WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
January 18, 2007

The Washington State Investment Board met in open public session at 9:50 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Pat McElligott, Chair Glenn Gorton, Vice Chair Senator Lisa Brown Charlie Kaminski John Magnuson George Masten Sandy Matheson Treasurer Mike Murphy Bob Nakahara David Nierenberg (via teleconference) Mason Petit Judy Schurke Dave Scott
Absent:	Jeff Seely Representative Helen Sommers
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Tom Ruggels, Senior Investment Officer – Private Equity Steve Draper, Senior Investment Officer – Real Estate Kristi Haines, Executive Assistant Paul Silver, Assistant Attorney General Dana Gold, Seattle University School of Law

[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 THE DECEMBER 21, 2006, MINUTES

Chair Gorton moved to adopt the December 21, 2006, Board meeting minutes. Chair McElligott seconded the motion.

Mr. Dear noted a correction on page 12 of the minutes, in the last paragraph, third sentence. The amount should be $23.9 billion, rather than $23.9 million.

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

PUBLIC COMMENT
There was no public comment.

[Treasurer Murphy and Mr. Scott were in attendance at 9:53 a.m.]

EXECUTIVE DIRECTOR'S REPORT
Mr. Dear provided his monthly report for January on Board governance, investments, operations, public affairs, and open procurement activities.

Mr. Dear provided an update on the custody contract. He said that five bids were evaluated by a team of eight staff, all of which have interaction with the custodian bank. Three firms are still under consideration. Staff will conduct due diligence on-site visits next week with two firms. Staff expects to bring a recommendation to the Board in February.

PRIVATE MARKETS COMMITTEE REPORT
Private Equity
The Private Markets Committee met on January 11, 2007.

KKR Asian Fund, L.P.

> **Mr. Masten moved that the Board approve the Private Markets Committee's recommendation to approve an investment of up to $500 million, plus fees and expenses, in KKR Asian Fund, L.P., subject to continued due diligence and final negotiation of terms and conditions. Ms. Matheson seconded the motion.**

Mr. Masten said that the recommendation is based, in part, on the following: (1) KKR has a strong franchise and an extensive network of industry relationships globally. While the firm's brand is particularly strong in North America and Europe, KKR has significant networks, relationships, and brand recognition in Asia as well that will benefit deal sourcing, transaction execution, and value-creation activities post investment; (2) The firm has assembled a very experienced team of six Asian executives to lead the Fund's investment activities. The senior Asian team has a complementary mix of private equity and operating expertise, supported by 11 additional investment professionals in Hong Kong and Tokyo. The Asian team also benefits from the substantial resources of the KKR organization that includes 93 investment professionals worldwide; (3) Although KKR's direct experience in Asia is limited to four recent investments, the firm has an excellent long-term investment record in North America and Europe. The investment strategy, decision-making process, monitoring, and value creation activities for the Asian investments will be consistent with those in North America and Europe. The same six-member Investment Committee approves all investments made by the firm in all geographies; (4) The WSIB has had a very long and successful relationship with KKR. Since 1982, the WSIB has participated in 14 KKR-sponsored investments. Those investments have produced more than $10.5 billion of net value on $5.8 billion in drawn capital, including cash distributions of $8.1 billion. In aggregate, WSIB's KKR investments have a net IRR of 17.2 percent and a net multiple of 1.8x as of September 30, 2006; and, (5) While the WSIB has exposure to the Asian region through a handful of other private equity partners, the region is still relatively under-represented in the private equity portfolio, making this investment an attractive portfolio fit.

Mr. Masten said that the KKR Asian Fund team attended the Private Markets Committee meeting and those Board members present found the team to be very impressive. He strongly urged that the Board approve the investment recommendation.

Treasurer Murphy reported that he was unable to attend the Committee meeting. He asked for further details on bridge loans and borrowing, noted on staff's executive summary, page 5, under key terms and conditions, and whether those investments would cause the total commitment to the fund to exceed the recommendation of $500 million. Mr. Ruggels said that both bridge loans and recycling are common industry practices. The situations are short-term in nature and the WSIB receives a return on the investments. In response to Treasurer Murphy's questions as to whether these could pose a delay in the drawdown of a commitment, Mr. Ruggels said that contractual term for drawdowns is six years.

The above motion carried unanimously

Green Equity Investors V, L.P.

Mr. Masten moved that the Board accept the Private Markets Committee's recommendation to approve an investment of up to $205 million, plus fees and expenses, in Green Equity Investors V, L.P., subject to continued due diligence and final negotiation of terms and conditions.

He said that the recommendation is based, in part, on the following: (1) The team has many years of experience with the seven partners having over 120 years of combined experience. The three managing partners have worked together in various capacities for over 20 years; (2) Leonard Green & Partners (LGP) has produced a strong long-term track record with substantial realizations. Since 1990, the team has drawn $2.5 billion in four prior funds and has returned $3.3 billion to investors. The four prior funds have a remaining net value of $1.8 billion and, in aggregate, have a net IRR of 28 percent and a 2.1x net multiple; (3) The team will invest Green Equity Investors V (GEI V) using the same successful investment strategy and process used since 1990 in prior GEI funds. GEI V will target middle-market buyouts, a segment of the market that is under-represented in the WSIB portfolio. The focus is on growing, cash flow positive businesses with strong management and a dependable, market-leading franchise. In addition, LGP rarely participates in club deals, so will have less overlap with other general partners (GPs) in the portfolio; (4) LGP has a differentiated method of proactively generating deal flow. All partners regularly visit senior management or owners of companies in industries that LGP believes have attractive investment characteristics. Deals are also sourced through an extensive network of relationships; and, (5) This is an opportunity to expand a successful relationship with a high-quality existing partner.

Ms. Matheson seconded, and the above motion carried unanimously.

Annual Plan
Chair McElligott announced that the Board would go into executive session at 10:20 a.m. to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the executive session was expected to last until 10:45 a.m. at which time the Board would reconvene in open public session.

[The executive session concluded at 11:46 a.m. and the Board took a brief recess.]
[The Board reconvened in open session at 11:52 a.m.]

> **Vice Chair Gorton moved that the Board accept the Private Markets Committee's recommendation to adopt the confidential private equity investment plan for calendar year 2007 that was presented and discussed in executive session, to be used as the guide for the Board and staff as to the types, number, size, and overall targets for private equity investments in 2007. Chair McElligott seconded, and the motion carried unanimously**

ADMINISTRATIVE COMMITTEE REPORT
The Administrative Committee met just prior to the Board meeting.

Executive Director Evaluation
Chair McElligott announced that the Board would go into executive session at 12:05 p.m. to review and discuss the performance of a public employee. He said the executive session was expected to last until 12:45 p.m., at which time the Board would reconvene in open session.

[The executive session concluded and the Board reconvened in open session at 1:07 p.m.]

> **Vice Chair Gorton moved that the Board accept the Administrative Committee's recommendation to approve the executive director evaluation as written. Ms. Matheson seconded, and the motion carried unanimously.**
>
> **Vice Chair Gorton moved that the Board approve increasing the executive director's salary to $209,486. Mr. Petit seconded, and the motion carried unanimously.**

[Treasurer Murphy was no longer in attendance at 1:08 p.m.]

Real Estate Discussion
Chair McElligott announced that the Board would go into executive session at 1:09 p.m. to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the executive session was expected to last until 1:20 p.m. at which time the Board would reconvene in open public session.

[The executive session concluded at 1:18 p.m. and the Board took a brief recess.]

[The Board reconvened in open session at 1:23 p.m.]
[Senator Brown was no longer in attendance at 1:23 p.m.]
[Mr. Scott was not in attendance at 1:23 p.m.]

> **Vice Chair Gorton moved that the Board accept the Private Markets Committee's recommendation approve the guidance provided to staff in executive session as to one of the WSIB's real estate investments. Ms. Matheson seconded, and the motion carried unanimously.**

PUBLIC MARKETS COMMITTEE REPORT

The Public Markets Committee met on January 10.

GMO Emerging Illiquid Fund, L.P.

Mr. Bruebaker reported that Grantham, Mayo, Van Otterloo (GMO) developed this strategy to invest in illiquid listed and unlisted companies within emerging markets with an emphasis on the combination of country and sector. This opportunity is new and unique, consisting of both public and private equity characteristics and features, and is a good strategy for patient, long-term investors such as the WSIB. He said the recommendation is based, in part, on the following: (1) The investment team is strong and will employ a well-defined and disciplined investment strategy that can leverage their expertise to employ creative ways to discover opportunities and invest in emerging markets. GMO has an existing network of relationships with local agents, which provides a competitive advantage in deal sourcing; (2) The firm's outstanding reputation, especially for their discipline in adverse markets; (3) GMO's attractive returns in its existing, more traditional emerging markets products; and, (4) This is an opportunity to expand a successful relationship with an existing high quality investment manager.

[Mr. Scott was in attendance at 1:24 p.m.]

> **Vice Chair Gorton moved that the Board approve the Public Markets Committee's recommendation to approve an investment of up to $50 million, plus fees and expenses, in GMO Emerging Illiquid Fund, L.P., subject to continued due diligence and final negotiation of terms and conditions. Ms. Matheson seconded, and the motion carried unanimously.**

BOARD GOVERNANCE FOLLOW-UP

Ms. Gold J.D., Director & Adjunct Professor, School of Law, Director, Center on Corporations, Law and Society, reported that she and two Seattle University (SU) School of Law professors had attended the Board's July retreat to observe the dynamics and interaction of the Board. She was asked to prepare observations and develop recommendations based on that interaction.

Ms. Gold applauded the Board for taking governance seriously, noting it is important that the WSIB model the expectations it has for companies within its portfolio. SU's observations from the retreat left them with the impression that WSIB is a highly functional board. WSIB's governance procedures and dynamics are pretty sophisticated.

Ms. Gold laid out the Board's fiduciary duties: set strategy and perform oversight of the executive director and WSIB performance. She presented a five state framework which describes boards over the range of passive to decision making and described the ideal level of involvement and checklists for ideal governance. She stated that from SU's work the middle state, "engaged board," is the best practice. Ms. Gold indicated that from her observations, WSIB is in many ways operating at an engaged board level—but there are items that need work. The material described the ideal level of involvement and provided a checklist for ideal governance. The checklist is a useful tool for Board self-assessment.

Ms Gold provided SU's observations on WSIB's strengths and challenges. For strengths she cited:

1) Highly functional Board;
2) A commitment to positive governance and ethics; and
3) Professional and collegial interaction on the Board where oversight can occur in a "safe" environment.

Additional strengths include the breadth of investment knowledge and the Board's willingness to engage outside experts for advice.

Ms. Gold suggested that the Board ask itself "what should we do to get better?" Mr. Kaminski observed that examination of the checklist seems to be a natural next step for the Board. Ms. Gold agreed. WSIB could use the check list for a "deep dive" on itself.

Mr. Magnuson raised the issue of renewing boards yearly and its jeopardizing institutional memory. The subsequent discussion concluded that the Board is helped by institutional memory. Institutional memory at WSIB is an asset. This is because of the steep learning curve required for members to come up to speed.

Ms. Gold indicated that WSIB is held to a higher standard than corporate boards because members are considered trustees.

Mr. Nierenberg asked that, for this discussion, the Board focus on three or four things to work on as opposed to the entire checklist provided earlier.

Ms. Gold responded by saying that the Board's biggest challenge is to differentiate between oversight and management. Ms. Gold said that the fine line between oversight and management is one of the most complicated and stickiest issues in corporate governance. She suggested that if the Board focuses more on strategy there would be less confusion. It is management's responsibility to implement strategy, but management should realize the Board has the right of active oversight and to ask questions, delve into strategic issues, perform deep-dives of its own choosing, and conduct performance evaluations.

Ms. Gold stated that executive sessions without staff and management is a best practice. The Board needs to look into management and management needs to know that the engaged oversight of management must be driven by the Board.

A discussion ensued regarding the multiple classes of directors within the WSIB, varying appointment processes, responsibilities of Board and Committee chairs, and code of conduct.

Ms. Matheson suggested that the Board discuss and agree on an acceptable set of oversight and behavioral protocols. Chair McElligott suggested that discussion occur in executive session at, or before, the next Board retreat. Ms. Matheson stated that the Board sets the example and needs to be aware of this. Mr. Magnuson brought up "discussion ad nauseum" and micro-management as issues.

Ms. Gold built on this topic stating that it is the role of the Chair to set standards and behavior. But, there has to be a will to do the right thing on the part of the Chair, the Board, and all participants. With respect to "blowing the whistle" there has to be a zero tolerance for retribution. Ms. Matheson stated that we need to schedule a discussion on behaviors. Mr. Masten responded that this is not a simple issue. Ms. Gold emphasized the role of executive sessions. Ms. Gold followed by saying that it is the responsibility of the entire Board to keep members in line.

Ms. Gold said that the other primary challenge that faces WSIB is rigid adherence to transparent deliberations at all times. Transparency is important because WSIB is a public board and has a responsibility to the public for same. WSIB is committed to transparent deliberations but has organically realized that there are time when executive sessions are appropriate; for example, so that the Board can have candid discussions about performing its duties of oversight and setting strategy.

Recommendations:
Strategy is a proactive task for the Board. It needs to decide where strategy is needed and must dedicate time at meetings for its discussion and its development. Ms. Gold stated that Mr. Dear has many ideas and issues where the Board can weigh in, and that this would be helpful to management.

The Board should solicit ideas from the executive director to identify additional topics where management needs more guidance on strategy. Regarding the latter, identifying those strategic issues and expectations will be a good template for the Board to use when it engages in its oversight role. Oversight and strategy are related.

Continuing on strategy, Ms. Gold stated that reserving more meeting time for discussion is really critical and is how the Board will create the space "to go deep (whether Board or management raised)" and also talk about issues that might get pushed aside for lack of time. If this means alerting the frequency and/or length of meetings, then this should be addressed.

Oversight: According to Ms. Gold, oversight is the second major area the Board needs to address. She stated that she was not sure how far along the Board is regarding setting its own agenda with input from the executive director and the organization. But, the Board appears to be going in this direction and more of this is great:

1) Getting the information it needs and wants to see;
2) Setting expectations; and
3) Working in collaboration with the executive director.

She went on to say that the Board needs to establish what it needs in order to evaluate both the organization's and executive director's performance. This will be driven by the Board's oversight role. The Board needs to evaluate when engaging in oversight whether it needs different information than when looking at a management decision.

Executive Sessions: According to Ms. Gold, executive sessions facilitate discussions on strategy and oversight, as well as provide the environment where hard questions can be asked. If an executive session is made a part of a Board meeting, then there is no need to discuss whether to have one or not—they become automatic. This way executive sessions are not just triggered when there is a pressing issue. It becomes more process-based rather than reactive.

[Ms. Schurke was no longer in attendance at 2:14 p.m.]

Mr. Kaminski asked Assistant Attorney Silver if there is an issue with respect to spontaneous executive sessions. Mr. Silver advised that the Board could call an ad hoc executive session and can regularly conduct executive sessions at Board meetings, but Committee meetings must be handled differently as they are considered special meetings. He said that executive sessions must meet one of the allowable criteria as set by statute. The law does require that the Board, prior to going into executive session, make a proper announcement as to why the Board is going into executive session. Mr. Silver went on to say that if there is no need for discussion at that time under the agenda item, then the Board could deal with it just as it currently does for *Public Comment* and the *Assistant Attorney General's Report.*

An executive session may or may not be Board-only, or both.

Mr. Dear asked if the personnel exemption is enough for the Board to talk about its own performance? Mr. Silver stated that it is robust enough to do so.

Mr. Dear suggested one topic from a "Board-only" executive session that would be enormously helpful for him: feedback after a Board meeting on what "worked" and what "needs to be changed."

Ms. Gold suggested that the draft of meeting notes be sent out on a timelier basis.

Ms. Gold asked whether the Board should create a Governance Committee.

Ms. Gold suggested that a good method for determining the lines between strategy (Board) and implementation (management) is to examine a big decision and carve out who decides what and how the decisions are made and measured. There is much work in the general governance area. For example: how does the Board tease-out what is management versus what is oversight? One way to determine this is to examine what decisions get made and who makes them.

Mr. Magnuson brought up the subject of how Board Committees are run and the issue of getting a complete, engaged discussion in the face of "volume" and bias. Ms. Gold stated that the Chair of the Committee should control the meetings, but that this does not remove individual members from maintaining control.

Mr. Kaminski thanked Ms. Gold for closing the loop on board best practices by building on the general best practices presentation and observations made during last summer's retreat so that the Board could hear how they apply in its own situation. He went on to say that this is not a zero-sum game where, for the Board to "win," the executive director has to "lose." Rather, both win or both lose, and the Board can be a resource for the executive director.

Mr. Kaminski asked Ms. Gold if she could provide us with a list of "deep dives" that boards have surfaced from her other work. He stated that he has his own list and knows that Mr. Nierenberg has one as well.

Mr. Kaminski suggested that the (currently agreed upon) quarterly Board-only discussions occur after "deep dive" sessions so that the Board can discuss the topic while the information is fresh.

Mr. Nierenberg asked that the subjects be planned in advance so that members can prepare for the discussion. He also would like to have a discussion on how the Board spends its time. In addition, Mr. Nierenberg stated that he wants to make sure that the Board recognizes that WSIB is blessed with the staff of the quality it has. He would also like to see the Board take time at the end of each meeting to answer the question: "How did we do?"

Recommended Conference List 2007

> **Ms. Matheson moved that the Board accept the Administrative Committee's recommendation to approve the 2007 Recommended Conference List, to include staff's recommendations of general partner annual conferences that focus on leveraged buyouts, international private equity, and venture capital investing. Vice Chair Gorton seconded, and the motion carried unanimously.**

AAG report

Mr. Silver reported on a recent appeal filed in the Enron class action to have the action brought as separate litigations. The Enron class action will proceed to trial if the trial court decision is upheld but the April date will likely be postponed. If the appeal is successful, the WSIB may need to bring a separate claim similar to what it did for WorldCom.

STRATEGIC ASSET ALLOCATION

Chair McElligott announced that the strategic asset allocation discussion would be postponed to the February Board meeting.

DIRECTED BROKERAGE POLICY 2.05.700 REVISION

Mr. Dear reviewed the WSIB's past practice of using commissions from investment managers for purchasing services directly related to investments (such as research and software) and reporting activity annually to the Board. He reported that the WSIB no longer does direct purchases, and the non-appropriated budget is used instead for these expenditures. The proposed policy revision reflects this change in practice and would no longer require annual reporting. Mr. Dear said that he would periodically report to the Board on recaptured directed brokerage proceeds deposited into WSIB funds.

> **Vice Chair Gorton moved that the Board approve the Directed Brokerage Policy 2.05.700 revision. Chair McElligott seconded, and the motion carried unanimously.**

OTHER ITEMS

Mr. Bruebaker informed the Board that staff had planned to update the asset allocation implementation plan in January 2007, but with the Board's permission staff would now continue to use the approved implementation plan and will update it upon the completion of the new asset liability study scheduled for July 2007. There was no disagreement with this direction.

There was no further business to come before the Board. The meeting adjourned at 2:37 p.m.

Pat McElligott
Chair

ATTEST

Joseph A. Dear
Executive Director