

WASHINGTON STATE INVESTMENT BOARD

Board Meeting Minutes

May 15, 2003

The Washington State Investment Board met in open public session at 9:41 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: John Charles, Chair
Debbie Brookman
Jeffrey Hanna
Charlie Kaminski
John Magnuson
George Masten
Patrick McElligott
Mike Murphy
Bob Nakahara
Paul Trause

Absent: Glenn Gorton
Jeff Seely
Representative Helen Sommers

Also Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Sue Hedrick, Executive Assistant
Liz Mendizabal, Communications & Legislative Coordinator
Beth Vandehey, Internal Auditor
Tom Ruggels, Senior Investment Officer, Private Equity
Steve Draper, Senior Investment Officer, Real Estate
Nancy Calkins, Senior Investment Officer, Public Equity
Linda Lester, Investment Officer, Public Equity
Diana Will, Investment Officer, Asset Allocation
Tom Bosworth, Investment Officer, Fixed Income
Steve Verschoor, Investment Accounting Controller
Jim Lee, Systems and Office Services Manager
Erwin Vidallon, Finance Manager
Kristi Bromley, Administrative Assistant, Investments

Paul Silver, Assistant Attorney General

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

Chair Charles called the meeting to order and identified members in attendance.

ADOPTION OF MINUTES – APRIL 18, 2002

**Treasurer Murphy moved to adopt the Board minutes of April 18, 2002.
Mr. McElligott seconded.**

Treasurer Murphy pointed out one correction. He indicated that, on page seven of the minutes, there was a reference to a motion, and the minutes indicated that he seconded the motion. He said he was not certain who it was, but he did not second the motion. Mr. McElligott said he thought he had.

The motion to approve the minutes, as corrected, carried unanimously.

PUBLIC COMMENT

There was no comment.

QUARTERLY PERFORMANCE REPORTS

Commingled Trust Fund (CTF) - Staff

Mr. Bruebaker provided the CTF performance report for the quarter ended March 31, 2003. He said that absolute investment performance was not good, particularly for equities. Among the factors was the war with Iraq and other geopolitical concerns. Mr. Bruebaker suggested that, until there is greater clarity about the prospects for renewed economic growth and continued improved corporate profitability, equity returns are likely to be modest, if at all. The Wilshire 5000 started the year in negative territory earning -3.19 percent for the quarter. Since the bear market started a little over three years ago, eight of the 12 quarters have been negative, and, during the three-year period, the return on an annualized basis has been a negative 16.3 percent. During the most recent quarter, the Federal Reserve continued to hold the Fed funds rate at 1.25 percent; it was 6 percent three years ago.

The CTF has declined \$11.2 billion during this bear market, but \$3.4 billion of that was transfers to participants or other accounts. At quarter end, the CTF is at \$35.7 billion, down \$552.5 million. This month's decline is made up of \$356 million of net payout and \$196.5 of investment losses. As of March 31st, all of the asset classes are within target allocation. The total fund lost 1.46 percent for the quarter. On a relative return basis, the WSIB has outperformed the TUCS Universe of Public Funds greater than \$1 billion in every single time period. For the first time, the ten-year return has dropped below the 8 percent actuarial rates to 7.79 percent. U.S. Equities are at \$11 billion, down \$370 million from the previous quarter. Mr. Bruebaker said we have negative

tracking error for the quarter, the fiscal year to-date as well as the one-year; we continue to have positive tracking for the three-, five- and ten-year periods.

\$4.6 billion is invested in Non-U.S. Equities, down \$386 million. The first nine of the 10 largest exposures by country remain the same, but Italy has replaced Korea for the tenth spot. For performance relative to the MSCI ACWI, we have underperformed for the quarter by 40 basis points. We've underperformed for the fiscal year to-date as well as the one-year and the ten-year, but outperformed for the three-year and the five-year periods.

Fixed Income is at \$10.2 billion, down \$378 million because we have liquidated \$600 million mostly to pay benefits along with some to transfers to other asset classes. We've outperformed the Lehman Universal as well as the Lehman Aggregate, for the quarter, the fiscal year to-date, and the one-, three-, five- and ten-year periods.

Mr. Bruebaker said that Private Equity is at \$5.1 billion. He indicated that Pacific Corporate Group would discuss performance for our Private Equity Program later in the meeting. Real Estate is at \$3.8 billion. We continue to have good performance in the one-, three- and five-year periods.

For the non-U.S. active managers, Nicholas-Applegate, Delaware and SSgA outperformed the benchmark for the quarter. For the one-year, three out of seven outperformed the benchmark; for the three-year, four out of seven outperformed the benchmark; and since inception, five out of seven outperformed the benchmark.

Mr. Hanna asked when the liquidity study is going to begin. Mr. Bruebaker said it will begin next month. Once we receive the updated study, we will also run the new projections for Private Equity.

Defined Contribution Plans

It was not a good quarter for performance of the defined contribution plans. Only the money market fund and the bond market fund were positive. Five out of 10 managers outperformed the benchmark. Only three of the 10 have outperformed for the long term. In the Deferred Compensation and Judicial Retirement Account, only the Independence Fund and the U.S. Stock Market Index outperformed the respective benchmarks for the year ended March 31, 2003.

Mr. McElligott asked if we have made the transfer from one socially responsible account to the new one. Mr. Bruebaker responded that we have a signed contract and the transfer date is July 1st.

Labor & Industries' (L&I) Funds

The Labor and Industries' (L&I) funds' total almost \$8.9 billion, up \$19.7 million from the previous quarter. We continue to have excellent long-term performance for all of the funds except the Supplemental Pension Fund. For the five-year period, we outperformed the CMI for the Accident Fund, the Medical Aid Fund, and the Pension Reserve Fund. For this quarter, we underperformed the CMI in each of the funds we manage.

Mr. Kaminski referred to the numbers on page two of the L&I funds 608 and 609, equity being 12 percent in one and 22 percent in the other. He asked if either of those numbers suggest a rebalancing is in order. Mr. Bruebaker stated that we are on the lower end of the range, but said that we are still within the policy range for equities of 12 to 18 percent.

Treasurer Murphy commented on Mr. Bruebaker's reference to the Supplemental Pension Fund and the fact that cash can be as high as 50 percent. He asked what the 16 percent represents. Mr. Bruebaker responded that the 16 percent is a single point in time, March 31st. Mr. Murphy then asked if we define what the CMI is. Mr. Bruebaker responded that we work jointly with the Department of Labor and Industries (L&I) and our consultant to define what the CMI is. Treasurer Murphy suggested that perhaps we need to redefine it so that it better reflects the cash flow. Mr. Bruebaker agreed and stated that staff would work with L&I staff and our consultant on this project.

Permanent and Other Trust Funds

The total for all of the Permanent Funds is \$718 million, up \$5.9 million. All of the funds are within their policy ranges for the asset allocation. We continue to have solid performance. On the ten-year, we have outperformed for all funds, and we've outperformed for the quarter and the one-year for all of the funds except Millersylvania, which is a \$5,000 account.

For the Other Trust Funds, we continue to have excellent long-term performance. For the five- and ten-year period, we continue to outperform the benchmark for every fund.

The Guaranteed Education Tuition (GET) portfolio is at \$201 million, up \$36.6 million. We are within the policy ranges for asset allocation for the GET portfolio. For the total return, we are performing well against the passive benchmark, but underperforming against the other benchmarks, the Absolute Return, which is a 7.5 percent return, and the CPI (or inflation) + 4.5 percent. For the DDEF, state and private funds, we continue to have excellent performance on the state funds that we manage, which are at \$122,000, up \$75,000 from the previous quarter. The private funds are managed by BGI and they are within a balanced fund.

Private Equity - Pacific Corporate Group Report

Chair Charles introduced Alison Bonaci and Eric Becker from Pacific Corporate Group (PCG). Ms. Bonaci distributed a handout which reviewed the year 2002.

PCG reported first quarter performance results for the private equity portfolio, which, as of March 31, 2003, had a total market value of \$5.3 billion with a 13.1 percent return since inception. The total valuation of the KKR portfolio as of March 31, 2003, was \$1.4 billion with returns since inception of 16.6 percent, and the Limited Partner Portfolio (all other private equity investments) was valued at \$3.9 billion with returns since inception of 6.8 percent based on an Internal Rate of Return (IRR) calculation which is the methodology recommended by the Association for Investment Management Research (AIMR).

Mr. Hanna referenced a table on page four of the PCG report, and a similar table on page thirteen in the CTF report. Comparing the numbers, the CTF report shows the KKR portfolio underperforming. Mr. Hanna asked how we reconcile the numbers in PCG's report versus the WSIB staff's report, and whose numbers are better for determining how well the CTF did.

A lengthy discussion ensued with regard to time-weighted numbers versus dollar-weighted numbers. The WSIB report uses time-weighted numbers by geometrically linking PCG's quarterly IRR returns; PCG's report uses IRRs which are dollar-weighted. Chair Charles asked that staff and PCG work together to come up with some information to present to the Board on this issue. Mr. Masten said he would also like to see how staff calculates the Total Allocation Portfolio (TAP). Chair Charles suggested there be a more comprehensive presentation at a future meeting.

Mr. Kaminski asked two questions. The first was whether the investment date for each of the partnerships on page seven of the PCG report was when the commitment was made or when the investment was made. Mr. Becker responded that he believed it was when the commitment was approved, but he would check on that and respond back. The second question concerned a Puget Sound Business Journal article on one of our general partners, OVP, forgoing management fees for the near future. Mr. Kaminski asked if PCG had seen any other instances of this happening either in our portfolio or in others' portfolios. Mr. Becker responded yes.

[A recess was taken at 10:54 a.m. and the open session reconvened at 11:07 a.m.]

ADMINISTRATIVE COMMITTEE REPORT

Approval to extend Cost Effectiveness Measurement, Inc. contract for one year (July 1, 2003 through June 30, 2004)

Chair Charles reported that the Administrative Committee heard a report from staff on the contract with Cost Effectiveness Measurement Inc. (CEM).

Chair Charles said the Administrative Committee recommends to the Board the one-year extension of the contract with CEM. Treasurer Murphy moved the motion. Mr. Trause seconded.

The motion carried unanimously.

Board Member Correspondence Procedures

Chair Charles reported that the Administrative Committee heard a presentation from staff on a draft Board member correspondence procedure. The Committee concluded that it should be shared in memo form with new members when they come on the Board rather than be a formal policy. It was also agreed that members should have some flexibility in deciding what should be sent to the executive director. No action was taken.

The Committee asked the executive director to report on the agency's policy for setting salaries of administrative staff. Chair Charles handed out two memos written by the Board's fiduciary counsel, Bill Song, relative to non-voting members' roles, and an attendance matrix.

PUBLIC MARKETS COMMITTEE REPORT

International Developed Markets Investment Management Contract Extensions

Mr. Kaminski reported that the Public Markets Committee met on May 6, 2003, and reviewed the emerging market exposure strategies. It was another of a series of educational sessions.

Mr. Kaminski said the Committee did not have a quorum to take action, but the consensus was that the Board authorize the executive director to extend the contracts with Artisan Partners, Delaware International Advisers, Dresdner RCM Global Investors, Nicholas-Applegate Capital Management, Putnam Investments, and Pyrford International for the final one-year extension through June 30, 2004, as provided in the existing terms of the contracts, with the appropriate increases to the fee ceilings.

Mr. McElligott moved the motion; Ms. Brookman seconded.

The motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

There was nothing to report.

EXECUTIVE STAFF'S REPORT

Executive Director's Report

Mr. Dear introduced Liz Mendizabal, the new Communications and Legislative Coordinator, and Erwin Vidallon, the new Business Services Manager. He reported that the WSIB budget surplus would be \$215,000, which is lower than the previously expected amount of \$350,000 due to higher-than-expected legal fees for the Attorney General's Office and the Board's fiduciary counsel. The cost of the administrative review was also not budgeted. Mr. Dear reported that he met with Senator Dino Rossi on the WSIB budget appropriation, but did not receive a commitment that the Senate would agree to the House's level, which is \$900,000 higher than the Senate's level. Engrossed Substitute Senate Bill 5192 did not pass the House before the cutoff, and it is unlikely it will be considered in the special session.

Monthly Investment Reports – Gary Bruebaker

Mr. Bruebaker gave the monthly investment report. The Commingled Retirement Trust Fund return for the month to-date was four percent. Last month, it was .4 percent. Assets Under Management were at \$49.8 billion, up \$1.6 billion from last month. The CTF is at \$37.1 billion, up \$1.3 billion

from last month. The combined range for Real Estate and Fixed Income together is 31 and 43 percent, and we're at 37.6 percent as of April 30, 2003.

The Wilshire 5000 through May 13th is up 11.6 percent. Every single capital market return is positive. The last time they were all positive was January 2001.

NOMINATION OF VICE CHAIR

Mr. Trause nominated George Masten for the position. Chair Charles called for a vote, which was not unanimous. Since there is a requirement of six votes for passage, Chair Charles said this item will be moved to the June meeting.

Chair Charles announced the Board would go into executive session for the Assistant Attorney General's report. He indicated that first Treasurer Murphy would like to make a comment concerning public disclosure.

Mr. Murphy stated that he believes the Board members should be fully knowledgeable about what their responsibilities are with regard to public information. He said that the Board is approached by a variety of firms, in a public session, to buy into their investment thesis, fee schedule and how they are proposing to invest WSIB funds. Subsequent to that, WSIB staff and attorneys and the firms' attorneys work together to develop a contract. Mr. Murphy said that if someone were to approach him as Treasurer and ask to look at any of his contracts, he would release them because those are public documents.

He suggested that Board members have a responsibility to their constituencies to make available contracts that relate to the Board's business. He acknowledged there may be information in those contracts that ought to be subject to redaction, such as the other investors in a particular fund since they may be private corporations or individuals whose private business is no one else's. Given that, however, the remainder of the information in the contracts should be considered public record.

He said that, when the WSIB receives a request from a firm, union, or individual to provide information as to how the Board conducts its business, he doesn't want to see a headline reporting that the State Investment Board refuses to release information. As a matter of public policy, the Board has a requirement under Chapter 42.17 RCW to narrowly construe exemptions and to broadly construe the disclosure of documents. This government has taken a stance on this for many years, and those people who wish to do business with the Board ought to understand that.

ASSISTANT ATTORNEY GENERAL'S REPORT - EXECUTIVE SESSION

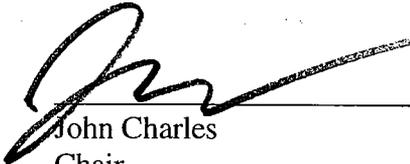
Chair Charles called the Board into executive session. He said the purpose is to discuss with legal counsel representing the Board matters concerning litigation and potential litigation which the Board may become or is likely to become a party. Chair Charles said the executive session is estimated to last at least 15 minutes. After the executive session, if there is a need for action by the Board, the Board will reconvene in open session to take up any such action.

[The open session concluded at 11:32 a.m. and the executive session convened at 11:37 a.m. The executive session concluded at 12:25 p.m. and the open public session reconvened immediately thereafter.]

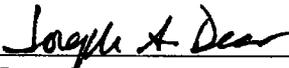
Mr. Masten moved that the Board authorize the Attorney General to take legal action deemed necessary as discussed in executive session on May 15, 2003. Mr. McElligott seconded and requested a roll call vote. Ms. Brookman voted aye, Chair Charles voted aye, Mr. Masten voted aye, Mr. McElligott voted aye, Treasurer Murphy voted aye, Mr. Trause voted aye.

The motion carried unanimously.

There being no further business to come before the Board, the meeting adjourned at 12:27 p.m.


John Charles
Chair

ATTEST


Joseph A. Dear
Executive Director