WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
January 19, 2006

The Washington State Investment Board met in open public session at 9:37 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Pat McElligott, Chair Debbie Brookman, Vice Chair Glenn Gorton Charlie Kaminski John Magnuson George Masten Sandy Matheson Treasurer Mike Murphy Bob Nakahara David Nierenberg Dave Scott Gary Weeks
Absent:	Senator Lisa Brown Jeff Seely Representative Helen Sommers
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Kristi Walters, Executive Assistant Paul Silver, Assistant Attorney General Christophe Rouvinez, Capital Dynamics

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

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

ADOPTION OF MINUTES – DECEMBER 15, 2005

Mr. Masten moved to adopt the December 15, 2005, Board minutes.
Vice Chair Brookman seconded the motion.

Mr. Kaminski asked to have the response to his question about the number of Washington and Northwest venture capital general partners that we are invested with reflected in the minutes. Mr. Kaminski said that the number was zero.

The motion, as amended, carried unanimously.

PUBLIC COMMENT

There was no public comment.

EDUCATION SESSION – PRIVATE EQUITY PORTFOLIO CONSTRUCTION

Mr. Dear introduced Christophe Rouvinez of Capital Dynamics. Mr. Rouvinez said his presentation would demonstrate combining private equity and risk management to construct a private equity portfolio, the effect of diversification on a portfolio, and include an analysis of the WSIB's portfolio.

[Mr. Weeks was in attendance at 9:44 a.m.]

Mr. Rouvinez described charts demonstrating average, median, and mode return probabilities of funds of various multiples pulled from Venture Economics performance data. In response to Treasurer Murphy's question about the correlation to internal rates of return (IRR), Mr. Rouvinez said that the same exercise would exhibit similar results using IRR. Mr. Rouvinez demonstrated how diversification and investing in more funds increases the probability of higher returns. He said that diversification continues to improve the return distribution up to about 30 equivalent funds and, beyond that, adding additional funds has minimal incremental benefit.

Mr. Rouvinez compared the IRR of private equity funds to time weighted returns of other asset classes. He pointed out that the difference in dispersion of private equity returns is huge compared to other asset classes and noted that dispersion within a diversified fund of funds is not as great, which would be similar for a portfolio such as WSIB's.

Mr. Rouvinez described the chart analyzing the WSIB portfolio's fund concentration and total exposure. He said that the chart is a good representation to compare against other portfolios. He explained how funds within the portfolio are broken down by exposure level to demonstrate how the portfolio should behave. He said that the WSIB's 182 funds should behave like a portfolio of 31 equally weighted funds, which is ideal.

Mr. Magnuson said that the Board should make private equity decisions in the coming year modeling the behaviors as best it can with Capital Dynamics' advice and measure its past against future decisions. Board members commented that a high level of diversification is good and provides protection in fiduciary responsibility.

Mr. Masten requested that Capital Dynamics provide an analysis on which performance quartile each of the funds within the WSIB portfolio are in.

ADMINISTRATIVE COMMITTEE REPORT

Executive Director Evaluation

Chair McElligott called the Board into executive session at 10:48 a.m. He said the purpose was to discuss the performance of a public employee. Chair McElligott said the executive session was expected to last until 11:10 a.m.

[The executive session concluded at 11:16 a.m. and the open session reconvened immediately thereafter.]

Mr. Gorton moved that the Board approve the Administrative Committee's recommendation to accept the executive director's evaluation as written. Treasurer Murphy seconded and the motion carried unanimously.

Chair McElligott announced a change in agenda order.

PRIVATE MARKETS COMMITTEE REPORT – PRIVATE EQUITY INVESTMENT RECOMMENDATION

KSL Capital Partners II, L.P.

The Private Markets Committee met on January 5, 2006, to discuss two investment recommendations as well as the private equity and real estate annual plans.

Mr. Masten moved that the Board accept the Private Markets Committee's recommendation to invest up to $100 million, plus fees and expenses in KSL Capital Partners II, L.P., subject to continued due diligence and final negotiation of terms and conditions. Mr. Weeks seconded the motion.

Mr. Masten said that the Private Markets Committee's recommendation to invest up to $100 million in KSL Capital Partners II, L.P. is based, in part, on the following: the management team, led by Mike Shannon, is experienced in the travel and leisure industries, and has a complementary mix of investment and operating expertise; the fund will continue KSL's proven, niche investment strategy, which has successfully created value in travel and leisure businesses. KSL seeks opportunities to enhance profitability by developing new or expanded businesses around existing assets; thereby, generating significant additional revenue with attractive operating margins. KSL has demonstrated strong performance with substantial realizations. Since 1992, the group has invested $524 million of equity, generating realized proceeds of more than $1.9 billion and continues to hold investments valued at $168 million. When adjusted for the current proposed fee structure, this equates to a net IRR of 20 percent and a net total value multiple of 3.5x. The fund is an excellent fit in the private equity portfolio, having little overlap with other partners' strategies.

The above motion carried unanimously.

Charterhouse Capital Partners VIII, L.P.

Mr. Masten moved that the Board accept the Private Markets Committee's recommendation to invest up to €150 million, plus fees and expenses, in Charterhouse Capital Partners VIII, L.P., subject to continued due diligence and final negotiation of terms and conditions. Treasurer Murphy seconded the motion.

Mr. Masten said that the Private Markets Committee's recommends an investment of up to €150 million in Charterhouse Capital Partners VIII, L.P. He noted that staff and Capital Dynamics had initially recommended an investment of up to €125 million, but the Committee expressed an interest in pursuing a larger commitment in the fund, if available. Both staff and Capital Dynamics are comfortable with the larger proposed commitment. The Committee's recommendation is based, in part, on the following: the team is deep, experienced, and stable; the investment team is one of the most experienced and most respected in Europe and the senior members of the investment team

are predominantly the same members that have been investing the Charterhouse funds since 1990. The firm has a strong track record with substantial realizations. Since 1990, Charterhouse has invested €3.8 billion in six funds and consistently produced attractive returns and multiples. In aggregate, the six funds have produced a net IRR of 30 percent and a 1.8x net multiple, including €5.4 billion in realizations. Charterhouse has demonstrated a focused and consistent investment strategy. Charterhouse focuses on control investments primarily in France and the United Kingdom in industries where they have extensive expertise. The firm has a strong deal flow. The investment team has an extensive network of relationships with business and financial leaders. The firm does not participate in consortium or "club" deals and will only participate in auctions in which they believe they have access to proprietary information or a competitive advantage not available to other private equity firms. This investment is an opportunity to expand our relationship with a high quality European partner.

The above motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT (CONTINUED)

2006 Strategic Initiatives

Mr. Dear noted that strategic plan development is referenced in the executive director charter. He reported that the management team developed three strategic themes for 2006: rigorous focus on investment performance and decision making; achieve exemplary governance; and develop, inspire, and support people who are passionate about investment management. The management team shared the themes with their respective divisions and staff developed project proposals.

Under the theme of a rigorous focus on investment performance and decision making, staff plans to adopt a best practices framework for the Private Equity program, establish a centralized research function, examine its investment beliefs and principles, implement Innovation Portfolio fund opportunities, and develop an investment product review process to plan operationally for new investment vehicles.

To achieve exemplary governance, staff plans for the Board to review select charters and policies and conduct an internal review at its July meeting. Staff also plans to continue improving the Board education program in specific areas. Ms. Matheson expressed a desire to have discussion about the Board's roles and responsibilities before the July meeting. Mr. Nierenberg shared a related idea to examine Board governance at some of the better governed pension plans and gain information on their successes in order to improve upon proven strategies. Mr. Dear agreed to discuss these ideas further with Ms. Matheson and Mr. Nierenberg.

Additional governance projects include expanding the Enterprise Risk Management effort by adopting the Committee of Sponsoring Organizations (COSO) of the Treadway Commission framework. Staff also plans to obtain an independent audit of the 2006 financials and apply Sarbanes Oxley Section 404 requirements where appropriate to financial reporting.

Mr. Dear said that to develop, inspire, and support people who are passionate about investment management, staff plans targeted recruitments to find the best people for the 10 new FTEs this biennium, develop and expand programs to retain existing staff through appropriate compensation, training, promotion and recognition; and conduct a manager/supervisor responsibilities training program to assist managers in guiding and supporting staff.

Mr. Dear said that progress on the strategic initiatives, as well as the private equity and real estate plans, will be shared throughout the year. He invited Board members to comment on and/or participate with these efforts. Mr. Nakahara observed that the 2006 themes and projects reflect process improvement efforts. He cautioned staff to be conscientious of costs, staff time, reviews, and consequences involved in trying to achieve compliance with Section 404 of the Sarbanes Oxley Act.

Recommended Conferences 2006-2007
Chair McElligott noted the recommended conference list in the Board packet. These conferences are pre-approved for attendance but still require his signature on a travel request form.

> **Mr. Masten moved that the Board approve the Administrative Committee's recommendation to accept the 2006-2007 Recommended Conference list. Vice Chair Brookman seconded the motion.**

Chair McElligott explained that the list is comprised of conferences that have been determined to be beneficial to Board members. Mr. Dear said that two conferences were added to the list this year at Mr. Kaminski's recommendation. He noted that members can also submit requests to attend conferences that are not on the list. Mr. Masten asked if the International Foundation conference was not listed because of its expense. Mr. Dear said that it could be added, but said he felt there are better conferences. Chair McElligott said that he had attended the International Foundation conference and found it very informative and educational, but it was expensive. Mr. Dear said he would be happy to speak individually with members on what conferences make sense with their schedules.

> **The above motion carried unanimously.**

[Treasurer Murphy was no longer in attendance at 12:00 p.m.]

STAFF'S REPORT
Executive Director's Report
Mr. Dear provided his monthly report for January on Board, investments, operations, communications and legislation activities. The WSIB received its 14th consecutive clean audit from the State Auditor's Office.

Treasurer Murphy described two identical governor request bills to create a pension stabilization account in the state treasury, which may only be used for payment of unfunded liabilities for public retirement plans. He said that OST supports the effort and asked members to make him aware of any concerns with the bills.

Monthly Investment Report
Mr. Bruebaker provided the CTF monthly investment report for December. For the month, U.S. equity returned 10 basis points (bps), underperforming the benchmark by 5 bps. For the year, it outperformed by 5 bps. International equity returned 4.8 percent, outperforming its benchmark by 1 bp for the month, while underperforming by 35 bps for the year. Fixed income returned 90 bps, underperforming the Lehman Universal by 6 bps for the month, while outperforming by 39 basis points for the year. Private equity returned 3.0 percent for the month. Draws were at $338 million and distributions were at $483 million. Distributions were more than double the average for either 2004 or 2005. In December, Fisher Lynch was approved and Nordic Capital Fund VI closed. Real estate returned 5.9 percent for the month.

Mr. Dear announced that the CTF has over $50 billion in assets.

ASSISTANT ATTORNEY GENERAL'S REPORT
Mr. Silver provided a summary of 2005 WSIB legal services. He noted that a number of outside law firms are used for fiduciary trust, real estate, and private equity issues; and the WSIB receives a ten percent or more discount from these firms' normal rates. Legal assignments are managed by WSIB staff or the AAG, who also reviews all billings prior to payment.

OTHER ITEMS
There was no further business to come before the Board. The meeting adjourned at 12:14 p.m.

Pat McElligott
Chair

ATTEST

Joseph A. Dear
Executive Director