WASHINGTON STATE INVESTMENT BOARD
Administrative Committee Meeting Minutes
December 11, 2006

The Administrative Committee met in open session at 9:00 a.m. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present:	Patrick McElligott, Chair Glenn Gorton, Vice Chair George Masten Treasurer Mike Murphy Dave Scott
Other Members Present:	Charlie Kaminski (via teleconference) John Magnuson David Nierenberg (via teleconference)
Others Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer James Mackison, Information Systems Manager Teresa Eckstein, Human Resource Director Kristi Haines, Executive Assistant Paul Silver, Assistant Attorney General Russell Kuhns, R.V. Kuhns and Associates, Inc. Andrea Krol, R.V. Kuhns and Associates, Inc.

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

Chair McElligott called the meeting to order.

ADOPTION OF THE JUNE 15, 2006, MINUTES

> **Vice Chair Gorton moved that the Administrative Committee adopt the June 15, 2006, meeting minutes. Treasurer Murphy seconded and the motion carried unanimously.**

INVESTMENT OFFICER COMPENSATION STUDY
Mr. Dear introduced Mr. Kuhns and Ms. Krol of R.V. Kuhns, consultants under contract with the WSIB to conduct the biennial investment officer salary survey. R.V. Kuhns was also used for the compensation study two years ago.

Mr. Kuhns reported that his company started collecting information from public funds in 1985, primarily for the purpose of performance reporting. Although they are not compensation experts, the strong relationships they have developed with public funds allow them access to compensation information. Mr. Kuhns said that there are 34 public funds in R.V. Kuhns' universe and 19 funds over $20 billion in size responded to the questionnaire sent in preparation for this compensation study, which is an appropriate peer group for the WSIB.

Some conclusions from the compensation analysis are that: (1) The WSIB has had exceptional investment results and certain public entities link performance to compensation; (2) The WSIB is well staffed and allocation of its staff is similar to other funds; (3) Many of the WSIB's investment position salaries are below the average of participating funds; and (4) Fifty-six percent of public funds over $20 billion in size have an incentive bonus program; the WSIB does not. R.V. Kuhns recommends that the Board consider increasing salaries for those positions falling below the survey average and initiating an incentive bonus program. He reviewed how the WSIB's investment positions compared against average salaries and as adjusted by the cost of living in Olympia, which is 14.2 percent higher than the national average.

Mr. Kuhns' provided performance and asset allocation comparisons of funds participating in the survey. The WSIB was one of the top performing funds with a one-year return of 14 percent, and has a higher allocation to alternative investments and lower allocation to U.S. equity than its peers.

WSIB statute directs compensation levels to be based on an average salary of state funds of similar size. To assist in establishment of ranges, the study provides an average top of salary ranges for each investment position level, as well as average top salary ranges as adjusted for Olympia's cost of living.

[Mr. Scott was in attendance at 9:16 a.m.]

Mr. Kuhns reported that the Joint Legislative Audit and Review Committee (JLARC) had reviewed and provided comment on the report. JLARC found that it was a good and comprehensive report. JLARC suggested that future studies include comparisons of internal/external management.

Treasurer Murphy observed that only four of the participating funds were at the national average for cost of living. He questioned why the proposed salaries were presented with a 14.2 percent cost of living adjustment when the comparisons are largely made to funds also in high cost of living areas. Mr. Kuhns said that no further cost of living analysis was done.

Mr. Dear introduced proposed ranges with a narrower (28 percent) band, as requested by Treasurer Murphy. A band of 41 percent was presented in the meeting materials, which followed past practice. The effect of bringing up the bottom of the salary range to narrow the band to the 28 percent span is that several investment officers' current salaries would fall below the proposed range for their position. Treasurer Murphy said that he requested a narrower band largely due to the large spread of the proposed chief investment officer salary range. He appreciates the reduction. Mr. Masten clarified that the Board sets the salary ranges, while the executive director acts on specific salary changes.

> **Mr. Masten moved that the Administrative Committee recommend that the Board adopt the new proposed 28 percent salary ranges for Investment Officers to become effective 60 days following the Board meeting, and direct staff to provide 60-day notification of the new ranges to the appropriate parties. Mr. Scott seconded the motion.**

In response to Treasurer Murphy's question as to the percentage of increase from current salaries, Mr. Dear replied that the comparison is to salaries as of September 1, 2006, when the state's cost of living adjustment (COLA) took effect. By policy, any COLA granted to state employees is translated to exempt staff, including investment officers. Mr. Dear reported that eight of the current investment officer salaries are below the proposed range, using the 28 percent band. Salary increases would need to occur over the next two years to increase staff to the new band level or positions would need to be reclassified. With a 41 percent band, current salaries would already fall within the proposed range. Additionally, an ideal salary administration process would have overlapping salary ranges, which does not occur with the 28 percent band. Treasurer Murphy said that he is opposed to granting a 28 percent salary increase from the current maximum investment officer salary over a two-year period to get staff into the new band.

A discussion ensued regarding compensating staff for performance and retention purposes, differences between public and private sector money market industry salaries, and state employee salary levels. Mr. Magnuson said that beneficiaries benefit from the retention of good investment staff and he believes it is appropriate to compensate staff for work resulting in exceptional returns.

[Mr. Nierenberg was in attendance at 9:44 a.m.]

> **The above motion passed with Vice Chair Gorton and Treasurer Murphy voting no.**

2007 STRATEGIC PLAN

Mr. Dear presented staff's proposed plan for discussion. The Committee was asked to provide comments on the proposal, which will be taken to the Board for final approval. Mr. Dear said this is an opportunity for members to engage with and impact the strategic plan.

Mr. Dear reviewed the frameworks for the strategic plan including the value chain, the five key drivers, and the value, capacity, and support diagram. He noted that the investment performance benchmarks established in Board policy for each asset class and portfolio define the outcomes for all the projects in the strategic plan. In response to Mr. Magnuson's comment about the real estate portfolio not matching its benchmark, Mr. Dear said that points out the deficiency of the NCREIF benchmark. Staff has attempted for two years to identify a better benchmark, but have not found one. Another problem exists with benchmarking the Labor and Industries' funds.

Treasurer Murphy asked for details on the information technology (IT) investment and its budget. Mr. Dear responded that a portion of that project was completed by hiring new IT staff. The need for this project was identified in 2004 and has progressed since then. The plan for 2007 is to build a data warehouse and, in 2008, to develop a performance attribution and risk analytics system. Mr. Mackison reported that the five-year cost would be approximately $5.5 million for investments beginning in 2007, which include the data warehouse, a performance system and, potentially, an investment accounting system. Mr. Dear emphasized that staff coordinates the project with the Department of Information Services, with oversight from the Information Services Board.

Mr. Dear said that he hopes that the Board can continue its discussion about what constitutes good board governance at its July meeting. Questions that the Board may want to consider involve investment beliefs, principles, and work methods to attain and maintain great performance, and developing and institutionalizing best practices. He said that a review of the past three years revealed that the Board spent approximately 12 percent of its time on strategic issues, 42 percent on transaction approvals, and the remaining percentage on receiving reports and other administrative issues. This data will be further refined and shared with the Board.

A discussion ensued relating to the private equity asset allocation project. It was noted that Board policy requires a review of the CTF asset allocation at least every four years. The last formal review of the asset allocation occurred in July/September 2005. Mr. Bruebaker noted that the current allocation was approved with the understanding that the Board would further review the private equity allocation once we actually got to the current target of 17 percent. Members shared their views on how often asset allocation decisions should be reviewed and discussed circumstances that affect the annual private equity plan.

[Treasurer Murphy was no longer in attendance at 10:31 a.m.]

With regard to the board governance project, Mr. Kaminski asked to have the word "review" added on page 17 under how the Board would like to spend its time, at the end of the sentence in the first bullet point. He said it relates to the asset allocation discussion. Several members said they would like to see the asset allocation revisited annually.

Mr. Magnuson mentioned that, with regard to Board time spent on transaction approvals, he would like to see more independent recommendations from consultants, as their recommendations often times match staff's recommendation.

> **Vice Chair Gorton moved that the Administrative Committee forward the proposed 2007 Strategic Plan to the Board for consideration. Mr. Scott seconded and the above motion carried unanimously.**

[Mr. Nierenberg was no longer in attendance at 10:46 a.m.]
[The Board recessed at 10:46 a.m. and reconvened in open public session at 11:01 a.m.]

EXECUTIVE DIRECTOR EVALUATION PROCESS
Chair McElligott advised that the form under consideration for this year is the same used in last year's evaluation of the executive director. There were no requests for revisions.
Vice Chair Gorton asked to have a copy of the 2006 strategic plan goals and accomplishments and last year's evaluation of the executive director included when the form is distributed for Board member input. Chair McElligott asked to have completed evaluation forms returned directly to him and he would compile input for discussion at the January Administrative Committee and Board meetings.

LEGISLATIVE POLICY
Ms. Mendizabal presented a list of issues anticipated for the 2007 Legislative Session. She advised that she and Mr. Dear would meet with several legislators once the session begins, and the Board would be kept apprised of activities and any issues.

Ms. Mendizabal reported that one issue anticipated this session is the introduction of legislation with regard to divesting from companies doing business with Sudan. Staff recommends that the Board memorialize its fiduciary duty by opposing any proposal that mandates or restricts its investments and independent decision-making authority.

She reported that six states have passed laws with regard to divestment from Sudan. Washington and 19 other states are anticipating similar legislation in the coming session. Ms. Mendizabal said that, while the WSIB is deeply concerned with the atrocities and human rights violations occurring in Sudan, it believes that divestment would not influence change and would not be in the best interest of beneficiaries. Staff believes that positive change can be influenced in other ways.

> **Mr. Masten moved that the Administrative Committee recommend to the Board that the WSIB oppose any proposals that would impose mandates or restrictions on the Board's investment and independent decision-making authority. Vice Chair Gorton seconded the motion.**

Chair McElligott emphasized the sensitivity of the situation. If divestment legislation is passed, it could create a situation for investment loss. Ms. Mendizabal advised that staff have met with Representative Jim Moeller who is expected to introduce the legislation. She noted that several organizations publish lists of companies reportedly doing business with Sudan. There are concerns with the accuracy of these lists as not one is identical to another. Another concern is that companies can be taken on and off lists. Mr. Dear advised that staff would actively work with Legislators to clarify and communicate the WSIB's concerns if the Board takes a position on the issue. Staff's recommendation does not specifically target the Sudan issue but, instead, addresses any interference with the Board's statutory mission and fiduciary duty. The coalition behind the divestment legislation has identified 19 companies doing business with Sudan, which help to support their illegal activities. He said that these companies may be better persuaded by active influence of shareholders communicating their concerns. There are things the WSIB can do and is already doing as responsible owners. These activities include: (1) Contacting all outside managers requesting that they identify any company within the WSIB portfolio that is on any organization's list; (2) Corresponding with companies identified to communicate the WSIB's position on the Sudan issue; (3) Acting in concert with other public pension funds to influence change; and (4) Formally requesting that the federal government identify companies doing business with Sudan, so that the WSIB can direct its money managers to divest holdings. To date, there has been no exercise of federal resources.

Mr. Masten said it is important to not allow this or any future issue similar to this to move forward. The Board's actions must be based on what is in the best interest of beneficiaries. He would like to see Congress address the issue rather than allowing state legislation to impose the responsibility on the Board. He supports the motion to oppose any such legislation.

Vice Chair Gorton said he does not think members' monies should be invested in Sudan, but believes that legislation is not the proper way to address the issue. Chair McElligott said that the Board should use its abilities to work with companies and hold them responsible.
Ms. Mendizabal advised that a Senate Resolution issued last year acknowledges the Board's efforts on the Sudan issue. Chair McElligott asked staff to ensure that good information supports the Board's efforts.

The above motion passed unanimously.

OTHER ITEMS

There was no further business to come before the Committee. The meeting adjourned at 11:22 a.m.