

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
April 16, 2009

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

Present: Glenn Gorton, Chair
Steve Hill
Charlie Kaminski
John Magnuson (via teleconference)
George Masten
Treasurer Jim McIntire
David Nierenberg
Mason Petit
Mike Ragan
Judy Schurke
Jeff Seely

Absent: Senator Lisa Brown
Pat McElligott, Vice Chair
Bob Nakahara
Representative Sharon Tomiko Santos

Also Present: Theresa Whitmarsh, Acting Executive Director
Gary Bruebaker, Chief Investment 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
James Mackison, Technology and Innovations Director
Carrie Wolfe, Data Warehouse Project Manager
Kristi Haines, Executive Assistant

Steve Dietrich, Assistant Attorney General
Dr. Horace “Woody” Brock, Strategic Economic Decisions

[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 FEBRUARY 19, 2009, MINUTES

Mr. Masten moved to adopt the February 19, 2009, Board meeting minutes.
Mr. Petit seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh provided her monthly report for April on board governance, investments, budget, staff, meetings, and open procurements. She announced the July Board planning meeting would focus on asset allocation, risk, and corporate governance. Ms. Whitmarsh reported the proposed budget from the House of Representatives included the WSIB's full 16.5 FTE request, while the Senate proposal included 8 FTEs, in support of new investment initiatives. Although the Legislature still needs to reach consensus, staff believes either budget would well serve the WSIB. Ms. Whitmarsh congratulated administrative staff on a recent Teamwork Incentive Program award. Chair Gorton welcomed Ms. Whitmarsh as the Acting Executive Director.

WOODY BROCK PRESENTATION

Dr. Brock gave a presentation entitled *When Everything is up for Grabs*. He theorized how a perspective on current market conditions can be gained by examining what is not the same in this recession from past periods. He said history rhymes, but does not repeat. Dr. Brock shared his view that growth and productivity are needed for the current conditions to improve, as well as changes to Federal policies.

[The Board took a brief recess at 11:30 a.m. and reconvened in open session at 11:41 a.m.]

CAPITAL MARKET ASSUMPTIONS

Ms. Will introduced the capital market assumptions for the Board's consideration. She said these provide building blocks to the asset allocation decision, which will be discussed at the July meeting. She explained the modeling is used to quantify the expected average annual return and risk level for each asset class over a 15- to 20-year time period, and takes into consideration both historical and current information. In capital market assumptions, returns are a middle point in a bell-shaped curve, or the median, not a geometric return. Risk is defined as deviation from the median, and correlation is how asset classes move in relationship to each other. She described how returns, risk, and correlation are examined to develop an efficient frontier, which can be used to determine if different securities can achieve higher returns at the same level of risk.

Ms. Will said WSIB's proposed capital market assumptions are based on the asset class as a whole, and take into consideration portfolio construction, so they do not necessarily agree with consultant assumptions. She explained the minor changes from the 2008 assumptions, including one additional asset class: Liquidity Plus, which is provided for modeling a liquidity buffer that staff will present in July. Messrs. Nierenberg and Kaminski suggested it might be worthwhile to discuss modern portfolio theories at the July meeting.

Mr. Masten moved that the Board adopt the 2009 WSIB capital market return, risk, and correlation assumptions as stated in the presentation materials.

	Expected Return	Standard Deviation
TIPS	4.50	6.00
Fixed Income	4.75	4.75
Tangible Assets	6.50	8.00
Real Estate	8.00	15.00
Global Equity	9.25	16.90
U.S. Equity	9.25	17.00
International Equity	9.25	19.00
Private Equity	12.25	29.00
Cash	3.00	1.50
Liquidity Plus	3.75	3.00
Inflation	2.50	

Correlation	TIPS	Fixed Income	Tangible Assets	Real Estate	Global Equity	U.S. Equity	Int'l Equity	Private Equity	Cash	Liquidity Plus
TIPS	1.00	0.40	0.35	0.10	0.00	0.00	0.00	0.00	0.25	0.30
Fixed Income	0.40	1.00	0.30	0.20	0.20	0.30	0.15	0.20	0.20	0.25
Tangible Assets	0.35	0.30	1.00	0.40	0.00	0.00	0.00	0.00	0.20	0.30
Real Estate	0.10	0.20	0.40	1.00	0.43	0.45	0.40	0.40	0.15	0.20
Global Equity	0.00	0.20	0.00	0.43	1.00	0.85	0.90	0.75	0.00	0.10
U.S. Equity	0.00	0.30	0.00	0.45	0.85	1.00	0.80	0.70	0.05	0.10
International Equity	0.00	0.15	0.00	0.40	0.90	0.80	1.00	0.65	-0.10	-0.05
Private Equity	0.00	0.20	0.00	0.40	0.75	0.70	0.65	1.00	0.00	0.00
Cash	0.25	0.20	0.20	0.15	0.00	0.05	-0.05	0.00	1.00	0.45
Liquidity Plus	0.30	0.25	0.30	0.20	0.10	0.10	-0.10	0.00	0.45	1.00

Mr. Ragan seconded, and the motion carried unanimously.

[The Board took a brief recess at 12:16 p.m., and reconvened in open session at 12:43 p.m.]

[Mr. Seely left the meeting at 12:43 p.m.]

[Treasurer McIntire was not in attendance at 12:43 p.m.]

AUDIT COMMITTEE REPORT

Mr. Petit reported the State Auditor's Office had begun its 2009 accountability audit of the WSIB.

Conflict of Interest Policy 2.00.100 Revision

Mr. Petit said the Audit Committee reviewed a proposed revision to the Conflict of Interest Policy, to include a transfer of duty for the annual review from the Attorney General's Office (AGO) to the State Auditor's Office; a clarification of guidelines for gifts, meals, and entertainment based on feedback received in annual ethics training sessions; and an update of the definition of "immediate family" as it pertains to filing requirements of the Public Disclosure Commission and permissible investments to reflect societal changes and provide clarity.

Mr. Petit moved that the Board adopt the proposed changes to Policy 2.00.100, Conflict of Interest. Mr. Masten seconded, and the motion carried unanimously.

Internal Audit Report 2009-02 – Trade Processing, Confirmation, and Settlement

Mr. Petit reported that Internal Audit's overall assessment of trade processing, confirmation, and settlement at the WSIB was good; procedures that ensure trades are processed, confirmed, and settled appropriately are strong; and there are no recommendations.

Mr. Petit moved that the Board approve Internal Audit Report 2009-02, Trade Processing, Confirmation, and Settlement. Mr. Ragan seconded, and the motion carried unanimously.

The Audit Committee also received a report on quarterly outstanding audit recommendations, an overview of the agency's Enterprise Risk Management program and key risk results for 2008, an investment risk report, an overview of the WSIB's investment compliance program, and updated results and progress on the WSIB's private equity and real estate compliance monitoring. The Committee also received a preview of the 2009 Proxy Voting Season from Glass Lewis.

PUBLIC MARKETS COMMITTEE REPORT

Mr. Ragan reported the Public Markets Committee met on March 3 to conduct a review of the Public Equity Emerging Markets Program and met again on April 7 for an update to the Enhanced Indexing Program Review originally discussed in February.

Emerging Markets Program Review

Mr. Ragan said the Committee discussed the emerging markets exposure in the Retirement Commingled Trust Fund public equity portfolio. He said there are two primary contributors to the significant underweighting to emerging markets. The first factor is the decision by the WSIB's international broad-market managers to not invest or invest less in emerging markets given the current market environment. The other factor was the limitation on how much money the WSIB could put to work as many emerging markets managers had previously closed their products to new assets. He said while the short-term underweight to emerging markets served the WSIB well in 2008, staff believes the optimal portfolio positioning is to move closer to neutral over the medium term and overweight emerging markets in the long term. Because of the market turmoil and corresponding decline in assets under management, a number of highly respected managers have reopened their funds creating an opportunity to invest with managers not previously available to the WSIB. The 2009 Public Equity Annual Plan identified an emerging markets search to determine the availability of exceptional managers to add to our portfolio in an effort to move closer to a neutral allocation and then eventually to a long-term overweight. Staff proposes that the search take place in the second half of 2009 and will further brief the Committee and the Board in June. The staff and the Committee also discussed each of the five dedicated emerging market managers being used by WSIB. In particular, there was a discussion around Pictet Asset Management. Pictet has consistently underperformed, and their Chief Investment Officer and emerging markets investment team has changed several times.

At the April meeting, staff updated the Committee on recent departures from the team at Goldman Sachs Asset Management that managed WSIB's non-U.S. equity enhanced index portfolio.

[Treasurer McIntire was in attendance at 12:50 p.m.]

Mr. Ragan moved that the Board terminate the emerging markets equity

portfolio managed by Pictet. Mr. Petit seconded, and the motion carried unanimously.

Mr. Ragan moved that the Board direct staff to begin a competitive process to identify additional emerging markets managers for consideration by the Public Markets Committee and Board. Mr. Petit seconded, and the motion carried unanimously.

Enhanced Indexing Program Review Update

Mr. Ragan moved that the Board terminate the non-U.S. equity enhanced index mandate managed by Goldman Sachs Asset Management. Mr. Petit seconded, and the motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT

Ad Hoc Committee Report

Chair Gorton reported the *Ad Hoc* Committee met on April 2 to discuss the Executive Director's role, options for conducting an organizational review, the Executive Director recruitment process, and the type of candidate sought by the Board to fill the position. The Committee reviewed its role to make recommendations for the Board's consideration on organizational structure and to determine a recruiting process. He said the Committee decided to draft a Request for Proposals (RFP) to hire an executive recruitment consultant to work directly with the Committee and Board to agree on a process for and conducting the Executive Director recruitment. *Ad Hoc* Committee members are continuing to refine the draft RFP document, contained in the Board packet. Chair Gorton said Committee members believe there is good staff currently in place and feel an organizational review is unnecessary.

Chair Gorton moved that the Board keep its current organizational structure. Mr. Masten seconded the motion.

Mr. Hill said what he took from the *Ad Hoc* Committee discussion was the Board would learn more about the organizational structure in moving forward, and could direct the newly hired Executive Director to perform an organization structure review if deemed necessary.

Messrs. Masten and Ragan confirmed the motion was correctly stated. Mr. Ragan said his understanding was the Board is always ready to reevaluate and adjust the organizational structure but, at this point, the *Ad Hoc* Committee did not see a reason to wait before it proceeded with the Executive Director recruitment. Mr. Nierenberg said an executive search firm could determine the scope of their project based upon stakeholder interviews. It is most important to thoughtfully frame the RFP, select the best search firm, and to later analyze if organizational changes are appropriate. Treasurer McIntire said he believed the intention was to examine staff leadership. He reviewed and is reasonably comfortable with the Executive Director position description, but believes a further discussion is necessary. The Board discussed the fact it could engage in an organizational review at any time. Mr. Masten said he intended his motion would focus the *Ad Hoc* Committee on filling the Executive Director vacancy, rather than the organizational review.

The motion carried, with Chair Gorton voting no.

Mr. Hill said he hoped to move forward on the Executive Director recruitment. He shared the Department of Personnel's (DOP) Executive Careers unit could serve as a resource, either as a search firm or advisor. Mr. Masten shared his concern the draft RFP was written to contract an executive search consultant for a five-year term. He hoped to focus a recruiter solely on the Executive Director recruitment. He said DOP could be a viable source of assistance. Mr. Nierenberg concurred. A discussion ensued on the role of the *Ad Hoc* Committee's role, and how to conduct the interview process.

Mr. Masten moved that the Board delegate to the Ad Hoc Committee the authority to work with Department of Personnel to draft an RFP, enter into a contract for a search consultant for the Executive Director position, either with DOP or an outside consultant, and to proceed with recruitment of Executive Director candidates, and bring a slate of candidates to the Board for consideration. The search committee can meet privately to the extent allowable by open public meetings act. Mr. Hill seconded the motion.

A discussion ensued on the Administrative Committee Charter, and the Board's ability to delegate the task as deemed appropriate.

The above motion carried unanimously.

Board Policy Review

Chair Gorton said the Committee examined five policies with content changes, three with minor changes, and a number of policies with no changes recommended by staff. He said Role of Consultants Policy 1.10.100 was pulled back for the Administrative Committee to review at a future date. There were no questions on the proposed policy revisions.

Mr. Petit moved that the Board adopt proposed policy revisions 2.00.260, 2.00.240, 2.10.900, 2.13.100, 2.13.200, 1.10.200, 2.00.210, and 2.10.600; and reaffirm approval of policies that have no changes recommended, except Policy 1.10.100. Mr. Masten seconded, and the motion carried unanimously.

Assistant Attorney General's Report

Chair Gorton announced the Board would 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 was expected to last about 5 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 1:21 p.m., and reconvened in open session at 1:28 p.m.]

Mr. Ragan moved that the Board direct staff to work with the Attorney General's Office to retain the law firm of Coughlin Stoia Geller Rudman and Robbins, subject to negotiation of acceptable terms and conditions, for the purpose of filing and prosecuting the lawsuit discussed during the executive session. Mr. Petit seconded, and the motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on April 2 and discussed one investment recommendation and the private equity portfolio. The Committee also heard a presentation by

Professor Josh Lerner, Harvard Business School, and Steve Lerch, WSIB Research Director. The Committee met again on April 15 to discuss one additional item of business.

TA XI, L.P.

Mr. Masten moved that the Board invest up to \$150 million, plus fees and expenses, in TA XI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Chair Gorton seconded the motion.

Mr. Masten reported TA Associates is an existing general partner relationship. The fund will target investments that range from growth equity to growth buyouts in profitable middle-market companies with above-average growth in technology, financial and business services, healthcare, and consumer industries predominantly in North America and Western Europe. He said the recommendation is based, in part, on TA Associates' experience, excellent performance across multiple economic cycles, proven investment strategy, strong sector focus, in-depth industry knowledge, and excellent fit in the WSIB private equity portfolio.

The above motion carried unanimously.

Private Equity Portfolio Structure

Chair Gorton announced 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 Board may also review and discuss the performance of Board members and of the Board during the executive session. He said the executive session was expected to last about 5 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 1:31 p.m., and reconvened in open session at 1:41 p.m.]

Mr. Masten moved that the Board authorize staff, based on the Board's decision not to actively invest in venture capital, to terminate the Pathway Capital Management contract and transition the reporting of the Pathway funds to Capital Dynamics. Mr. Petit seconded, and the motion carried unanimously.

KKR Annex Fund

Mr. Masten moved that the Board invest up to \$94 million plus fees and expenses in KKR E2 Investors L.P. (the Annex Fund) and correspondingly reduce the WSIB's commitment to the KKR European Fund III, L. P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Petit seconded the motion.

Mr. Bruebaker reported the Annex Fund is being formed to invest in select portfolio companies of the KKR European Fund II in which KKR anticipates additional capital being invested. He said this is not expansion capital. The WSIB committed \$500 million to Europe 2 in September 2005, and \$700 million to Europe 3 in February 2008. Europe 2 has been fully invested, and the WSIB's commitment has been fully drawn down. Europe 3 is early in its investment period and very little has been drawn down. The return goal for each investment in the Annex Fund will be based on today's market in companies that KKR knows very well. This

is doing 2009 and 2010 investments in companies based on today's conditions. There are more favorable economics with this deal. Mr. Bruebaker said all advisory committee members will be voting on this and the WSIB staff stands behind it. Mr. Nierenberg said he hoped other general partners would come to the WSIB with similar opportunities.

The above motion carried unanimously.

[Ms. Schurke left the meeting at 1:46 p.m.]

DATA WAREHOUSE

Overview

Mr. Mackison provided an overview of the Data Warehouse system. Staff worked with the vendor, DSTi, to set-up the system which takes data from multiple systems and data providers and standardizes and stores it so that queries can be made relating to investment exposures and performance.

[Treasurer McIntire left the meeting at 1:48 p.m.]

Mr. Mackison explained staff undertook the project to centralize data, reduce manual reporting and research processes, become less reliant on external entities for information, and develop a system to address risk and support decisions. He described system benefits, project cost, and the schedule and deliverables. A discussion ensued on the confidence level in reliability of output.

Mr. Mackison introduced Ms. Wolfe to provide the Data Warehouse demonstration.

Demonstration

Chair Gorton announced 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 Board may also review and discuss the performance of Board members and of the Board during the executive session. He said the executive session was expected to last about 15 minutes, at which time the Board would reconvene in open session.

[Mr. Hill left the meeting at 2:03 p.m.]

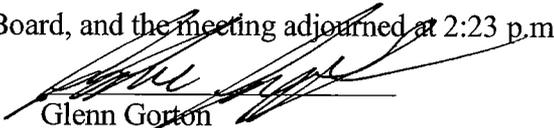
[The Board went into executive session at 2:03 p.m., and reconvened in open session at 2:22 p.m.]

BOARD DISCUSSION

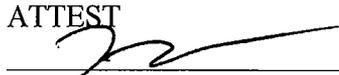
Chair Gorton asked members to give due consideration to travel necessary to attend conferences and meetings, given the current state of the economy.

OTHER ITEMS

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


Glenn Gorton
Chair

ATTEST


Theresa J. Whitmarsh
Acting Executive Director