

WASHINGTON STATE INVESTMENT BOARD
Administrative Committee Meeting Minutes
January 19, 2012

The Administrative Committee met in open public session at the Washington State Investment Board (WSIB) boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Committee Members Present: Treasurer James McIntire, Chair
George Masten
Steve Hill (via teleconference)
Judi Owens
Mike Ragan (via teleconference)

Other Members Present: Bill Longbrake (via teleconference)
Richard Muhlebach (via teleconference)
Natasha Pranger (via teleconference)
Jeff Seely (via teleconference)

Others Present: Theresa Whitmarsh, Executive Director
Victor Moore, Chief Operating Officer (via teleconference)
Gary Bruebaker, Chief Investment Officer
Patty Davis, Administrative Assistant

Steve Dietrich, Assistant Attorney General
Doug Extine, Deputy State Treasurer
Wolfgang Opitz, Assistant State Treasurer

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

Chair McIntire called the meeting to order at 8:31 a.m. and took roll call.

ADOPTION OF THE NOVEMBER 17, 2011, MINUTES

Mr. Masten moved to approve the November 17, 2011, Administrative Committee meeting minutes. Mr. Ragan seconded, and the motion carried unanimously.

STRATEGIC PLAN THEMES

Strategic Plan Input

Ms. Whitmarsh presented the new process for developing the 2012 Strategic Plan. Ms. Whitmarsh described the themes that went into building the long-range plan, along with member input, for the final product. The final Strategic Plan will be presented in February to the Administrative Committee and the Board.

[Mr. Hill arrived at 8:33 a.m.]

Assumptions

Ms. Whitmarsh related that the WSIB's success in the past has been the result of being ahead of the market, a willingness to be different, (i.e., the Real Estate Operating Company strategy,) and the discipline to follow the WSIB's processes and investment beliefs. Going forward, success will be similar even though the

marketplace and the geopolitical environment are more complex and challenging. Round-the-clock media coverage also creates greater political and reputation risk challenges.

Essentials for Success

Ms. Whitmarsh suggested that future success is dependent on three things. First, in attracting the right people as skilled staff, choosing the right partners, consultants, service providers, and having a dedicated and competent Board. Second, having adequate resources to support qualified staff, research, technology, global travel, and professional services. Maintaining flexibility in appropriation and spending are also key. Although the complexity of the fiscal environment in the state will create a challenge to the proposed plan, management still feels the need to build out staff over the next couple of years. Last, maintaining a strong reputation that attracts skilled staff, allows the WSIB to be viewed as a preferred partner, and promotes members willingness to serve on the Board and support the need for adequate resources.

Key Themes for Long-Range Plan

Ms. Whitmarsh presented the proposed 2012 Strategic Plan which includes investment, organizational, and governance strategies. In addition, Ms. Whitmarsh identified proposed themes for each investment group.

Strategies

Ms. Whitmarsh explained the investment strategies have been built by the investment team from the bottom up. They have been presented to the Committees on an annual basis and adopted by the Board.

Ms. Whitmarsh noted the organizational strategies are driven by investment strategies and are handled by the middle and back office. These strategies were presented at the Board off-site in July and discussed in the Board's *ad hoc* Governance Committee.

Ms. Whitmarsh noted that to gain support for additional resources and flexibility from the WSIB's beneficiaries, legislators, and other key stakeholders, the WSIB will seek incremental changes to existing organizational models rather than pursuing wholesale change. This endeavor will include telling the WSIB story. The focus of change must be on the value to beneficiaries both in terms of cost and return.

Ms. Whitmarsh advised the governance strategies are actively being assessed by the Board's *ad hoc* Governance Committee. The *ad hoc* Committee wants to ensure the WSIB has a governance structure that is responsive to a more complex investment environment.

Ms. Whitmarsh related there are five key initiatives underway within the governance strategy. First is the telling of the WSIB story and why the state should invest in the WSIB. Second, maintaining Board independence, member continuity, and competence. Third is Board effectiveness and how and where the Board spends their time. Fourth is guiding and assessing investment strategy which involves detailed discussions with the Board. Fifth is assessing enterprise risk. This issue has been assigned to the Audit Committee for further work.

Themes

For the Private Equity theme, Ms. Whitmarsh indicated that the WSIB will continue moving toward the model portfolio with balanced partner selection and diversification by strategy, sector, and geography. The challenge becomes balancing the performance goal of the portfolio with the asset allocation target.

Ms. Whitmarsh observed that, for Real Estate, the focus is on necessity real estate in markets with solid demographics and positive economic, social, and political trends. The WSIB will continue the use of strong REOC intermediaries whose interests are fully aligned with the WSIB. The challenge continues to be in retaining staff who have built a unique strategy and finding quality REOC managers across the globe.

In the Public Equity section, Ms. Whitmarsh noted that staff have prioritized their strategies beginning with a continued focus on manager monitoring, further review and refinements to defined contribution plans, analyzing both a passive strategy and hedging of the public equity portfolio. Staff will also consider the use of hedge funds as a separate strategy. Staff will continue to review emerging markets and small and micro-cap strategies. The challenge is the limit of how much they can do with current staffing.

Ms. Whitmarsh explained that Mr. Kennett will present the Fixed Income strategy later in the Board meeting.

[Ms. Owens arrived at 8:50 a.m.]

Ms. Whitmarsh noted the basic approach the Board has taken in the past is solid and should work well for the WSIB in the future. The WSIB is operating in a more complex environment that creates a need for additional resources.

Mr. Hill complimented Ms. Whitmarsh on the plan. He feels it is concise and clear and moves the Board in the right direction. Chair McIntire inquired if a heat map could be developed to identify where the risk is for human capital within the organization. It is important for the WSIB to keep up with the complexity of their assets and the investment environment.

Resource Plan

Mr. Moore presented a proposed resource plan for the Strategic Plan. As the WSIB adds resources in the front office for investment strategies, the demands on the middle and back office increase as well. Executive management believes adding five back office staff over the next five years will provide the WSIB with adequate support in the areas of performance reporting, trade settlement, innovation technology, and administrative workloads. There will be an increased workload related to the conversion of the book of record to the custody bank. A recent study of the options for conversion presented the WSIB with an option of adding up to five staff internally to perform reconciliation of the accounting data. This would begin in the second year of the next biennium. Overall costs will reduce as more work is managed internally and external vendor contracts expire.

The individual asset classes suggest the following additional staff:

- Investments – 8 FTE in fiscal year (FY) 2013-2015, and 5 FTE in FY 2015-2017;
- Accounting Book of Record Conversion – 5 FTE in FY 2013-2015; and
- Align Organizational Capacity – 3 FTE in FY 2013-2015, and 2 FTE in FY 2015-2017.

The total resource plan estimate for the 2013-2015 biennium is 16 additional FTEs and seven FTEs for the 2015-2017 biennium. This adds up to slightly less than \$18 million in resources. The dollar amounts come from both appropriated and non-appropriated funds.

Mr. Hill expressed concern in balancing increased resource needs with applying efficiencies within the organization. Mr. Mackison advised members a number of productivity initiatives are underway, and the process improvements will continue throughout the organization. Mr. Hill requested those efforts be related in the telling of the WSIB story.

Mr. Moore explained the relationship between appropriated and non-appropriated funds. As more funds are internally managed, it decreases non-appropriated funds and only slightly increases appropriated funds. He suggested this relationship be used both in telling the WSIB story and when establishing strategy for

legislative budget requests. Showing the value of the shift between appropriated and non-appropriated funds when determining strategies can show it as a net gain for the funds. Members felt this was a reasonable approach to allow an increase staff.

Mr. Moore reviewed the budget timeline. The McLagan salary survey and proposed salary bands will be brought to the April 2012 Administrative Committee and Board meetings. The budget request will be brought to the June 2012 Administrative Committee and Board meetings. The approved budget request will then be submitted to the Governor's office in August 2012. Any request legislation will be brought to the September 2012 Administrative Committee and Board meetings. Chair McIntire commented that this proposal will be difficult in this tight budgetary climate. It will be necessary to work carefully with beneficiaries, stakeholders, and legislators. Mr. Hill expressed support for the effort and the continued work of the Governance Committee.

CASH MANAGEMENT TRANSFER / OFFICE OF THE STATE TREASURER

Chair McIntire introduced Mr. Opitz, Assistant State Treasurer and Mr. Extine, Deputy State Treasurer. Messrs. Opitz and Extine presented the proposed legislation that would transfer the responsibility of the 11 separate cash accounts from the WSIB to the Treasurer's Office. Messrs. Opitz and Moore assured members they had contacted key stakeholders and did not hear opposition to the legislation.

**Mr. Masten moved that the Administrative Committee recommend the Board support the proposed legislation regarding cash management transfer.
Mr. Hill seconded, and the motion carried unanimously.**

[Ms. Pranger arrived at 9:25 p.m.]

[Mr. Seely arrived at 9:27 p.m.]

[Mr. Muhlebach arrived at 9:28 p.m.]

There was no further business to come before the Committee and the meeting adjourned at 9:29 a.m.