

**WASHINGTON STATE INVESTMENT BOARD**  
**Board Meeting Minutes**  
**January 17, 2008**

The Washington State Investment Board met in open public session at 10:01 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Glenn Gorton, Chair (via teleconference)  
Sandy Matheson, Vice Chair (Acting Chair)  
Charlie Kaminski (via teleconference)  
John Magnuson  
George Masten  
Treasurer Mike Murphy  
Bob Nakahara (via teleconference)  
David Nierenberg  
Mason Petit  
Mike Ragan  
Judy Schurke

Absent: Senator Lisa Brown  
Pat McElligott  
Jeff Seely  
Representative Helen Sommers

Also Present: Joe Dear, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Theresa Whitmarsh, Chief Operating Officer  
Steve Lerch, Research Director  
Beth Vandehey, Risk and Compliance Manager  
Steve Draper, Senior Investment Officer – Real Estate  
Bill Kennett, Senior Investment Officer – Fixed Income  
Tom Ruggels, Senior Investment Officer – Private Equity  
Diana Will, Senior Investment Officer – Asset Allocation  
Kristi Haines, Executive Assistant

Paul Silver, Assistant Attorney General  
Robert A. Berry, Goldman Sachs  
Don Raymond, Canada Pension Plan Investment Board

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

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

## **OATH OF OFFICE – MICHAEL P. RAGAN**

Acting Chair Matheson administered the oath of office to Mike Ragan, an active member of the Teachers' Retirement System, who is appointed for a new three-year term effective January 1, 2008, through December 31, 2010. Mr. Ragan briefly described his background and experience.

## **COMMITTEE ASSIGNMENTS**

Acting Chair Matheson invited comment on the Chair's recommendation of Committee assignments.

**Treasurer Murphy moved that the Board approve the following appointments:**

- **Appoint Mike Ragan as a member of the Audit and Public Markets Committees;**
- **Replace Senator Lisa Brown on the Public Markets Committee with Mr. Masten and appoint Mr. Masten as the Public Markets Committee Chair, which also appoints him to the Administrative Committee; and**
- **All other members remain on the Committees to which they are currently assigned.**

**Mr. Masten seconded and the motion passed unanimously.**

## **ADOPTION OF THE DECEMBER 20, 2007, MINUTES**

**Mr. Masten moved to adopt the December 20, 2007, meeting minutes.**

**Treasurer Murphy seconded the motion.**

Ms. Schurke asked if the word "nonappropriated" was correct on page 7 of the minutes. Mr. Dear confirmed the minutes were accurate.

**The above motion passed unanimously.**

## **PUBLIC COMMENT**

There was no public comment.

## **EXECUTIVE DIRECTOR'S REPORT**

Mr. Dear provided his monthly report for January on Board governance, staff, investments, operations, public affairs, open procurement activities, and meetings. He provided an updated Board and Committee meeting schedule, which added an Administrative Committee in April. He noted the annual Board member education report was also attached to the monthly report. Mr. Dear reported on current developments relating to the Iran divestment issue and agency request legislation.

Ms. Schurke asked for an update on efforts to address the inaccuracies of the Pew Charitable Trust report relating to the funding status of Washington State retirement systems. Acting Chair Matheson reported that the link had been disabled from the Pew report. Five other states also reported significant problems with the report. Pew has been given reasons why their data contained errors; the report only included closed Plans 1, not open plans. Pew is reviewing their methodology and correct data is anticipated. Acting Chair Matheson said that *Pensions & Investments* magazine

may publish a correction, and all national pension organizations in the country have been notified of the inaccuracies. Mr. Dear said that the Governor's Office and Department of Retirement Systems have the lead on this issue.

Treasurer Murphy asked staff to consider deferring the November 5-6 Private Markets Committee meeting to the following week due to the election. Mr. Dear said staff is trying to maximize attendance and will look into rescheduling it.

#### **TWENTY-SIXTH ANNUAL REPORT, 2007**

Mr. Dear presented the Board's annual report for approval. The report contains the audited financial statements for Fiscal Year 2007, which were reviewed by the Audit Committee and accepted by the Board, and narrative reports. Mr. Dear said the annual report is produced entirely in-house at low cost and only a limited number of copies are printed. The annual report will be posted on the WSIB website.

**Mr. Masten moved that the Board approve the Twenty-Sixth Annual Report, 2007. Ms. Schurke seconded the motion.**

Mr. Nierenberg asked to have language restated on page 16 relating to "asset trust strategy." He also noted concern with the prominent mention of Enterprise Risk Management (ERM) throughout the report. He cautioned not to overstate the Board's current position, being in the early phases of risk management and measurement. He also pointed out that pages 10 and 15 describe diversification as a means of risk mitigation and management. Mr. Nierenberg reminded staff that partner selection and asset classes where the Board tries to outperform benchmarks are other ways to mitigate and manage risk. Mr. Dear believes it is important to report the ERM efforts to demonstrate that the Board thinks comprehensively and would prefer to leave the ERM language as is. He said staff would clarify "asset trust strategy."

**The above motion passed unanimously.**

#### **ADMINISTRATIVE COMMITTEE REPORT**

Acting Chair Matheson reported that no action was taken at the Administrative Committee.

Acting Chair Matheson announced that the Board would go into executive session to review and discuss the performance of a public employee. She said the executive session was expected to last until approximately 10:50 a.m., at which time the Board would reconvene in open session.

[The executive session began at 10:35 a.m., and the Board reconvened in open session at 11:17 a.m.]

#### **PRIVATE MARKETS COMMITTEE REPORT**

Acting Chair Matheson announced that the Board would go back into executive session to discuss financial and commercial information relating to the real estate annual plan and the private equity annual plan 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. She said

the executive session was expected to last until approximately 11:45 a.m., at which time the Board would reconvene in open session.

[The executive session began at 11:17 a.m., and the Board reconvened in open session at 12:11 p.m.]

### **Real Estate Annual Plan**

**Mr. Masten moved that the Board adopt the confidential 2008 Real Estate Annual Plan that was presented and discussed in executive session. Treasurer Murphy seconded and the motion passed unanimously.**

### **Private Equity Annual Plan**

**Mr. Masten moved that the Board adopt the confidential 2008 Private Equity Annual Plan that was presented and discussed in executive session. Ms. Schurke seconded the motion.**

Treasurer Murphy said he had not received information he asked staff to provide. He announced that he would vote no on the motion, as he believes the plan will exceed the Board's allocation target. Mr. Masten spoke in support of the motion noting his belief that history will repeat itself and it will take years to reach the target.

**The above motion passed, with Treasurer Murphy voting no.**

### **Tangible Assets Policy 2.10.900 Adoption**

**Mr. Masten moved that the Board adopt the proposed Tangible Asset Investment Policy 2.10.900. Mr. Petit seconded the motion.**

Mr. Masten said the proposed policy continues the WSIB's historical process, with investment control by the Board based on staff's recommendation.

**The above motion passed unanimously.**

Mr. Masten reported on three investment recommendations forwarded by the Private Markets Committee.

### **Real Estate Investment Recommendation – Prosperitas Real Estate Partners II, L.P.**

**Mr. Masten moved that the Board approve an investment of up to \$50 million, plus fees and expenses, in Prosperitas Real Estate Partners II, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten said the recommendation, if approved, along with an additional \$50 million invested through the Emerging Markets Fund of Funds, would total an investment commitment of \$100 million. The fund's target size is \$600 million. The fund will invest opportunistically in real estate transactions throughout Brazil. The WSIB invested \$50 million in the first Prosperitas fund. He said the recommendation is based, in part, on the Brazil's compelling demographics and strong and increasingly stable economy. These factors have led to strong demand for most types of real estate. At present, relatively few investors are focused on the country, leading to less competition and the potential for an early mover advantage. The Prosperitas team has shown good underwriting discipline and an ability to source quality investment opportunities, with an emphasis on lower-risk real estate strategies.

**Ms. Schurke seconded the motion.**

Mr. Magnuson said it is important that members understand the apparent risks of the investment, which has a single country focus and strong key man risk. He spoke in support of the recommendation as he believes the Board will be compensated for taking the risk forward.

**The above motion passed unanimously.**

**Private Equity Investment Recommendation – Madison Dearborn Capital Partners VI, L.P.**

**Mr. Masten moved that the Board approve an investment of up to \$150 million, plus fees and expenses, in Madison Dearborn Capital Partners VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten reported that Madison Dearborn Capital Partners VI will be a \$10 billion buyout fund targeting large, control transactions primarily in North America. The WSIB is an existing investor with Madison Dearborn, having committed \$109.9 million to Fund III in 1999, \$300 million to Fund IV in 2000, and \$175 million to Fund V in 2006. He said the recommendation is based, in part, on Madison Dearborn's strong performance; deep, stable, and experienced team; and successful strategy with a focus on seven industries in which the firm has developed substantial knowledge and expertise. Since 1993, the firm has invested \$11.2 billion in 115 transactions that have produced net distributions to limited partners of \$8.1 billion, with \$11.6 billion of net remaining value, for a net IRR of 22.0 percent and a net value multiple of 1.8x. Madison Dearborn was a good partner during difficult times, voluntarily waiving management fees in Fund III and lowering fees in Fund IV when the funds were significantly negatively impacted by the downturn in the telecommunications sector beginning in 2000. The firm worked hard to turn around the performance of Fund III, which is now showing a net double digit return.

**Ms. Schurke seconded the motion.**

Treasurer Murphy advised that, while he voted for the recommendation at the Committee meeting, he anticipated getting further information from staff relative to the annual plan. He said he had not

yet received the requested information, so he would vote against the motion as he is concerned that the private equity allocation target will be exceeded. He said that Madison Dearborn is a good firm.

**The above motion passed, with Treasurer Murphy voting no.**

**Private Equity Investment Recommendation – Bridgepoint Europe IV, L.P.**

**Mr. Masten moved that the Board approve an investment of up to €150 million, plus fees and expenses, in Bridgepoint Europe IV, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten reported that the fund will invest in middle-market companies, primarily in the U.K. and Western Europe and, to a lesser extent, in Eastern Europe and the Nordic region. The WSIB is an existing investor with Bridgepoint, having committed €100 million Fund III in 2005. He said the recommendation is based, in part, on Bridgepoint's deep and experienced investment team; solid, long-term track record with substantial realizations; and investment strategy that targets middle-market European companies. Since 1998, the firm has drawn €4.3 billion for investment in 105 companies and has achieved an overall net IRR of 15 percent and net multiple of 1.6x, including €4.3 billion in distributions. The investment is a good fit in the WSIB private equity portfolio and is complementary to the WSIB's significant exposure to larger European funds targeting much larger companies.

**Mr. Petit seconded the motion.**

Treasurer Murphy said he would vote no, consistent with his earlier decisions based on his concern of exceeding the allocation target. He said he likes Bridgepoint's numbers, but has two concerns: currency risk and drawdowns over the past two years

**The above motion passed, with Treasurer Murphy voting no.**

Mr. Masten noted an article in *Pensions & Investments* magazine about an enhanced index manager that is experiencing performance problems. Mr. Dear said the manager is within the WSIB portfolio and concerns with the investment had been verbally reported and underperformance relative to the benchmark was contained within past quarterly performance reports. Mr. Masten directed staff to bring the manager before the Public Markets Committee in February.

[The Board took a brief recess at 12:27 p.m.]

[Mr. Nakahara and Treasurer Murphy left the meeting at 12:27 p.m.]

[The Board reconvened in open session at 12:40 p.m.]

**RESEARCH WORKSHOP - RISK**

Ms. Whitmarsh introduced the Research Workshop on Risk. In building the WSIB's risk program, staff had opportunities to look at other investment management risk frameworks. The Goldman Sachs and Canada Pension Plan Investment Board frameworks represent best in class. Mr. Lerch was introduced to provide an overview of what the WSIB has discussed previously, what it believes, and where it is currently with risk management.

Mr. Lerch said that initial risk efforts surrounded ERM, with a goal of creating a risk-aware culture and getting staff to think about risk in a wide-ranging sense across a broad spectrum of the agency. Six key risks were identified: fiduciary, market, strategic, government environment, operational, and reputation. To date, identified risks have been mostly operational. The current goal is to expand risk management into investments.

Mr. Lerch reviewed behavioral biases discussed at the July retreat, which serves as a starting point to develop a framework to protect against such biases. It is also important to distinguish risk versus uncertainty. The WSIB cannot protect itself against all risks, but should have a goal to receive compensation for risks taken portfolio wide, and protect against permanent risks. He said that risk consideration needs to be central to the investment management process.

### **Robert A. Berry - Goldman Sachs**

Mr. Berry provided an overview of the risk function at Goldman Sachs. Goldman's risk management process includes management oversight and guidelines, information sharing, cost/benefit analyses, identification and prevention of franchise-threatening events, organizational awareness and a risk culture, segregation of duties, and remedies to deal with process weaknesses. He said risk management is a mature process within the industry and it would be beneficial to any organization to insert it into its decision-making. He reported that Goldman fared the credit markets' events well and continuously improves its risk management program.

Mr. Berry described the governance and organization structure at Goldman Sachs. Mr. Berry then addressed Goldman's risk objectives, philosophy, and culture. He said they expect to take risk and experience market and credit loss, but do not want to take reputation losses. He stressed the importance of having timely communications.

In response to Mr. Bruebaker's question about how frequently Goldman has exceeded its VaR (Value at Risk) limits as compared to its model, Mr. Berry said that exceptions have been very low up until the very recent past; models are being refined to adapt to changes.

Mr. Nierenberg asked Mr. Berry to describe how incentive compensation works within Goldman's risk management area. Mr. Berry replied that it is discretionary, based on performance of the individual, business unit, and firm. He said it is important to adequately compensate the risk group to prevent poaching of talent to the revenue producing units.

[The Board took a brief recess at 1:55 p.m. and reconvened in open session at 2:07 p.m.]

### **Don Raymond – Canada Pension Plan Investment Board**

Mr. Raymond introduced the risk and accountability framework used at the Canada Pension Plan (CPP) Investment Board. He said CPP conducted a major strategy review in 2005, which resulted in a build up of internal capabilities.

Mr. Raymond described CPP as a professional investment management organization operating in the private sector with public sector accountability. He gave an overview of CPP's organizational structure and described its board, which is comprised of 12 people with proven financial experience.

He described CPP's mandate and its interpretation relative to the liabilities of the CPP. He commented on the balance of independence and accountability with its governance framework.

CPP's investment mission is to help lower future contribution rates by diversifying into higher returning assets and improve performance with beta diversification and active management. CPP measures success by its risk return accountability framework.

Mr. Raymond described CPP's total portfolio approach to manage risk and expected returns directly; manage asset classes with similar risk-return characteristics in a manner that accounts for both; manage investment risks at the total portfolio level; control active risk using a one-year VaR limit that cannot be exceeded; encompass alpha and beta decisions with active risk; budget and manage active risks within board limits; and view the portfolio as a risk allocation, with higher expected risk-adjusted returns allocated to the most risk capital. He said CPP's total portfolio overlay is a fairly new concept, with everything flowing through risk and performance measurement systems to create clear accountability on who makes what decisions. He said implementation has been challenging. Mr. Raymond described staffing increases resulting from the 2005 strategy review.

#### **BOARD DISCUSSION**

Acting Chair Matheson said there was nothing to discuss.

#### **OTHER ITEMS**

There was no further business to come before the Board. The meeting adjourned at 3:15 p.m.

  
Sandra J. Matheson  
Acting Chair

ATTEST

  
Joseph A. Dear  
Executive Director