

WASHINGTON STATE INVESTMENT BOARD
Administrative Committee Meeting Minutes
November 20, 2008

The Administrative Committee met in open session at 8:31 a.m. on November 20 in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

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

Other Members Present: John Magnuson

Also Present: Joe Dear, Executive Director
Theresa Whitmarsh, Chief Operating Officer
Kristi Haines, Executive Assistant

Steve Dietrich, Assistant Attorney General
Chris Murphy, McLagan Partners

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

Chair Gorton called the meeting to order.

ADOPTION OF THE SEPTEMBER 17-18, 2008, MINUTES

Mr. McElligott moved to adopt the September 17-18, 2008, Administrative Committee meeting minutes. Mr. Petit seconded, and the motion carried unanimously.

INVESTMENT OFFICER COMPENSATION PLAN DISCUSSION

Mr. Murphy introduced himself to the Committee. He provided a summary of WSIB's investment program and staff. A significant portion of the program is internally managed by staff, who are responsible for returns. He said McLagan's analysis of pay levels compared to other large pension organizations is that WSIB is not competitive because WSIB salary levels are significantly below the median. Overall, WSIB salary levels are 19 percent below the median for large pension funds. On a total pay basis (salary plus incentive opportunities), the WSIB is 44 percent below the median.

Mr. Murphy reviewed industry pay trends. He noted that the WSIB must compete with the private sector for talent. The market downturn will have significant impact on pay. Mr. Murphy said that McLagan has had recent discussions with their clients about what happened in 2008 and what will happen in 2009. He said bonus levels are down 25 percent across the board; they are down 35 percent for senior levels. Mr. Murphy discussed incentive compensation structures

within private and public sectors tied to relative and absolute performance. He said that staff is not necessarily responsible for absolute returns because the Board sets the allocation. But staff is responsible for generating excess value, and that needs to be looked at in order to be competitive. Mr. Murphy said the Board should consider the fee expense involved in outsourcing what is currently done internally by staff. He said the fund is saving money by managing in-house. A discussion ensued on whether current market conditions may cause adjustments in overall compensation structures.

Mr. Murphy said that McLagan's recommendations are based on the interview results with staff and Board members that focused on attracting and retaining top talent, diversification in the portfolio, and performance. The recommendations are: (1) adopt a comparator group that reflects similar public funds; (2) consider targeting salary and total compensation levels to the median of the comparator group; and, (3) in the longer term, consider targeting a total compensation level based on a comparative group comprised of both public and private funds, because the WSIB competes with the private sector for talent. The recommendation is for the blended group to be comprised of 75 percent public and 25 percent private funds. He said the trend within both sectors for incentive compensation is pay for performance. Mr. Murphy reviewed trends within public and private sectors for the different position levels.

Mr. Murphy said that during staff discussions, he found that staff likes public service, enjoys working at the WSIB as it is a well run organization, and feels they have control over the job they do. He noted that the recommendation to increase salaries is challenging given staff's feedback and WSIB's relatively low turnover rate. However, Mr. Murphy said considerations for the long-term are how to ensure you replace staff with comparable talent. The WSIB needs to be competitive and consider the cost benefit of internal management versus outsourcing.

Mr. Murphy said some of the Board felt that implementing an incentive program could change the culture. In considering that point, Mr. Murphy said that he does not believe incentive tied to performance will be a factor. He has never met an investor who is not driven to beat the benchmark.

In summary, McLagan's recommendation is to be more competitive with large public funds by implementing a 50 percent total compensation increase in phases by targeting total compensation to the median, introducing the incentive program, and then targeting a blended group to benchmark pay on the longer term, which represents an additional 15 percent increase.

Mr. Murphy said that incentive opportunities represent the majority of the 50 percent initial changes.

Mr. Dear said the compensation issue would be brought back in December for possible adoption. Vice Chair Matheson questioned the timing of implementing any changes. Mr. Dear said that numbers are needed for the budget, and adjustments could be made later. He said he feels it would be a mistake to start any incentive program given recent losses. Mr. Petit spoke in favor of adjusting salary levels but wants to set aside incentive pay. He asked about WSIB's turnover experience. Mr. Dear said there has not been turnover at the senior level, but we lost investment officers in both Private Equity and Fixed Income recently due to compensation. He stressed that compensation should be addressed before there is a retention issue. Mr. Petit added that he would like to see robust internal and college recruitment efforts. He said he supports the blended comparator group but questions the 75/25 percent mix. Vice Chair Matheson said she wants base pay to be competitive not just for retention purposes, but because it is the right thing to do.

Mr. Masten spoke in favor of raising base salaries, but is not convinced incentive pay is good. He cautioned about the political risk. He said the WSIB should exercise caution in moving forward with any base pay adjustment and believes incentive pay would be a terrible mistake.

[Mr. Magnuson arrived at 9:25 a.m.]

COLLABORATION INITIATIVE

Mr. Dear said staff has engaged in discussion with European, Australian, and Canadian funds regarding a collaboration effort and decided to continue participating on an ad hoc basis going forward. The matter was placed on the agenda as staff anticipated an expenditure would be involved. Ms. Whitmarsh said the group decided to organize itself differently, without the need to create an entity to manage the meetings. Rather, the involved funds would take turns hosting meetings and doing the staff work. In response to Mr. Masten's question, Ms. Whitmarsh said the relationship with the International Centre for Pension Management costs approximately \$25,000 annually. Vice Chair Matheson said it is extremely worth the cost.

2009 RECOMMENDED CONFERENCES

Chair Gorton referenced the listing within the Committee packet and asked if there were any proposed changes.

Vice Chair Matheson moved that the Administrative Committee recommend that the Board approve the 2009 Recommended Conferences listing.

Mr. Masten seconded, and the motion carried unanimously.

ASSISTANT ATTORNEY GENERAL'S REPORT

Chair Gorton asked Mr. Dietrich to provide his report at the Board meeting due to time constraints.

OTHER ITEMS

There was no further business to come before the Committee and the meeting adjourned at 9:32 a.m.