WASHINGTON STATE INVESTMENT BOARD

Board Meeting Minutes
January 15, 2004

The Washington State Investment Board met in open public session at 9:31 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	George Masten, Chair Debbie Brookman John Charles Glenn Gorton Jeff Hanna Charlie Kaminski John Magnuson Patrick McElligott, Vice-Chair Mike Murphy Dave Scott Representative Helen Sommers Paul Trause Senator Joseph Zarelli
Absent:	Bob Nakahara Jeff Seely
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Sue Hedrick, Executive Assistant 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.]

Mr. Masten called the meeting to order at 9:41 a.m. and identified the members in attendance.

ADOPTION OF MINUTES – December 18, 2003

> **Mr. McElligott moved to adopt the Board minutes of December 18, 2003. Mr. Charles seconded. The motion carried unanimously.**

PUBLIC COMMENT

Geralyn Lutty, regional director and vice president of the UFCW Northwest region, said she was here representing 5,000 members of the Washington Public Employees Association who count on the board to secure their retirement, and as a representative of 120,000 Safeway workers in California, Washington and across the country. Ms. Lutty said that, in southern California, three major retail chains, led by Safeway, are proposing to eliminate affordable health care for 70,000 employees. This proposal has caused Safeway workers to go on strike. Albertsons and Kroger Co.

have locked out their employees. Ms. Lutty said they are entering the fourth month of this dispute, which has caused a serious hardship on workers, the community, consumers and investors. The WSIB is a significant shareholder in Safeway through its index fund holdings; the WSIB is also a key client of KKR which holds four of the nine seats on the Safeway board.

[Senator Zarelli arrived at 9:34 a.m.] [Rep. Sommers arrived at 9:37 a.m.]

Michael Garland, corporate transactions coordinator of the AFL-CIO Office of Investment, spoke on investors' mounting concerns about Safeway. He distributed a packet of information about Safeway including Wall Street reports, communications from institutional shareholders to the company expressing concerns with the board and other issues. Mr. Garland said that most of his comments were detailed in a paper entitled, "Safeway's Confrontational Labor Strategy, Consequences for Shareholders and the Role for KKR." Mr. Garland summarized some of the key points from his paper. He urged the Board to communicate these concerns to KKR and urge them to play a constructive role in redirecting Safeway's labor strategy and ensuring that they focus on Safeway's long-term problems.

Mark Baca, a state employee at the Department of Revenue, urged the Board to make sound and wise investments regarding the testimony it heard today. Kerri Baker, a 28-year employee of Safeway in Centralia, said she is concerned that she might also lose her health care benefits if the same situation occurs in Washington State.

ADMINISTRATIVE COMMITTEE REPORT – DRAFT PUBLIC DISCLOSURE POLICY
Mr. Masten said the Administrative Committee meeting took place earlier this morning, and the committee is recommending to the Board adoption of Policy 2.00.250.

Mr. Masten moved the committee's recommendation. Mr. Charles seconded.

Treasurer Murphy discussed his concerns with the trade secret exemption in the policy. He said he has a difficulty with identifying in the policy exemptions that are not included in RCW 42.17, the public disclosure act. He said the Board does not have, own or control any trade secrets that he is aware of, and it's never been brought to the Board's attention any specific information that is in the records that would be specifically identified as trade secrets. So, for the Board to include that in the policy would be to give difficult direction to staff. He said the policy should be clear, unambiguous and direct so that staff can apply it without needing answers to questions years down the road. He recommended the trade secret exemption be removed.

[Mr. Trause arrived at 9:50 a.m.]

Mr. Dear said that staff recommends the policy be explicit in its potential exemptions so that those making requests will know on what basis the WSIB is deciding whether or not to release information. He said that a state Supreme Court case involving the University of Washington did determine the trade secrets law does apply in the consideration of whether or not a document is public, and in that instance, the trade secret act outweighed the public disclosure law, and the information requested was not disclosed.

The motion carried with Treasurer Murphy voting no.

PUBLIC MARKETS COMMITTEE REPORT
International Active Core Investment Manager Selection

Mr. Gorton reported on the January 13 Public Markets Committee meeting. In July 2003, the Board approved changes to the structure of the Commingled Trust Fund's international equity program. At the November 2003 Board meeting, the Board directed staff to prioritize the international equity manager search for the core mandate. At the Public Markets Committee meeting, the Committee interviewed five firms as potential managers for the WSIB's active international developed markets core equity mandate. The firms interviewed were:

Arrowstreet Capital, L.P.
Bank of Ireland Asset Management
Capital Guardian Trust Company
Fidelity Management Trust Company
Philadelphia International Advisors, L.P.

After the interviews, staff and Callan Associates independently indicated their preferences for the top three firms and then ranked the fourth and fifth firms. The Committee then had an in-depth discussion of the pros and cons of each of the firms as well as discussions about various combinations. The Committee, by consensus, selected the following firms for the WSIB active core international equity developed markets mandate, subject to continuing due diligence and successful negotiation of acceptable terms and conditions:

Arrowstreet Capital, L.P.
Capital Guardian Trust Company
Fidelity Management Trust Company

In the event that staff is not able to complete contracts with these firms, the fourth and fifth ranked firms are Philadelphia International Advisors and Bank of Ireland, respectively. Mr. Gorton said that site visits will begin soon and transition strategies will be developed with one of the WSIB's transition managers.

Mr. Gorton moved that the Board approve the Public Markets Committee's consensus recommendation of the apparently successful offerors for the WSIB active core international equity developed markets mandate, subject to continuing due diligence and successful negotiation of acceptable terms and conditions. The three firms include Arrowstreet Capital, L.P., Capital Guardian Trust Company and Fidelity Management Trust Company. Mr. Trause seconded. The motion carried unanimously.

AUDIT COMMITTEE DISCUSSION ON ROLE OF NONVOTING BOARD MEMBERS

Mr. Charles said that, as a follow-up to the discussion at the last Board meeting, the Audit Committee is requesting input from board members and staff on areas that would be beneficial to the board in terms of advice, recommendations, and experience of nonvoting members. At the committee's request, Mr. Dear wrote a memo on nonvoting board members' roles and skills. Mr. Charles said the purpose of today's discussion is to create a process and a clear methodology for

identifying and selecting nonvoting board members. He said this is an opportunity for the board to re-review its process for appointing nonvoting members, not necessarily to make any changes to the membership.

Mr. Dear referenced a list of areas of expertise that voting members can review in assessing candidates for nonvoting membership. He said there is only one statutory criteria that the voting members have to satisfy, that nonvoting members be "considered experienced and qualified in the field of investments."

Treasurer Murphy said that, when he served as chair of the Audit Committee, his role was to bring in candidates from available lists that the Board and staff had developed over the years. The Board had specifically identified individuals who came on the Board when he was chair. Mr. Hanna brought his vast experience in international equity, Mr. Magnuson was chosen for his significant experience in real estate, and Mr. Seely was selected because of his knowledge and involvement in venture capital and private equity. Mr. Murphy said that Mr. Nakahara and Mr. Kaminski were appointed prior to his terms as chair. He feels that the nonvoting members have served the Board very well.

Mr. Kaminski listed possible adds to the criteria for selecting nonvoting members:

- Experience in asset/liability management, the Labor & Industries funds in particular
- Academic experience in economics and accounting could be put in the general consulting category
- Institutional history of members

Mr. Scott said he feels it is important for voting members to have a greater understanding of what dynamics exist that make up the set of skills the Board needs for its nonvoting members. He said the Board probably has the right people in those positions, but he would like a greater base of knowledge by which to ascertain that in the future.

Mr. Magnuson said he would like to receive more information regarding fiduciary responsibility, perhaps at the July retreat. Mr. Masten suggested that, if board members have additional feedback, they should send it to Mr. Charles prior to the next Audit Committee meeting in February.

ECONOMICALLY TARGETED INVESTMENTS

Annual Report

Mr. Dear gave an overview of the Economically Targeted Investments (ETI) policy and introduced Janet Kruzel, an investment officer in the WSIB's private equity group, who presented the first annual report on the ETI program. The Board adopted the ETI policy in March 2003 and Ms. Kruzel joined the staff in August to focus on it. The policy reiterates the Board's commitment to a single standard for making investment decisions, and requires the WSIB to ask its private equity general partners (GPs) to report annually on Washington-based investments evaluated during the prior year.

Fifty-one of 67 general partners responded to a request for information on their investment activity in Washington State in 2003. The responses show that Washington has earned the interest and access of top-quality GPs, the state is rich with investment opportunities, there is no problem attracting GPs to the region, and not all of the deals that are considered are done.

Mr. Hanna said he found the numbers hard to interpret in order to determine if the Board is or is not doing a good job. He asked if it would be easier to interpret whether the Board is doing well or badly if there was some sort of weight versus benchmark number. Ms. Kruzel agreed with Mr. Hanna's comments and said improved measurements will be added this year.

Mr. Kaminski said that, of the $1.3 billion in value in our portfolio in Washington, 50 percent of that is in passive public equity, 24 percent is in fixed income. Real estate is very much dominated by buildings that are occupied and is overweight. Private equity, however, is 4.5 percent of our portfolio as opposed to the benchmark, which is 17 percent. That gives the message that there's a lot more that can be done.

Ms. Kruzel introduced Dr. Lee Cheatham, executive director of the Washington Technology Center (WTC), who presented a report on the WTC's activities.

Washington Technology Center Presentation

Dr. Cheatham explained the purpose of the WTC. The center was established by the legislature in 1983 with a mission to "be a nationally pre-eminent organization that focuses state, federal and private resources on the development and commercialization of new products and technologies as a vital part of Washington's economic growth."

The center has three main businesses: microfabrication laboratory facilities, new industry initiatives and regional and technical services. He listed the WTC's accomplishments, and said that, for every dollar of state investment, the center has levered it nearly 11 times.

Dr. Cheatham said the goals of the WSIB/WTC memorandum of understanding (MOU) are to help the WSIB implement the ETI policy, provide greater access for GPs to Washington opportunities, and improve company readiness for WSIB/GP investment. The WTC has agreed, through the MOU, to create a submission website, participate in educational event programs, and connect via the WTC Angel Network with existing organizations.

[The board took a break at 11:07 a.m. and reconvened at 11:21 a.m.] [Rep. Sommers left at 11:10 a.m.]

EXECUTIVE STAFF'S REPORT

Executive Director's Report

Mr. Dear presented his report for January. He noted that House Bill 2346, concerning economically targeted investments, has been introduced. Mr. Dear distributed the bill and described in some detail what it would do. Mr. Magnuson commented that he was skeptical that any legislation would improve upon the progress that has already been made in terms of ETIs in Washington State. The bill is scheduled for a hearing on January 23 in the House. Mr. Dear said he will testify on it.

Mr. Scott asked whether a plan has been formulated in response to the public comment received on the Safeway strike in southern California. Mr. Dear responded that he has had several conversations with representatives of KKR and with partners directly to relay to them the Board's concern about the management proposal and its desire to see the parties reach an acceptable agreement at the bargaining table. Although the Board does not have a direct economic interest in Safeway through KKR, he noted the Board's long-term relationship with KKR in voicing its concern. He said he expects there will be further conversations with them going forward. Mr. Scott asked that Mr. Dear provide a reminder of who is on the board and who they represent. Mr. Dear said he would be happy to do that.

Treasurer Murphy added his comments to those of Mr. Scott and encouraged the director to be strong with the Board's partners. He suggested the focus of Mr. Dear's comments should reiterate that, the monies we have invested and continue to invest with KKR are union dollars. So, it would be contrary to the Board's expectations if they are attempting to cause unions not to be properly negotiated with.

MONTHLY INVESTMENT REPORTS

Mr. Bruebaker presented the monthly asset allocation report as of December 31, 2003. The fourth quarter, the Wilshire 5000 was up 12.4 percent, and up 31.6 percent for the year. The Wilshire 5000 outperformed the Russell 3000 for the year, while the Russell 3000 outperformed the Wilshire 5000 for the month. Value outperformed growth for both the month and the year for this period. Small cap continues to dominate for the year by a substantial amount, although large cap did outperform for the month of December 2003.

International equity markets performance was outstanding. For the one-month and one-year in international equities, value continues to outperform, and the dollar is continuing to weaken.

Assets under management were at almost $55.9 billion, up $1.3 billion for the month. The Commingled Trust Fund (CTF) performance for U.S. equity was at 4.5 percent for the month, outperforming the index by two basis points for the month, and outperforming by 18 basis points for the year.

The international equity had a 7.5 percent return, although we have underperformed the index by eight basis points for the month and we've underperformed by 220 basis points for the year. Mr. Bruebaker said this is one of the things we intend to correct with the new international structure the Board is implementing.

The fixed income portfolio earned 1 percent for the month, underperforming the Lehman Universal by 13 basis points, and the Lehman Aggregate by 1 basis point, fiscal year to-date. The CTF has outperformed the Universal by 12 basis points. During this period, the CTF was slightly hurt by its shorter duration and TIPS exposure, which were not favorable during this month.

December was the fourteenth straight month where the aggregate credits outperformed like-duration treasuries. The CTF governments outperformed the index governments by 7 basis points; however, the credits underperformed by 20 basis points and securitized underperformed by 1 basis point.

Looking at the total year for fixed income for 2003, the CTF outperformed the Universal and the Aggregate by 112 and 284 basis points, respectively.

The return for private equity was 1.2 percent for the month. Draws were $147 million, $66 million for KKR and $81 million for the rest of the portfolio, compared to a monthly average for the year of $71 million. Draws for the year were $860 million. This is the lowest draw amount we've had since 1998, which had $700 million. Distributions for the month were $266 million, compared to a monthly average of $86 million. Distributions for the year as a whole were $1.04 billion, the second highest on record.

First Reserve, a $200 million investment approved by the Board, was closed this month.

Real estate was at 0.7 percent for the month. Corporate Properties of America made a number of acquisitions, while Olympia Properties sold a building in Chicago for $18.7 million, a gain of about $800,000.

The CTF is at $42 billion, up $1.2 billion from the previous month, and we are within all policy ranges adopted by the Board for every asset class.

ASSISTANT ATTORNEY GENERAL'S REPORT
There was no report.

ADMINISTRATIVE COMMITTEE REPORT – EXECUTIVE DIRECTOR'S EVALUATION

Mr. Masten called the Board into executive session at 11:43 a.m. He said the purpose is to review and discuss the performance of the Washington State Investment Board's Executive Director. He estimated that the executive session would last until approximately 12:00 pm, and after completion of the executive session, the Board would resume its open public session to adjourn.

[The executive session concluded at 12:09 p.m. and the open session reconvened immediately thereafter].

There being no further business to come before the Board, the meeting adjourned at 12:10 p.m.

George Masten
George Masten
Chair

ATTEST

Joseph A. Dear
Joseph A. Dear
Executive Director