

## WASHINGTON STATE INVESTMENT BOARD

### Board Meeting Minutes

November 20, 2008

The Washington State Investment Board met in open public session at 9:38 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Glenn Gorton, Chair  
Sandy Matheson, Vice Chair  
Senator Lisa Brown  
Charlie Kaminski  
John Magnuson  
Allan Martin (for Treasurer Mike Murphy)  
George Masten  
Pat McElligott  
Bob Nakahara  
David Nierenberg (via teleconference)  
Mason Petit  
Judy Schurke  
Representative Helen Sommers

Absent: Mike Ragan  
Jeff Seely

Also Present: Joe Dear, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Theresa Whitmarsh, Chief Operating Officer  
Steve Draper, Senior Investment Officer – Real Assets  
Bill Kennett, Senior Investment Officer – Fixed Income  
Phil Paroian, Senior Investment Officer – Public Equity  
Tom Ruggels, Senior Investment Officer – Private Equity  
Diana Will, Senior Investment Officer – Asset Allocation  
Kristi Haines, Executive Assistant  
  
Steve Dietrich, Assistant Attorney General  
Matt Smith, State Actuary  
Dave Woolford, Capital Dynamics

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

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

## ADOPTION OF THE SEPTEMBER 18, 2008, MINUTES

**Mr. McElligott moved to adopt the September 18, 2008, meeting minutes.**

**Mr. Petit seconded, and the motion carried unanimously.**

### PUBLIC COMMENT

Ms. Marguerite Young and Mr. Chris Cane of the Service Employees International Union introduced themselves. Ms. Young commented on the proposed \$750 million investment to KKR 2009 Fund. She noted that WSIB has the largest commitment to KKR, the highest private equity allocation in the nation, and is close to the top end of the private equity allocation adopted one year ago. She pointed out that other states are raising concerns about private equity and cutting back on their investments.

[Mr. Kaminski arrived at 9:41 a.m.]

Ms. Young said the investment is ill advised and its timing is bad. She commented on remarks made by Mr. Roberts about the leveraged buyout market. She also shared a concern with the dramatic expansion of the KKR firm, its expansion into other products, and the adjustments necessary to do business in a new climate. Mr. Cane, a Public Employees' Retirement System (PERS) 2 member, shared his concern with the amount the WSIB has invested with KKR. He does not believe it is good given the financial climate, and would like to see more diversification.

### COMMITTEE ASSIGNMENTS

**Chair Gorton moved that the Board approve the Chair's recommended Committee assignments. Mr. Masten seconded, and the motion carried unanimously.**

<b>Administrative Committee</b> <b>Chair</b> Glenn Gorton <b>Members</b> Sandra J. Matheson Patrick McElligott Mike Ragan Mason Petit	<b>Public Markets Committee</b> <b>Chair</b> Mike Ragan <b>Members</b> Charles A. Kaminski John W. Magnuson George Masten Robert S. Nakahara David Nierenberg Mason Petit Representative Santos Judy Schurke
<b>Private Markets Committee</b> <b>Chair</b> Patrick McElligott <b>Members</b> Glenn Gorton Charles A. Kaminski	<b>Audit Committee</b> <b>Chair</b> Mason Petit <b>Members</b> Senator Brown Charles A. Kaminski

John W. Magnuson George Masten Sandra J. Matheson Treasurer (Elect) McIntire David Nierenberg Jeffrey Seely	George Masten Sandra J. Matheson Treasurer (Elect) McIntire Robert S. Nakahara
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**EXECUTIVE DIRECTOR’S REPORT**

Mr. Dear provided his monthly report for November on market conditions, investments, Board governance, staffing, operations, meetings, and open procurements. He called the Board’s attention to the staff’s current views on rebalancing and noted that the issue would be discussed further during the quarterly performance report.

[Representative Sommers arrived at 9:50 a.m.]

**UPDATE ON PENSION LIABILITIES**

Mr. Smith presented information related to the latest actuarial valuation as of June 30, 2007. These are long-term assumptions, going out 30-40 years.

Mr. Smith described how the study looks at experiences, participant data, and contribution rates. He said there are two components with contribution rates: current annual cost, and Plan 1s past cost. He reviewed the recommended employer and member contribution rates for 2009-2011 resulting from the study. Mr. Smith highlighted key funding policies and recent funding policy changes, which include establishing minimum contribution rates, longer asset smoothing periods, and additional funding to account for longer life spans into the future.

The study looked at pension liabilities and used some key assumptions, such as valuation interest rates, salary increases, inflation, and growth in membership. Mr. Smith discussed the pension assets and explained that a smoothing method is used for recommending contribution rates rather than using market values, which are too volatile. Combining the assets and liabilities provides the funding status of the retirement plans. Mr. Smith said the results showed that the PERS 1 and Teachers’ Retirement System (TRS) 1 are underfunded. The other plans are well funded.

Mr. Smith described the effect of recent investment performance (based on October returns) on the funding status projections. He said an investment return of 2 percent for the fiscal year ending June 30, 2009 would mean all the deferred gains would be gone, while a return of less than 2 percent would eliminate all deferred gains and would create deferred losses to be amortized and would impact contribution rates.

In response to Senator Brown’s question on how Washington State funding ratios compare with other public pension plans, Mr. Smith said that Plans 2 and 3 are in the upper 5 to 10 percent, but Plan 1 is below average. Responding to Mr. Nakahara’s question regarding which key assumption affects projections the most, Mr. Smith said the 8 percent return assumption has the most effect.

Representative Sommers commented that she thought contribution rates would handle the underfunded status for PERS 1 and TRS 1. Mr. Smith said the funding is back loaded with the

majority of the payments made toward the end. These funds will see progress during periods of exceptional investment performance.

Responding to Mr. Masten's questions, Mr. Smith said that it helps the funding status when members delay retirement, but longevity has the opposite effect.

At Representative Sommers' request, a handout was distributed detailing the cost relating from the study.

[The Board recessed at 10:38 a.m. and reconvened in open session at 10:55 p.m.]

## **ADMINISTRATIVE COMMITTEE REPORT**

### **Investment Officer Compensation Plan Discussion**

Chair Gorton reported the Administrative Committee had a good discussion on McLagan's recommendations for the WSIB's Investment Officer Compensation Plan. Members were of the opinion that some adjustments should be done with regard to the base salary, but there is not much interest in doing anything with incentive compensation now, given the State's current position and the condition of the financial markets. He reported that McLagan would return to next month's Administrative Committee. Chair Gorton encouraged Board members to attend and participate in that discussion.

Mr. Nierenberg said he hoped the Board would approach the compensation plan discussion without restraints related to incentive compensation.

### **Collaboration Initiative**

Mr. Dear said that the WSIB had engaged in serious discussions with European, Canadian, and Australian funds regarding potential collaboration efforts. Initially it was thought there would be administrative costs associated with it, but the participating funds decided to proceed without forming an official entity to manage that effort. Staff will keep the Board apprised of developments. Mr. Dear thanked Ms. Whitmarsh for her good work on this opportunity.

## **2009 Recommended Conferences**

**Chair Gorton moved that the Board approve the 2009 Recommended Conferences listing. Mr. Masten seconded, and the motion carried unanimously.**

Chair Gorton announced that the Board would now go into executive session to discuss litigation or potential litigation with legal counsel since public knowledge regarding the discussion is likely to result in an adverse legal or financial consequence to the WSIB. He said the executive session is expected to last about five minutes at which time the Board will reconvene in open session.

[The Board went into executive session at 11:01 p.m.]

## **Assistant Attorney General's Report**

[The Board reconvened in open session at 11:07 a.m.]

## **BOARD DISCUSSION**

Chair Gorton invited all WSIB staff for the Board discussion. The Board recognized staff for their many years of dedicated work on behalf of beneficiaries. Mr. Kaminski thanked staff and remarked on the significant improvements within the agency since 1992. He encouraged staff to take the WSIB to the next level by building on what has been learned entering into this period where performance will not continue as it has in the past. Ms. Schurke pointed out the WSIB staff is not just a top performer relating to investing, but is also known as a leader within state government. She complimented the completeness of staff work done for the Board. Vice Chair Matheson said the attributes of a really good business often show the most during bad times. Mr. Masten said that he has seen alignment of interest between Board and staff over the years. He recognized the quality of staff and said every job within the agency is important. Mr. Martin said that during his recent campaign, about 20 percent of the questions he received were about the WSIB. He was proud each time to say what a well-run organization it is, and that it operates in the best interest of public service.

[The Board recessed at 11:31 a.m. and reconvened in open session at 12:13 p.m.]

## **PRIVATE MARKETS COMMITTEE REPORT**

Chair Gorton announced that the Board would go into executive session 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 is expected to last until about 12:30 p.m., at which time the Board will reconvene in open session.

[The Board went into executive session at 12:13 p.m. and reconvened in open session at 12:47 p.m.]

Mr. McElligott reported that the Private Markets Committee met on November 5 and 6, 2008, and discussed illiquid assets allocations, the Private Equity annual plan, and one investment recommendation.

### **Review of Illiquid Assets Allocation**

During the Review of Illiquid Assets Allocation, the Committee discussed the extreme market conditions, and the Board-adopted asset allocation policy ranges. In accordance with the Board's Retirement CTF Asset Allocation Policy 2.10.050, a conscious review by the Board is needed and was discussed during executive session.

### **Private Equity Annual Plan**

Additionally, the Committee met with staff in executive session to plan Private Equity activities for calendar year 2009 at the November Private Markets Committee meeting. This included a general update on the construction and performance of the Private Equity portfolio and discussion of investment strategies and commitments planned for 2009. Topics included overall goals for the Private Equity portfolio and investment pacing to achieve the Board's allocation target for Private Equity.

**Mr. McElligott moved that the Board adopt the confidential 2009 Private Equity Annual Plan that was discussed in executive session. Mr. Masten seconded, and the motion carried unanimously.**

## **KKR 2009 Fund, L.P.**

**Mr. McElligott moved that the Board invest up to \$750 million, plus fees and expenses, in KKR 2009, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Masten seconded the motion.**

Mr. McElligott reported that this is a mega-cap buyout fund being raised by Kohlberg Kravis Roberts & Co. (KKR) that will target large, franchise-leading businesses in North America and will also co-invest in all investments made by KKR's European and Asian Funds. This recommendation is based, in part, on KKR's strong franchise, global organization with extensive resources and expertise, strong track record, successful value-creation strategy, institutionalized decision-making and monitoring processes, and important long-term relationship with the WSIB.

**The above motion carried unanimously.**

Mr. Martin asked if this investment would cause the WSIB to exceed its target range. Mr. Bruebaker stated that both WSIB and Capital Dynamics' models indicate that we will exceed our target range for private equity with or without this investment within the 2010-2015 timeframe, coming back down in 2016 and after. He also pointed out the limitations of the models. Mr. Masten said this represents a great opportunity for a great partner to make investments that will pay off in the future.

[Mr. McElligott departed at 12:56 p.m.]

[Senator Brown departed at 12:58 p.m.]

## **QUARTERLY DISCUSSION OF MARKETS**

### **Portfolio Discussion**

Mr. Dear introduced the discussion and provided information on the housing market.

Mr. Bruebaker gave highlights from the third quarter investment performance report.

The Senior Investment Officers discussed performance and market conditions for the current quarter, and their view of the markets going forward for the asset allocation, Fixed Income, Public Equity, Real Assets, and Private Equity areas.

[Mr. Nierenberg left the teleconference at 1:32 p.m.]

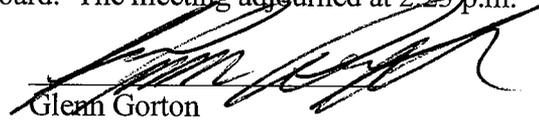
### **Private Equity Environment**

Mr. Woolford reviewed the volume and value of leveraged buyout transactions from 1998 to present and average transaction size from 1996 to present. Purchase price multiples are at 9.3x for year-to-date 2008, but he expects those will drop down to 7 to 7.5x. He discussed bank leverage and capital ratios, and the difference between U.S. and European transactions.

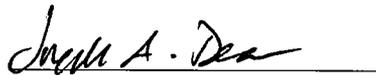
Mr. Woolford said that global private equity fundraising for 2008 is at the same pace as it was in 2006. While it has fallen off from the first quarter, there are areas that continue to be strong, which include distressed debt/turnaround, infrastructure, mezzanine, and secondaries. He described the supply and demand for secondaries, and said he expects it to be strong due to excess supply, which results in low prices.

**OTHER ITEMS**

There was no further business to come before the Board. The meeting adjourned at 2:23 p.m.

  
Glenn Gorton  
Chair

ATTEST

  
Joseph A. Dear  
Executive Director