**WASHINGTON STATE INVESTMENT BOARD**
**Board Meeting Minutes**
**July 20-21, 2005**

The Washington State Investment Board met in open public session in the Jefferson Room at Skamania Lodge, 1131 SW Skamania Lodge Way, Stevenson, Washington.

Present:

George Masten, Chair
Pat McElligott, Vice Chair
Debbie Brookman
Senator Lisa Brown
Glenn Gorton
Jeff Hanna
Charlie Kaminski
Sandy Matheson
John Magnuson
Treasurer Mike Murphy
Bob Nakahara
Dave Scott
Jeff Seely
Representative Helen Sommers
Gary Weeks

Also Present:

Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Deputy Director for Operations
Diana Will, Senior Investment Officer – Asset Allocation
Nancy Calkins, Senior Investment Officer – Public Equity
Steve Draper, Senior Investment Officer – Real Estate
Bill Kennett, Senior Investment Officer – Fixed Income
Tom Ruggels, Senior Investment Officer – Private Equity
Kristi Walters, Executive Assistant
Paul Silver, Assistant Attorney General

Keith Ambachtsheer, K.P.A. Advisory Services Ltd.
Allan Emkin, Pension Consulting Alliance
Neil Rue, Pension Consulting Alliance
Bob McCrory, EFI Actuaries
Michael Phillips, Russell Investment Group

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

Chair Masten called the July 20, 2005, session to order at 8:32 a.m. and roll call was taken.

## ADOPTION OF MINUTES – JUNE 16, 2005

**Treasurer Murphy moved to adopt the June 16, 2005, Board minutes. Vice Chair McElligott seconded and the motion carried unanimously.**

## PUBLIC COMMENT

There was no public comment.

## STAFF AND ASSISTANT ATTORNEY GENERAL'S REPORT

**Securities Litigation Update**

Chair Masten called the Board into executive session at 8:34 a.m. He said the purpose was to discuss litigation and potential litigation with legal counsel assigned to the Board since public knowledge regarding the discussion is likely to result in adverse legal or financial consequences to the WSIB. Mr. Masten said the executive session was expected to last about 15 minutes.

[The executive session concluded at 8:54 a.m. and the open session reconvened immediately thereafter.]

**Vice Chair McElligott moved that the Board authorize the State Attorney General's Office to work with the Lerach law firm to finalize and execute a settlement of the WSIB's WorldCom bond claims along the lines of the key terms outlined to the Board in executive session on July 20, 2005. Ms. Brookman seconded and the motion carried unanimously.**

**Strategic Plan Update and Plan for 2005-06 Staff Review and Outlook**

Mr. Dear reviewed the WSIB's strategic direction from pre-2003 forward, focusing on the five key drivers for long-term success. He reported on progress to date of the projects underway to implement the five key drivers. Ms. Matheson and Vice Chair McElligott commented on the importance of integrity. Mr. Dear reviewed investment performance as of June 30, 2005.

[The Board recessed at 9:52 a.m. and reconvened at 10:10 a.m.]

## BEYOND PORTFOLIO THEORY: THE NEXT FRONTIER

Mr. Ambachtsheer presented information on the challenges to the current pension fund paradigm. He stressed the importance of clearly understanding the economic value of a pension plan's assets and liabilities as a prerequisite to developing a comprehensive risk management framework. He discussed his integrative investment framework and how it can be applied to pension plan design and management. He discussed improving pension fund governance through management models, rethinking pension fund design, and implications for traditional defined benefit plans.

[The Board recessed at 11:58 a.m. and reconvened at 1:07 p.m.]

## STRATEGIC ASSET ALLOCATION: THE "SCIENCE"

Mr. Dear introduced Mr. Emkin, Mr. Rue, and Mr. McCrory. Mr. Emkin said that their presentation would provide a framework for the Board to reach a new asset allocation decision

based on new information and analysis. He said that simulations would be run using modeling software that will include sensitivities to input factors. The model is a tool for discussion purposes. The ultimate decision is up to the Board's judgment and common sense.

Mr. Rue said that the goal was to assist the Board to develop a clear understanding of drivers for long-term financial conditions, establish consensus on risk tolerance, and consider and select an appropriate asset allocation policy. He described the planned interactive risk tolerance voting session. Mr. Rue introduced asset/liability study concepts and described some background of the WSIB defined benefit plan.

Mr. McCrory reviewed several asset-liability models of Washington plans under its current asset allocation.

[The Board recessed at 2:20 p.m. and reconvened at 2:35 p.m.]

Mr. Rue reviewed the asset class assumptions. He described mean variance and provided an analysis of the data sample and input adjustments made. Mr. McCrory reviewed the return- and liability-oriented decision factors included in the WSIB study against the tradeoffs associated with them.

Board members voted on the weights to give five factors in the model to establish their collective risk tolerance. In response to questions from Treasurer Murphy, Mr. McCrory described how the results from the scoring process match to the scores of the portfolios input to the modeling software. Mr. Bruebaker directed Treasurer Murphy to the constraints listed on page 64 of the EFI/PCA study. Treasurer Murphy expressed a lack of confidence with the system.

The Board discussed the implications of the asset class mix resulting from the voting process, which resulted in a higher allocation to equities than current policy.

[The Board recessed at 4:05 p.m. and reconvened at 7:00 p.m.]

**DINNER PRESENTATION**

Mr. Phillips gave a presentation on corporate governance and values.

[The Board recessed at 8:50 p.m. on July 20, 2005.]

[The Board reconvened at 8:30 a.m. on July 21, 2005.]

Chair Masten called the July 21, 2005, session to order and roll call was taken.

[Treasurer Murphy was no longer in attendance at 8:30 a.m.]

**STRATEGIC ASSET ALLOCATION: THE "ART"**

Mr. Bruebaker addressed the question of whether the assets of the Plan 1s would have a different asset allocation from the Plan 2s and 3s because their liabilities are significantly different. He said

that the Board votes from yesterday were input into the Plan 1s only versus the entire portfolio, and the equity/bond split was the same. Staff recommends that the Board continue to manage the CTF with a single strategic asset allocation. Staff will continue to consider the question and will bring forward any recommendation for changes at the appropriate time.

Mr. Bruebaker reported that staff went through the voting process yesterday and came up with a 71/29 split between equities and bond like investments, respectively, similar to the Board's 72/28 split. However, he said that staff is uncomfortable with this amount of exposures to equities. Twelve percent of real estate is the most staff could prudently get to within next four years. And, 17 percent is the right number for private equity over the next four years for prudently getting the money to work. Mr. Bruebaker said that, regardless of the percentages, staff would continue to recommend investing in private equity and real estate deals that meet investment standards and risk/return profile for the CTF. In addition, current policy provides a range around the target allocation of plus or minus two percent for real estate and plus or minus four percent for private equity. Mr. Bruebaker said that asset allocation should be done *at least* every four years but can be done more frequently, so if there were a recommendation prior to the next study, staff would come to the Board.

Mr. Bruebaker said that staff believes a 25 percent allocation to fixed income is the minimum they would recommend given the liquidity needs of the plans and the allocation given to illiquid investments. Mr. Bruebaker reported that staff believes that international equities will outperform domestic equities over the next four years, with emerging markets outperforming the rest of the world. He reported that staff recommends a change in the equity allocation from 31 percent domestic and 15 percent international to an allocation of 23 percent U.S. equities and 23 percent international equities. This allocation exposes the WSIB to maverick risk, that is, looking different than other plans. He noted that the world ex U.S. market cap is greater than 51 percent with the market cap of the U.S. relative to the world is less than 49 percent. In response to Mr. Kaminski's concern about currency exposure, Mr. Bruebaker said that staff would recommend that currency risk be managed at the portfolio level to decrease risk.
Representative Sommers asked to have the results of the voting session sent to members prior to the September Board meeting.

**PORTFOLIO MANAGEMENT: THE NEXT FRONTIER**

Ms. Will introduced staff's recommendation to add a new investment vehicle to the CTF for investments that do not meet the investment philosophy and/or risk and return goals of existing asset classes. She said the proposed target allocation of the Development Portfolio is 0 to 5 percent. Ms. Will outlined the proposed research and recommendation process. Staff described investments and the amount of those investments that may fit into this type of portfolio.

Mr. Weeks asked if the Board could give staff authority to hire a money manager as a pilot project, so that delays can be avoided in the recommendation process. Chair Masten pointed out that the draft policy had not yet been presented before any of the Committees and he proposed that it should come before the Administrative Committee for further discussion. He said that he has been hesitant to delegate hiring authority to staff but feels that the Board should consider something that speeds things along. Mr. Dear said that revisions to the Service Provider (Selection) policy could grant

flexibility and increase speed. Senator Brown and Ms. Matheson supported the idea. Ms. Matheson expressed a desire for staff to pay particular attention to the Board's fiduciary responsibility and consistency in their proposal. Mr. Nakahara expressed a concern with public perception about potentially short circuiting processes. Several members expressed a concern that the Development Portfolio title could be misleading since it might be associated with economic development. In response to a question from Ms. Brookman, Mr. Bruebaker said that this policy is not for economically targeted investments. Vice Chair McElligott asked Ms. Will to provide him with a copy of Ohio PERS's development policy.

Chair Masten said that the Administrative Committee would meet in September to review the proposed policy and procedures.

**PERSONNEL DISCUSSION**

Chair Masten called the Board into executive session at 9:44 a.m. He said the purpose was to discuss the performance of a public employee. Chair Masten said the executive session was expected to last until about 10:00 a.m.

[The executive session concluded at 11:10 a.m. and the open session reconvened immediately thereafter.]

**OTHER ITEMS**

There was no further business to come before the Board. The meeting adjourned at 11:10 a.m.

George Masten
Chair

ATTEST

Joseph A. Dear
Executive Director