

WASHINGTON STATE INVESTMENT BOARD
Administrative Committee Meeting Minutes
September 17-18, 2008

The Administrative Committee met in open session at 8:31 a.m. on September 17, 2008, in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: Glenn Gorton, Chair
Sandy Matheson, Vice Chair
George Masten
Mason Petit

Committee Members Absent: Patrick McElligott

Other Members Present: Charlie Kaminski
Mike Ragan

Also Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Chief Operating Officer
John Lynch, Contracts Manager
Kristi Haines, Executive Assistant

Steve Dietrich, Assistant Attorney General
Rick Beal, Watson Wyatt
Bill Smith, Watson Wyatt
Linda Steffen, Watson Wyatt
Chris Murphy, McLagan

[Names of other individuals attending the meeting are listed in the permanent record.]

Chair Gorton called the meeting to order.

[Mr. Kaminski was in attendance via teleconference on September 17.]

ADOPTION OF THE JUNE 19, 2008, MINUTES

Mr. Masten moved to adopt the June 19, 2008, Administrative Committee meeting minutes. Mr. Petit seconded, and the motion carried unanimously.

EXECUTIVE DIRECTOR REAPPOINTMENT

Mr. Petit moved that the Administrative Committee recommend that the Board appoint Mr. Dear to a new three-year term from November 12, 2008, until November 11, 2011, and forward its action to the State Finance Committee. Mr. Masten seconded, and the motion carried unanimously.

2009 MEETING SCHEDULE

Mr. Dear presented the Committee's proposed meeting schedule for 2009.

Mr. Masten moved that the Administrative Committee accept the proposed meeting schedule for 2009. Mr. Petit seconded, and the motion carried unanimously.

CODE OF CONDUCT POLICY 2.00.150 REVIEW

Mr. Dear said Board policy requires that each policy is reviewed within three years. Staff has no recommended changes.

Mr. Masten moved that the Administrative Committee recommend that the Board approve the Code of Conduct Policy 2.00.150 as is. Vice Chair Matheson seconded, and the motion carried unanimously.

ASSISTANT ATTORNEY GENERAL'S REPORT

Mr. Dietrich provided an update on the Enron litigation. On September 8, the federal district judge approved the plan of allocation for the \$7.2 billion settlement fund, as proposed by the Lead Plaintiff, the University of California Regents. Attorney fees of \$688 million were also approved, which represents 9.2 percent of the settlement fund. The claims administrator plans to begin processing claims by year end and, once that is complete, the amount to be allocated to each class participant can be determined. Mr. Dietrich did not have an update on the amount the WSIB can expect to receive. He said the attorney fees awarded were consistent with the agreement negotiated by the lead plaintiff and were reasonable under the circumstances. Fee awards measured as a percentage of the settlement can be significantly higher than the award in this case.

OTHER ITEMS

Mr. Dear reported on recent market events, responded to members' questions, and said a more comprehensive report would be provided at the September 18 Board meeting.

[The Committee briefly recessed at 9:30 a.m. and reconvened in open session at 9:51 a.m.]

INVESTMENT OFFICER COMPENSATION CONSULTANT FINALIST INTERVIEW – WATSON WYATT WORLDWIDE, INC.

Mr. Smith, Ms. Steffen, and Mr. Beal introduced themselves to the Committee and summarized their background and experience.

Mr. Smith highlighted Watson Wyatt's response to the Board's Compensation Consultant Request for Qualifications and Quotations (RFQQ). He said Watson Wyatt had done a number of studies for public pension funds over the past few years and has observed that the market for staff is increasingly more competitive due to a variety of pressures, most notably the opportunities for staff to go elsewhere, or into private sector.

He described the process Watson Wyatt would use to gain understanding of WSIB's philosophy, conduct a competitive market assessment, and examine current performance processes and best practices to prepare their preliminary and final reports. Mr. Smith described his firm's proposed fees for this engagement.

Mr. Smith concluded his presentation by stating that Watson Wyatt has the experience to do the work, is local, has worked with other states on compensation projects, has the necessary resources, and would be privileged to work with the Board.

In response to Mr. Masten's question about a maximum fee level, Mr. Smith said the total amount could be refined during discussions to nail down what data would be used.

Vice Chair Matheson stressed the Board's desire to develop a compensation plan that is flexible through market conditions, fits our culture, is forward-looking, and not necessarily based on comparisons. She pointed out that incentive programs need careful consideration, and asked Mr. Smith for examples of designs that did not work and why. Mr. Smith acknowledged that incentive programs can create problems, and one mistake is to focus on short-term results. The key is to align interests with stakeholders and beneficiaries. He said measures other than performance could be used such as milestones, instituting changes, or error rates. Mr. Petit stressed the importance of developing a program based on a long-term perspective.

Mr. Masten asked if consideration had been given to: the impact an incentive program could have on other staff; what motivates, attracts, and retains staff; location/environment compared to other places; salaries in relationship to beneficiaries; the economic environment; and, WSIB salaries as compared to other state agencies. Mr. Smith said questions would be asked in the initial project stages to gain an understanding of WSIB's environment.

Mr. Masten stated his concern that incentive pay would drive decision-making. Mr. Smith said they would strive to develop a balance between the work staff does and how they do it. He stressed that Watson Wyatt is not advocating incentive pay, but addressed it as it was included in the RFQQ.

Mr. Dear said the new legislation included expansion of the salary survey and authorized development of an incentive plan if the Board chooses to do so. It is important for the Board to drive any policy change. Mr. Masten pointed out the legislation does not require an incentive program, and he would be fine paying higher salaries. He shared his concern that compensation based on returns could result in increased risk to the portfolio.

Mr. Petit stressed the importance of having a plan that makes sense. Vice Chair Matheson said that incentive pay is a component of the legislation but need not be the focus. The key is to manage staff to achieve performance and consider if incentive pay is a tool to do that.

Ms. Whitmarsh reminded the Committee that performance compensation is in place for classified staff, who can receive up to 15 percent of their base salary.

Mr. Lynch relayed that McLagan would be interviewed next. He noted that both firm's fees were based on an understanding they would not undertake a new survey and neither includes implementation assistance.

[The Committee recessed at 10:51 a.m. on September 17, 2008.]

September 18, 2008

[The Committee reconvened in open session at 8:00 a.m. on September 18, 2008.]

[Mr. Ragan and Mr. Bruebaker were in attendance at 8:00 a.m.]

**INVESTMENT OFFICER COMPENSATION CONSULTANT FINALIST INTERVIEW
– MCLAGAN**

Mr. Murphy introduced himself and described McLagan's financial services focus. Their main line of business is compensation surveys, and consulting services including: benchmarking, incentive plan design, and advising. He reviewed McLagan's client base and types of studies performed.

[Mr. Kaminski arrived at 8:04 a.m.]

Mr. Murphy reviewed McLagan's experience, expertise in survey design, and its proprietary database. He said a customized peer group could be readily constructed that is similar to the WSIB's investment approach in complexity, internal management versus outsourcing, etc. He noted that 24 of the top 25 large pension funds participate in their survey, and McLagan has done consultant work for approximately half of those funds.

Mr. Murphy said a key part of the assignment would be to interview members and gain understanding of the objectives, outcomes, philosophy, and views on incentive pay such as ties to quantitative and/or qualitative measures, or total fund performance. An appropriate peer group would be established with consideration of the extent private sector comes into play. McLagan would determine comparative groups with an understanding of what each investment officer does in order to properly benchmark their position for an apples-to-apples comparison. They would then come back with competitive data, information on the marketplace for private and public entities, and make a recommendation based on that information, building in WSIB requirements. McLagan has done this assignments many times and expects to complete the work in an expeditious fashion.

Committee members posed similar questions to McLagan that were asked during the earlier consultant interview. Mr. Murphy said that a key element of McLagan's process would be the interview process, so that their product would be aligned with where the Board wants to be. They are sensitive to the issues surrounding incentive pay. Mr. Murphy commented on other pension funds that McLagan has done work for, and program differences.

Mr. Murphy described McLagan's fee proposal.

**INVESTMENT OFFICER COMPENSATION CONSULTANT – DISCUSSION AND
RECOMMENDATION**

The Committee discussed the two consultants' proposals. Mr. Kaminski noted McLagan's robust database. Mr. Lynch said both consultants' references were first class.

Vice Chair Matheson moved that the Administrative Committee recommend McLagan for approval by the Board to conduct a salary survey and undertake the subsequent design of an incentive compensation plan. Mr. Petit seconded, and the motion carried with Mr. Masten voting no.

OTHER ITEMS

There was no further business to come before the Committee and the meeting adjourned at 8:43 a.m.