WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
April 21, 2005

The Washington State Investment Board met in open public session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	George Masten, Chair Patrick McElligott, Vice Chair Debbie Brookman Glenn Gorton (via teleconference) Jeff Hanna Charlie Kaminski John Magnuson Sandra J. Matheson Treasurer Mike Murphy Bob Nakahara Judy Schurke Dave Scott Jeff Seely
Absent:	Senator Lisa Brown Representative Helen Sommers
Also Present:	Joe Dear, Executive Director Theresa Whitmarsh, Deputy Director for Operations Diana Will, Senior Investment Officer-Asset Allocation Steve Draper, Senior Investment Officer-Real Estate Tom Ruggels, Senior Investment Officer-Private Equity Kristi Walters, Executive Assistant Paul Silver, Assistant Attorney General Matt Smith, State Actuary Marty McCaulay, Office of the State Actuary

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

Chair Masten called the meeting to order and roll call was taken.

OATH OF OFFICE FOR NEW MEMBERS

Chair Masten administered oaths of office to Judy Schurke, Acting Labor and Industries (L&I) Director, and Sandra J. Matheson, Department of Retirement Systems (DRS) Director.

COMMITTEE ASSIGNMENTS

Chair Masten moved to appoint Ms. Matheson to the Audit and Private Markets Committees in accordance with the Board Charter Policy 1.00.110. Treasurer Murphy seconded and the motion carried unanimously.

Chair Masten moved that the Board appoint Treasurer Murphy as the Audit Committee Chair in accordance with Board Charter policy 1.00.160. Vice Chair McElligott seconded and the motion carried unanimously.

ADOPTION OF MINUTES – FEBRUARY 17, 2005

Treasurer Murphy moved to adopt the February 17, 2005, Board minutes. Ms. Brookman seconded and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

CAPITAL MARKET ASSUMPTIONS

Ms. Will discussed staff's recommendations for 2005 capital market assumptions. She noted that the capital market assumptions are brought to the Board each April and are used for asset allocation studies performed during the year. Ms. Will said that an asset allocation study on the retirement systems would be discussed at the July Board retreat. Studies will also be conducted this year on the Guaranteed Education Tuition (GET) Fund and Horizon Funds. Ms. Will said that there are minor changes from last year's assumptions. The white paper in the Board packet describes how the recommended numbers were developed.

Mr. Hanna commented that the return numbers for the asset classes seem on the high end compared to the criteria described in the white paper, particularly the assumption for domestic equities. He noted that about two-thirds of the assets in the CTF are affected by this one assumption. He also noted the different models provided in staff's report. He said that the recommended assumptions seem to be more tactical than strategic.

Ms. Will said that balance is the key. The Board had been more toward the aggressive side in the past so, from the range of numbers, staff's recommendations are at the top of the range.

Ms. Will noted a correction on Page 6 of the white paper, under Real Estate. Staff's recommendation for real estate is 7.75 percent.

Mr. Kaminski asked if the numbers were run unconstrained. Ms. Will said that they were and those results were shared with Chief Investment Officer Gary Bruebaker, but are not included in the Board packet. Mr. Kaminski requested to have those results shared with the Board.

Ms. Will reported that Pension Consulting Alliance (PCA) was hired to consult on the WSIB's asset allocation study. PCA will conduct a survey with Board members to obtain their views on the

critical assumptions that make up a strategic asset allocation study. PCA will bring an interactive model to the Board retreat that demonstrates how variables affect the portfolio.

Vice Chair McElligott moved that the Board adopt the 2005 WSIB capital market return, risk, and correlation assumptions as stated in the Board packet materials. Ms. Brookman seconded the motion.

Mr. Nakahara complimented Ms. Will on the white paper. He asked if anything had been learned from what the WSIB had done over the past ten years. Specifically, if past asset allocation were too aggressive or conservative. Ms. Will said that she felt past allocations were aggressive. This is the first year she is not recommending a drop.

A discussion ensued regarding the impact of lower returns. Mr. Dear indicated that today's agenda includes an education session by Matt Smith, State Actuary, which will surface these issues. He said that the Board's approval of capital market assumptions is needed today, but there will be opportunities to see the impact of different assumptions before the ultimate asset allocation decision is made this July or September.

The above motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT

Board Education Policy 2.00.200 Revision

Chair Masten noted that the proposed policy change is to have education sessions organized by staff considered official meetings for which eligible members will be compensated. He said that up until now such seminars required the Chair's approval.

Chair Masten moved that the Board accept the Administrative Committee's recommendation to approve the revised Board Education Policy 2.00.200. Vice Chair McElligott seconded the motion.

Treasurer Murphy asked which members were affected by the policy. Chair Masten clarified that it is for those members who currently receive $50 compensation per meeting.

[Mr. Gorton was in attendance via teleconference at 10:01 a.m.]

The above motion carried unanimously.

State Street Bank Custodian Contract Extension

Chair Masten reported that two years remain on the State Street Bank (SSB) custodian contract, if the Board approves an extension. Treasurer Murphy clarified that the current contract expires this September.

Chair Masten moved that the Board accept the Administrative Committee's recommendation to request that the State Treasurer extend the State Street

Bank Custody contract for a two-year term, extending the contract to September 30, 2007. Vice Chair McElligott seconded the motion.

Treasurer Murphy said he presumed that the same terms and conditions of the existing contract still apply. Mr. Dear indicated that some modifications to the operational terms are expected but they are not substantial. Ms. Whitmarsh reported that no change in fee structure would occur. She said that a survey of other custodians and pension funds was conducted, which concluded that the SSB fee structure is competitive. SSB has introduced new technology that will help meet WSIB compliance concerns. Ms. Whitmarsh said that definite time commitments on the introduction of the compliance software would be included in the renewal.

Treasurer Murphy noted that since the action before the Board would direct him to take action on the matter, he would abstain from the vote.

The above motion carried with Treasurer Murphy abstaining.

AUDIT COMMITTEE REPORT

Public Equity Manager Barclays Global Investors (BGI) Audit 2005-03

Chair Masten moved that the Board approve the Audit Committee's recommendation to accept the Public Equity Manager Barclays Global Investors (BGI) Audit 2005-03. Treasurer Murphy seconded the motion.

Chair Masten reported that the BGI audit was clean, with no recommendations. The internal auditor was pleased with BGI's interaction. Treasurer Murphy pointed out that the audit scope did not include the discussion points with BGI last year when they failed to follow the WSIB's direction on proxy voting. Mr. Dear clarified that there was a separate review of asset managers' compliance with the Board's proxy voting policy. Last year, BGI did not vote the way that the Board had expressed an interest, but they are in compliance with WSIB policy.

The above motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

Ms. Brookman reported that the Private Markets Committee met on April 7 but was unable to take action due to a lack of quorum. The consensus of members present at the meeting was to forward the following items to the Board for consideration.

Real Estate

Real Estate Consultant Contract

Ms. Brookman requested that the Board authorize the re-hiring of Courtland Partners, Ltd., as the WSIB's general real estate consultant. Courtland responded to the RFP for general consulting and scored the highest points on their submission. Staff is generally pleased with the services Courtland has provided over the past five years.

Ms. Brookman moved that the Board authorize the hiring of Courtland Partners, Ltd., as the WSIB's general real estate consultant, subject to final negotiations of the contract. Vice Chair McElligott seconded the motion.

Mr. Nakahara requested an explanation of the "generally pleased" remark. Mr. Draper said improvement could be made in a few areas and Courtland is responding well to staff's requests.

The above motion carried unanimously.

Washington Holdings Structured Finance, LLC – Investment Recommendation
Ms. Brookman asked for the Board's consideration of an investment of $250 million, plus fees and expenses, in Washington Holdings Structured Finance, LLC. Washington Real Estate Holdings is seeking to raise capital to expand their existing strategy of investing in structured finance transactions. Consideration is based, in part, on their high-quality management team which has an excellent track record and a long, successful relationship investing on behalf of the WSIB; and the opportunity for attractive risk-adjusted returns, including the ability to mix more lower-risk deals into their strategy. Ms. Brookman said that it is an excellent fit into the portfolio because of its strong income component and attractive governance terms.

Ms. Brookman moved that the Board approve an investment of $250 million, plus fees and expenses, in Washington Holdings Structured Finance, LLC, subject to continued due diligence and final negotiation of terms and conditions. Vice Chair McElligott seconded the motion.

Treasurer Murphy asked how the investment can be considered real estate and not fixed income. He said it seems similar to buying a Freddie Mac or Fannie Mae due to its secondary position. Mr. Draper said the investments proposed by the partnership are equity-like, and he would not characterize it as fixed income since these investments are not tradable securities, but highly negotiated private market deals. Mr. Magnuson described that "secondary" in context to Freddie Mac and Fannie Mae means securities that are bought and sold a second time from the first time. The proposed investments are second lien positions, not a secondary market of transactions.

In response to Board members' questions, Mr. Draper said that the underwriting of these investments looks at the underlying security, which is real estate, as though they may ultimately become the owner of it. The security for these investments is high-quality commercial properties. If default occurs, our partnership can become the owner of the property.

Treasurer Murphy questioned the proposed terms for management fees and carried interest in the investment. Mr. Draper said that most WSIB real estate partnerships are structured similarly to this partnership. Treasurer Murphy further noted that the general partner co-investment is de minimus. Mr. Draper responded that management has essentially their entire liquid net worth co-invested in the original Washington Holdings deal, and this partnership would basically take the remainder of their liquid net worth. Staff is not concerned about the size of the co-investment due to WSIB's excellent governance rights in this deal. Mr. Draper explained why increasing the preferred return is not appropriate. Mr. Magnuson said doing so would price the Board out of the opportunity.

Treasurer Murphy said that he is not comfortable with the co-investment level. Typically, he wants incentive in sharing the deal risk. Mr. Draper said he feels that the incentive lies in tying up the liquid net worth of the management team.

The above motion carried with Treasurer Murphy voting no.

Private Equity

Warburg Pincus Private Equity IX, L.P. – Investment Recommendation

Ms. Brookman said that the next item for consideration is an investment of up to $700 million, plus fees and expenses, in Warburg Pincus Private Equity IX, L.P., a $7.0 billion global private equity fund. Consideration is based, in part, on the brand name and strong reputation of the firm in the private equity industry which provides significant quality deal flow; the firm's proven multi-stage, global investment strategy which is differentiated and provides flexibility to adjust investment focus as market conditions change; its deep partner team and substantial global resources, including 275 people in eight offices around the world. She reported that the firm has produced an excellent long-term track record, generating a net IRR of 18.1 percent and a 2.07x net multiple on $16.7 billion invested capital in ten prior funds since 1971. The fund would provide an excellent portfolio fit, with meaningful exposures to venture capital and Asian investments, two sub-sectors that are currently under-represented in the portfolio. The general partner has a strong focus on alignment of interest with its partners and does not charge transaction or advisory fees to its portfolio companies. The investment provides an opportunity to expand a successful relationship with a high-quality partner.

Ms. Brookman reported that staff and Pacific Corporate Group had originally recommended an investment of up to $400 million in the fund. However, during the meeting, several Committee members expressed an interest in pursuing a larger commitment, if available. There were several reasons given by Committee members for seeking a larger commitment. Warburg Pincus is a high quality partner with whom the Board has had a long and successful relationship. The firm's investment strategy is differentiated and provides broad diversification benefits to the portfolio, including exposures that are currently under-represented in the portfolio, such as venture capital and Asian investments. The firm has successfully completed a leadership transition in recent years, and the organization remains strong and well positioned for the future. Finally, a larger commitment is consistent with the WSIB's strategy of reducing the number of general partner relationships, concentrating more capital with groups in which the Board has a high degree of confidence. In response to questions from the Committee, the general partner indicated that a larger commitment would be available to the WSIB, and that Warburg Pincus would make every effort to accommodate whatever the Board desired to invest. Following discussion, it was the consensus of the Committee to forward this item to the Board for consideration of an investment of up to $700 million.

Ms. Brookman moved that the Board approve an investment of up to $700 million, plus fees and expenses, in Warburg Pincus Private Equity IX, L.P., subject to continued due diligence and final negotiation of terms and conditions. Chair Masten seconded the motion.

Mr. Kaminski requested that staff respond to his question about increasing the recommended investment amount and exploring a "second tranche" commitment that would allow the Board to target incremental exposure specifically in Asia and venture capital investments. Mr. Ruggels said that he did not think Warburg Pincus was contacted about the possibility of such an arrangement. At the Committee meeting, Warburg had expressed a willingness to accommodate what the Board desired, without promising anything. Co-investing opportunities were also discussed; however, the WSIB is not staffed nor set-up for that. Mr. Ruggels said that the intention is to move toward getting that capability in the future.

Mr. Dear said that Mr. Bruebaker had responded that an investment of $700 million is within the range of the private equity plan approved by the Committee, but above that would take it out of the range and cause other impacts.

A discussion ensued about a higher investment recommendation, co-investing, the relationship with the partner, and opportunities for venture capital and Asian investments.

Treasurer Murphy asked Mr. Kaminski if he is against the recommendation. Mr. Kaminski said he is for it, but would like more than the recommended amount if a second tranche could be created.

The above motion carried unanimously.

Banc Fund VII , L.P. – Investment Recommendation

Ms. Brookman asked for the Board's consideration of an investment of up to $50 million in Banc Fund VII, L.P., a $400 million (target) private equity fund that will invest in U.S. financial services companies. The Banc Funds Company is an existing general partner relationship for the WSIB. Consideration is based, in part, on the general partner's focused, highly specialized niche strategy with limited competition; its stable, experienced investment management team, with deep expertise in the fund's target investment sectors; and strong, consistent investment performance through multiple investment cycles with a low loss ratio. Ms. Brookman said it offers an excellent portfolio fit, with virtually no overlap with other general partners' strategies and an opportunity to expand a successful relationship with a high quality partner.

Ms. Brookman moved that the Board approve an investment of up to $50 million, plus fees and expenses, in Banc Fund VII, L.P., subject to continued due diligence and final negotiation of terms and conditions. Treasurer Murphy seconded the motion.

Mr. Seely said that Banc Fund has a great track record. Mr. Magnuson reported that their materials showed investments in Washington State based small and regional banks.

The above motion carried unanimously.

Pathway Capital Management – Additional Allocation Recommendation
Ms. Brookman said that the final item for the Board's consideration is an additional allocation of $200 million to be invested by Pathway in venture capital investments on behalf of the WSIB under the terms and conditions of the existing contract. The consideration is based, in part, on Pathway's stable, experienced management team with no turnover in senior management, ability to access quality partnerships and obtain meaningful commitments, strong long-term performance with a net IRR of 24.1 percent since inception. Pathway is an integral part of the WSIB venture capital portfolio requiring limited staff resources and has a successful long-term relationship with the WSIB.

> **Ms. Brookman moved that the Board approve an additional allocation of to $200 million to be invested by Pathway Capital Management under the terms and conditions of the existing contract. Vice Chair McElligott seconded the motion.**

Treasurer Murphy said he does not know why the Board is even considering this and it is a serious "no" vote from him. He noted that Pathway has not made any money for the WSIB since 1998. Ms. Matheson asked for comments from other members. Mr. Seely indicated he had expressed similar concerns at the Committee meeting. Mr. Magnuson said he agreed with Mr. Seely. He asked how Pathway's performance compares with other available alternatives. Mr. Dear said that Invesco is performing a similar service for the WSIB, and their performance is significantly worse. He reported that the WSIB currently has no other firms performing this function, but plans to bring a request for proposals later in the year to explore other options. Mr. Scott asked if there are indicators that performance will improve. A discussion ensued regarding venture capital investments, the WSIB's target allocation, and Pathway's strengths. Mr. Hanna said that it is difficult to get into small opportunities and he is particularly impressed with Pathway's screening process. Ms. Brookman said she relies a great deal on the investment professionals to bring deals forward. The Board's asset allocation calls for a certain amount to go into venture capital. She indicated it may take awhile to see how the more recent investments will ultimately perform. Vice Chair McElligott said he has concerns with the deal but is okay with it at this time since the contract's initial term expires next year and Pathway's status can be re-evaluated at that time. He noted that the 2000-2001 investments are not dead yet but that he would like to see risk taken in selecting first time and new general partner relationships. Mr. Dear said that staff would raise the concern about overly restrictive screens with Pathway.

Treasurer Murphy said that he respects members' opinions but the performance is intolerable. Staff should investigate others that would allow the Board to invest in small deals but if no one else is out there, perhaps the Board should not be in that sector. He further stated that Pathway already has an allocation and they should deal with what they have been given. He asked staff to research monies lost on Pathway's investments. Mr. Dear said that staff would respond, but he feels the 2000-2001 investments are too new to reach conclusions about gains or losses.

Chair Masten said that he supports the deal and thinks the Board should continue with Pathway for now. If an additional allocation is not approved, Pathway will not be able to pursue new deals going forward.

Ms. Matheson said that it seems like the sector is the focus and the Board should stick to its target allocation. Mr. Kaminski said that this is a good time to be in venture capital and that recent deals have been high quality.

The above motion carried with Treasurer Murphy voting no.

[Vice Chair McElligott and Mr. Nakahara were no longer in attendance at 11:11 a.m.]
[The Board recessed at 11:11 a.m. and reconvened at 11:26 a.m.]

STAFF'S REPORT

Executive Director's Report

Mr. Dear provided his monthly report for April on board governance, staff, investments, operations, communications and legislation activities. In response to members' questions regarding the SunGard Data Systems, Inc., acquisition, Mr. Dear said that each of the involved WSIB partners has equal ownership positions. Mr. Ruggels said that the WSIB is not in the deal at the same proportion with all three general partners; the WSIB has approximately $135 million through KKR and $35 million roughly divided equally between the other two.

Mr. Magnuson expressed a concern regarding real estate staffing. Mr. Dear reported that favorable action on a candidate is expected soon. A headhunter has also brought forward candidates. Two additional real estate staff positions are expected in the budget for the next biennium.

Monthly Investment Report

Ms. Will provided the report for the month ended March 2005. She said that inflation was the biggest concern last month. Interest rates were raised by 25 basis points. This was anticipated and did not have much affect on the markets. However, the Feds statement regarding inflation and fuel prices did concern the markets. The WSIB equity market index was down 1.74 percent. International markets under-performed; the MSCI ACWI benchmark was down 2.75 percent. The Fixed Income benchmark was down 0.7 percent. The WSIB did outperform the benchmark. U.S. fixed income was down 0.46 percents versus the index, which was down 0.73 percent. This was due to continuing low duration and a high quality portfolio. U.S. equity outperformed by 3 bps. International markets were down slightly from the benchmark but is well within its range.

ASSISTANT ATTORNEY GENERAL'S REPORT

Chair Masten called the Board into executive session at 11:47 a.m. He said the purpose is to discuss litigation or potential litigation matters. Chair Masten estimated that the executive session would last 15 minutes and after completion of the executive session the Board would resume its open public session.

[The executive session concluded at 12:13 p.m. and the open session reconvened immediately thereafter].

[Mr. Seely was no longer in attendance at 12:13 p.m.]
[The Board recessed at 12:14 p.m. and reconvened at 12:26 p.m.]
[Ms. Schurke was no longer in attendance at 12:26 p.m.]

EDUCATION SESSION – ASSETS AND LIABILITIES

Mr. Smith and Mr. McCauley introduced themselves to the Board. Mr. Smith reviewed the funding equation for contribution rates and explained the interdependency between the investment policy and assumed rate of return. He said that the current long-term assumption is 8 percent. He recommended that the rate change to 7.75 percent, which would have increased the 2005-07 general fund-state contributions by about $92 million. Mr. Smith reviewed the WSIB's statutory mandate, the affect of changing investment policy to match the 8 percent expected return versus not changing policy, and non-investment risk measurements that are standard components of an asset liability study.

Mr. McCauley described the steps involved in an asset liability study, which includes capital market simulations; forecasting assets to develop an "efficient" frontier; projecting liabilities, benefit payments, and liability durations; and funding calculations to determine optimal portfolios and excluding mixes that do not meet goals.

OTHER ITEMS

There was no further business to come before the Board. The meeting adjourned at 1:22 p.m.

George Masten
Chair

ATTEST
Joseph A. Dear
Executive Director