily being added to create portfolio diversification. Mr. Dunn replied that real estate is positively correlated with the inflation rate while bonds are negatively correlated. Mr. Smith asked if real estate entailed more risk. Mr. Dunn replied that his primary concern was with rising inflation due to the liability structure of the SIF account and its sensitivity to inflation and rising medical costs. Mr. Dunn indicated that returns on real estate are typically positively correlated with inflation, unlike bonds which are negatively correlated with inflation.

Real estate includes traditional and non-traditional commercial real estate sectors. Hybrid types have a real estate component and an operational component which increases risk and returns. Publicly traded real estate is traded on the NYSE and other global exchanges, but is not as diversified as private real estate. Private real estate is the Bureau's focus due to the CIO's concerns about portfolio diversification. There are two types of real estate investments: equity interests and debt interests. Mr. Palmer asked if the interest rate could be adjustable. Mr. Krivinskas responded in the affirmative. Mr. Krivinskas discussed the reasons for investing in real estate and the institutional definitions of real estate risk. Mr. Nemtsov mentioned the types of private and public real estate. Mr. Smith asked the percentage of real estate in the Russell 3000. Mr. Dunn estimated that publicly traded real estate equities or REITs were less than 1% of the Russell 3000 indexed portfolio. Mr. Nemtsov mentioned the considerations related to private real estate. Mr. Smith asked if the terminal value had any significance when calculating the value. Mr. Nemtsov responded that the terminal value can be very significant. Mr. Nemtsov mentioned current real estate market dynamics, emphasizing that valuation had rebounded modestly in recent quarters. Mr. Smith asked to what extent managers rely on historical cap rates. Mr. Krivinskas replied that for non-core, it is relied upon quite often, but not often with core real estate.

Mr. Dunn referred to the Chief Investment Officer Investment Policy Recommendation Real Estate Asset Class Strategy Memo for SIF dated April 18, 2011. The memo is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Dunn noted that all four investment consulting firm RFP finalists interviewed by the RFP Evaluation Committee recommended real estate as an appealing investment for the Bureau due to its ability to be an inflation hedge and to provide substantial up-front income. The CIO recommends that 6% of the State Insurance Fund portfolio be invested in real estate. Of that, it is recommended that 75% be committed to private core real estate funds with the remaining 25% be committed to value-added private real estate funds. Mr. Dunn indicated that value-added opportunities are available. With core funds, the intent is to select 5-7 core funds where the majority will have similar strategies with several having some specialty strategies. Mr. Dunn added that he wants to have some non-traditional real estate sector investments. Non-core real estate properties are usually held for 3-4 years while core property ownership is typically held longer over 7-10 years. Investing in real estate will reduce the Bureau's exposure to U.S. Treasuries. Mr. Dunn noted that the Bureau is also top heavy in government bonds. He added that government bonds currently have a low yield, but are tremendously liquid. RVK estimates that core real estate will return 7.0% after fees while value-added real estate will return 9.0% net of fees over a long-term period. Over the long term, the allocation to real estate is estimated to provide a 3.1% annual incremental return for SIF, equal to approximately $35 million. Core and non-core real estate have a low rate of return correlation with bonds. REITS are not being recommended since they have a 70-80% correlation with equities, where the Bureau already has exposure with its indexed portfolios to the Russell 3000 benchmark index.

The Ohio Bureau of Workers' Compensation Statement of Investment Policy and Guidelines (IPS) is being recommended to be amended by Mr. Dunn to add a real estate diversification requirement where the amount of the Fund's assets invested in any one core real estate fund cannot be more than $250 million and in any one value-added fund cannot exceed $50 million. The investment into value-added funds will be staged over 2-3 years. Mr. Smith referred to the Private Real Estate Recommendation-State Insurance Fund Memo, dated April 28, 2011 and prepared by RVK. The memo is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting. Mr. Cooper pointed out that RVK agrees with the recommendations of the BWC CIO for real estate. Mr. Smith added that the Bureau's Administrator, Stephen Buehrer had been unable to attend the current Investment Committee meeting due to a conflict, but had been thoroughly briefed on the real estate investment recommendations by the Bureau's CIO. He added that Mr. Buehrer supports the recommendations.

Mr. Zuk asked how RVK would learn information about the available value-added funds and inquired as to whether prospectuses would be provided for review. Mr. Krivinskas replied that there would not be prospectuses available, but added that RVK has an open door policy when it comes to meeting with people. Applicants are asked to fill out the internal proprietary questionnaire and provide a copy of their private placement memorandum. At this point, RVK will decide whether or not to proceed with due diligence. Mr. Zuk asked how the decision is made as to which funds to invest in. The answer was that RVK provides a list of funds that have been screened and are within the deal pipeline on a quarterly basis after a review of the quantitative and qualitative criteria. Mr. Smith asked how the evaluation was being done. Mr. Krivinskas replied that this would be an open process with candidates and that a RFP would not be issued. Mr. Dunn added that

RVK would provide the recommendations and then the due diligence would be performed by the BWC investment staff with support from RVK. He noted that some might be "club deals" where a group of investors who are all clients of RVK and have similar investment goals will band together in order to get lower fees and approach a manager. Mr. Cooper added that there is a general process in place. For selecting open-ended funds, an estimated five to seven candidates will be chosen after a RFP is issued as opposed to closed-ended funds whereby candidates will be proposed as opportunities present themselves. Mr. Zuk and Mr. Smith both commented that a process will need to be solidified.

Mr. Lehecka asked if the funds had enough flexibility to be rebalanced if the real estate funds owned end up outside of the ownership target in the policy. Mr. Dunn replied that there would need to be a significant change in the market to cause a rebalancing, but if one was necessary, investors have the ability to sell their interest in core funds every quarter. Mr. Krivinskas pointed out that with regard to the sale of interest and the ability to rebalance, there is a greater ability to sell down core than non-core because non-core is illiquid. With core real estate, an investor can enter or exit with 45 days notice. He added that currently there are actually some entry queues, but cautioned that in 2008, investors were not able to exit. Mr. Cooper and Mr. Dunn both reiterated that it was unlikely that the fund would ever go outside of the policy targets once fully invested unless extraordinary movement in the markets occurred. Mr. Price asked for examples of private core and value-added real estate. Mr. Krivinskas replied that value-added is determined based on the type of risk. Core real estate is well leased, high quality, low leveraged, stabilized real estate in large metropolitan areas. With value-added (also called non-core) real estate, one of the requirements for core real estate in being well-leased properties is missing. This therefore increases the investment risk of value-added real estate but also provides the opportunity for the higher returns on value-added fund properties with good management. Mr. Dunn pointed out that the exhibits in the Chief Investment Officer Investment Policy Recommendation Real Estate Asset Class Strategy State Insurance Fund Memo dated April 18, 2011 explain both types of real estate. Mr. Dunn also pointed out that Exhibit B of his memo describes the criteria for properties in a core real estate fund that must be met for eligibility and inclusion in the real estate benchmark index being proposed. Mr. Krivinskas added that real estate must have three years of returns to be included in the benchmark index. Mr. Price pointed out that there are vacant retail and industrial properties throughout Ohio. He indicated that he was having trouble finding a balance between the very persuasive real estate investment presentation and the realities of a difficult economy. Mr. Krivinskas replied that most core fund properties are in larger metropolitan areas with higher populations and job growth, but value-added properties are available in Ohio.

COMMITTEE CALENDAR

Mr. Smith referred to the 12-month Investment Committee Calendar, dated April 20, 2011. The calendar is incorporated into the minutes by reference and was provided to the Committee in advance of the meeting.

ADJOURN

A motion to adjourn the meeting at 12:03 p.m. was made by Mr. Haffey and seconded by Mr. Caldwell. Roll call was taken and the motion passed 6-0.