WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
July 14-16-2009

The Washington State Investment Board met in open public session at 1:04 p.m. on July 14, 2009, in the Miller Room at 3600 Suncadia Trail, Cle Elum, Washington.

Present:	Glenn Gorton, Chair Patrick McElligott, Vice Chair Senator Lisa Brown Steve Hill Charlie Kaminski John Magnuson George Masten Treasurer Jim McIntire Bob Nakahara David Nierenberg Mason Petit Mike Ragan Representative Sharon Tomiko Santos Judy Schurke Jeff Seely
Also Present:	Theresa Whitmarsh, Acting Executive Director Gary Bruebaker, Chief Investment Officer Liz Mendizabal, Public Affairs Director 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 Steve Lerch, Research Director Kate Sandboe, Corporate Governance Officer Beth Vandehey, Risk and Compliance Director Kristi Haines, Executive Assistant Marie Repcik, Administrative Assistant Brian Buchholz, Assistant Attorney General Ernie Ankrim, Russell Investments Charley Ellis, Author and Investor Rick Funston, Deloitte & Touche LLP Bob McCrory, EFI Actuaries KT Rabin, Glass Lewis and Company Neil Rue, Pension Consulting Alliance Ann Yerger, Council of Institutional Investors

July 14, 2009

Chair Gorton called the meeting to order and took roll call.

ADOPTION OF MINUTES – JUNE 18, 2009

> **Mr. McElligott moved to adopt the June 18, 2009, Board minutes. Mr. Masten seconded, and the motion carried unanimously.**

PUBLIC COMMENT

There was no public comment.

STRATEGIC PLAN UPDATE

Ms. Whitmarsh introduced her review of the strategic plan framework, 6-year plan, and the 2009 strategic plan. The building block for the strategic plan is the strategic framework of value, support, and capacity, which must operate well in order for the WSIB to deliver its mission. The foundation of the strategic framework is a skillful Board.

The WSIB measures value by its performance, which has been challenging in the current environment. For the first time since inception of the Commingled Trust Fund (CTF), the WSIB has not met the actuarial assumption of 8%, but the trend line is improving. As of May 31, 2009, the fund has returned 7.94% since inception. Legislative and budget support, assets coming to the WSIB for management, and positive media coverage, along with goodwill, access to strong managers, proprietary deal flow, and ability to attract talent are among the tangible and intangible ways the WSIB measures support. Mr. Magnuson suggested the WSIB should concentrate on retaining and developing talent first, and then consider how to attract others to the organization.

The WSIB measures capacity through use of the Cost Effectiveness Measurement (CEM) tool, with the goal to stay within the northwest quadrant of positive value added at low cost. Ms. Whitmarsh discussed the challenge to stay within that quadrant based on the WSIB's asset allocation, investment management, and governance structures. In response to a question, Mr. Bruebaker stated the CEM database analyzes costs among its peer universe.

Ms. Whitmarsh said the 6-year plan approved by the Board last June included plans to address anticipated challenges. The biggest challenge foreseen was the complex and competitive investment environment and return assumption. The four budget themes included sustaining excellent investment performance, enhancing risk management and control, strengthening the technology infrastructure, and aligning organizational capacity.

[Representative Santos arrived at 1:19 p.m.]

Ms. Whitmarsh reviewed the suggested work and resource requirements for each of the 6-year plan budget themes. The WSIB proposed an additional 16.5 FTE in its 2009-2011 biennium resource plan.

Within the Private Equity area, Mr. Kaminski asked to have a bullet point added to memorialize the Board's decision to move away from venture capital. Some members commented on situations that venture capital investment may be appropriate. Staff suggested continuing the discussion during the fall planning session.

[Mr. Nierenberg arrived at 1:38 p.m.]

Within the Research area, Mr. Nakahara suggested that staff consider how it might track when research efforts result in good performance. Ms. Whitmarsh said staff would share insights, but tangible data may be difficult.

Ms. Whitmarsh reported that staff would like the Board's input on how to further develop the Board's corporate governance. Mr. Magnuson asked what affect the BlackRock/Barclays Global Investors merger would have on proxy voting. Ms. Mendizabal said staff had obtained copies of the proxy voting policies of both. She pointed out the combined organization may very well have a policy that is more of a combination of the two rather than one or the other.

[Mr. Seely arrived at 1:47 p.m.]

Ms. Whitmarsh discussed the Risk program and the Board's commitment to incorporate risk into every discussion. She described the difficulty in analyzing illiquid investments (such as Real Estate and Private Equity) and the importance of supplementing risk analysis with judgment and experience. The collaborative effort between Operations and Investments staff relieves Investment Officers from detailed compliance work within the multiple relationships they manage. She said Compliance staff review complex contracts and side letters to ensure partners are within the terms of their agreements. Mr. Magnuson suggested staff consider what threshold it has for reporting exceptions to the Board. Ms. Whitmarsh said the Audit Committee receives compliance reports. Staff's goal is to never surprise the Board. She immediately reports significant issues to the Board Chair. Mr. Nakahara asked if the Internal Audit area could be restated to reflect that high risk areas receive considerable audit attention.

Ms. Whitmarsh reported the actual resource plan approved by the Legislature includes 8 FTEs. In response to Mr. Hill's question, Ms. Mendizabal said she would follow-up with him on the extent the appropriated budget fits within the overall budget.

Ms. Whitmarsh provided project updates from the 2009 strategic plan. The asset allocation and liquidity management value initiatives and 2009 annual plans are complete. The asset allocation recruitment and data warehouse value initiatives have experienced some issues but are in process. Incorporating risk into decision-making, procuring a risk system, performance attribution, and 2010 annual planning value initiatives are on track. Support initiatives for public outreach and communication, Council of Institutional Investors (CII) leadership, the collaboration effort, and securities lending are on track, and compliance has been expanded into Real Assets. Tactical capacity initiatives to expand global funds, tangible assets, and other innovative vehicles; and increasing productivity through automation are done. Expense reduction, investment accounting daily close and alternative asset, new FTE recruitment, and electronic records projects are on track. Implementation of the data warehouse performance system has experienced some issues with commingled data delays. The investment officer compensation survey was set aside, and the formal internship program FTE request was not funded. Ms. Whitmarsh said management team would try for an internship program next year.

Mr. Nierenberg stressed the importance of the compensation issue, avoiding turnover, and maintaining the investment organizational culture. Ms. Whitmarsh said management team works hard to maintain the culture and pointed out the non-financial incentives available.

[Ms. Schurke arrived at 2:15 p.m.]

Initiatives to support a skillful Board in 2009 included a number of strategic and education sessions on liquidity, asset allocation, investment beliefs, the off-site planning session, annual risk workshop on private equity, Woody Brock semi-annual presentations, private markets valuations, and ethics. Education sessions on hedging, United Nations Principles for Responsible Investment (UNPRI), and Infrastructure are planned for the fall. Additional Board projects include reviewing benchmarks, implementing asset allocation decision, developing the corporate governance plan, exploring communication plans with the Department of Retirement Systems, and developing process improvements with technology and innovations.

INVESTMENT BELIEFS
Mr. Bruebaker introduced his follow-up session on CTF investment beliefs. At the June presentation, the Board had expressed its desire to consider formally adopting the CTF investment beliefs in July. Mr. Bruebaker reviewed the importance and challenges in developing investment beliefs.

Members participated in an exercise during which they rated each investment belief as: (1) *strongly agree*, (2) *agree*, (3) *disagree*, or (4) *strongly disagree*. Treasurer McIntire and Senator Brown were not in attendance for the exercise.

<u>Mission</u>
1. The mission of the fund is to maximize returns at a prudent level of risk. The time horizon for this mission is long-term (i.e., 15+ years). All participating members *strongly agreed.*

<u>Risk</u>
2. Only some investment risks can be clearly defined and measured at the present time (or ever in some cases). 7 members *strongly agreed* and 6 members *agreed.*
3. The CTF should be compensated for the investment risks it takes. 11 members *strongly agreed* and 2 members *agreed.*
4. Risk must be considered at the portfolio level. 9 members *strongly agreed*, 3 members *agreed*, and 1 member *disagreed.*

<u>Asset Allocation</u>
5. A broadly diversified portfolio is preferable to a liability-driven portfolio because it offers higher expected returns while also assuring benefit security over the long-term. 7 members *strongly agreed* and 6 members *agreed.*
6. The relative performance of asset classes and investment styles is generally subject to reversion to the mean, although timing such move is challenging. 6 members *strongly agreed* and 7 members *agreed.*
7. Active management in an asset class is warranted if:
    - The asset class, segment(s) of the asset class, or investment strategy is reasonably inefficient;
    - There exist managers or partners with skill, persistent performance, and sufficient capacity to meet the WSIB's needs, and
    - The WSIB is able to cost-effectively identify and retain those skilled managers or partners.

    3 members *strongly agreed* and 10 members *agreed.*

8. While skilled private equity and real estate partners demonstrate persistence in performance, even they will inevitably have less successful funds; therefore, there is a need for diversification among general partners. 10 members *strongly agreed* and 3 members *agreed.*
9. Investment or asset class constraints and/or mandates reduce investment returns. 9 members *strongly agreed*, 3 members *agreed*, and 1 member *disagreed.*
10. All good investment opportunities attract investment capital and so do many poor investment opportunities. 2 members *strongly agreed*, 9 members *agreed*, and 2 members *disagreed.*

Performance Measurement

11. The primary performance measure for the total fund is performance relative to the fund's passive policy benchmark. 3 members *strongly agreed*, 7 members *agreed*, and 3 members *disagreed.*
12. The most relevant performance measure for a public market investment manager is performance relative to an appropriate passive market benchmark. 1 member *strongly agreed*, 10 members *agreed*, and 2 members *disagreed.*
13. Currently available performance benchmarks for private markets have significant shortcomings and should be used with discretion. 10 members *strongly agreed* and 3 members *agreed.*
14. Expenses of the fund are expenditures of assets of the trust and, therefore, should be carefully measured and managed. 9 members *strongly agreed*, 3 members *agreed*, and 1 member *strongly disagreed.*

Organizational Core Competencies

15. The WSIB must fulfill the mission of the Fund in a manner consistent with the highest fiduciary standards. In keeping with this belief, we abide by the following principles:
    - Integrity is not negotiable, and
    - Prudence is best demonstrated by a well documented and sound process

    11 members *strongly agreed* and 2 members *agreed.*
16. The success of the investment program and the fulfillment of our mission does not depend on a single competency, but rather requires multiple competencies, including:
    - Clear, rational, and strongly held investment beliefs;
    - Excellence in board governance;
    - Highly skilled staff;
    - Alignment of investment policies and practices with investment beliefs,
    - Operational excellence and continuous improvement, and
    - Effective utilization of best-in-class managers, investment partners, and advisors

9 members *strongly agreed* and 4 members *agreed.*

Members discussed potential wording changes to some of the investment beliefs.

Mr. Masten moved the Board adopt the investment beliefs as provided in the meeting materials. Vice Chair McElligott seconded the motion.

Mr. Kaminski suggested the third investment belief include the words "at least fairly."

Mr. Ragan moved to amend the motion so the third investment belief reads, "The Commingled Trust Fund (CTF) should be compensated at least fairly for the investment risks it takes." Mr. Hill seconded the motion.

Mr. Masten believed the wording is appropriately written.

The motion carried with Messrs. Masten and Petit voting no.

Mr. Petit moved to amend the motion so the fourth investment belief reads, "Risk must be considered at the investment, asset class, and portfolio level." Mr. Hill seconded, and the motion carried with Vice Chair McElligott and Mr. Masten voting no.

Mr. Kaminski suggested that adding "over long term" may also be appropriate. Mr. Ragan pointed out the first investment belief satisfies that request.

Vice Chair McElligott moved to amend the motion so the tenth investment belief reads, "Most good investment opportunities attract investment capital and so do many poor investment opportunities." Mr. Ragan seconded, and the motion carried unanimously.

Mr. Kaminski suggested the fourteenth investment belief could use work. He asked to what extent non-appropriated expenses cannot be managed due to the constraint of the appropriated budget. Ms. Whitmarsh indicated management team pays close attention to both, and took that point into consideration when phrasing the investment belief.

Based on comments made by Ms. Schurke, Mr. Magnuson suggested a preamble to the investment beliefs may be appropriate to memorialize whether these are investment beliefs for today, or if the Board should always move in this direction.

Representative Santos moved to table action on the original motion until the Board receives the results of its voting exercise so it can further discuss areas where there might be disagreement. Ms. Schurke seconded and the motion failed, with all other members voting no.

The motion to adopt the investment beliefs as amended carried unanimously.

In response to members' comments on investment beliefs 11 and 12, Ms. Whitmarsh said there are plans this fall to further discuss the benchmarks during the annual plan discussion for each asset class.

ASSET ALLOCATION

Mr. Bruebaker introduced the asset allocation discussion. What is important in the changes based on various votes is change in direction not the absolute outcome of the asset allocation based on the vote. He announced members would participate in a voting exercise on asset allocation, and it is critical to understand the impact a change in voting has on asset allocation. He said the asset allocation models are imperfect at best, but serve to stimulate discussion. Modeling will be overlaid with investment knowledge and experience to craft a solution that makes sense for the CTF and conviction to stay the course. Staff will come back to the September Board meeting with an asset allocation recommendation along with any additional items the Board would like to consider. Once the Board makes its decision, staff will come back to a following meeting with the implementation plan.

[The Board briefly recessed at 3:11 p.m. and reconvened in open session at 3:29 p.m.]
[Treasurer McIntire arrived at 3:29 p.m.]

Ms. Will reviewed the history of the retirement funds. Since assets funding is affected by Legislative decisions, it is important to look at the asset allocation to understand the risks and the affect on liabilities. Over the years, the percentage of Fixed Income has gone from just under 60 to 20%. Private Equity and Real Estate have grown, and cash is shrinking. The changes in asset allocation do not mean past decisions were wrong. Risk tolerance needs to be examined in consideration of future direction. She pointed out the modeling software does not take defined contribution (DC) assets into consideration, which is about 7% of the portfolio and is expected to grow primarily due to cash flow. It is important to keep in mind that DC monies can leave the CTF at any time. The model demonstrates only the liquidity of defined benefit (DB) monies.

Messrs. Rue and McCrory introduced themselves. They had presented asset allocation also to the Board in 2005 and 2007. They had several discussions with staff in preparation of revisiting the Board's asset allocation strategy. Staff had asked them to look at innovative ways to measure liabilities so liquidity cash management was built into the model as a measure.

Mr. Rue said the goal is to review and possibly modify the CTF's strategic investment allocation policy, reflecting the WSIB's unique definition and tolerance for investment risk. He noted that asset/liability concepts were included in the materials. He described the modeling process, including presentation of simulated projections to provide awareness of future risks. Trustees would go through the voting exercise to prioritize/emphasize their concern about risk. The model takes those inputs and identifies an investment portfolio that addresses the risk concerns.

Mr. Rue compared the CTF policy allocations against where the fund is actually at as of May 31, 2009, and demonstrated the implied risk allocation policy. He noted that at least 62% of assets have equity risk premium orientation. A discussion ensued on allocation trends and CTF value over the past 10-year period. An examination of what other institutions are doing with allocations to manage risk is planned for September. Mr. Nierenberg strongly supported continuing to explore alternative risk strategies, such as hedging. Mr. Rue demonstrated rolling 12-month correlations and returns between January 1991 and March 2009. He noted that 2008 was the first time within that period when there was correlation compression and all major financial risk assets lost significant value. He mentioned that some assets did well during that period, and suggested the WSIB may want to think about how to bring other assets into its portfolio. Ms. Will noted that a Liquidity Plus asset class was introduced to the model. It is comprised of money markets and some Treasury notes to provide liquidity during down markets, but creates a little more return than cash would provide.

Mr. McCrory presented simulated projections of the 13 DB retirement plans based on financial variables. He said the projections would be slightly different than State Actuary projections due to a few assumption differences. Mr. Rue pointed out the amount of volatility within the cost and funding ratio simulations. The projections should help WSIB to frame its risk tolerance, which is one of the most important inputs to asset allocation selection. He described that a risk philosophy is a specific combination of weighted decision factors. The goal is to come up with a consensus risk philosophy. Mr. Rue reviewed decision factors considered in past allocation decisions. This year, the modeling includes a cash flow stress.

A discussion ensued on DC monies within the CTF, the difficulty DRS and WSIB experiences in attempting to manage liabilities with cash outflows, and how DC was allowed in the Total Allocation Portfolio. Mr. Hill suggested that members revisit the subject at a future time.

The decision factors for the Board's consideration were: (1) maximize average real rate of return years 2 through 20, (2) minimize volatility of real rate of return years 2 through 20, (3) minimize DRS employer cost volatility years 4 through 20, (4) minimize DRS funding ratio volatility years 4 through 20, and (5) minimize CTF cash flow stress years 3 through 20.

Members participated in an exercise during which they had 100% to divide and place weightings among the five decision factors. Senator Brown was not in attendance for the exercise.

The resulting asset mix was 40% Global Public Equity, 22% Fixed Income, 12% Real Estate, 22% Private Equity, 4% Tangible Assets, and 0% Liquidity Plus. Compared against the current Board-approved asset allocation mix, these results would add 3% to global Public Equity, add 2% to Fixed Income; and decrease Real Estate, Private Equity, and Tangible Assets by 1, 3, and 1% respectively. Mr. Nakahara said liquidity concerns would be fixed by the reduction in the Private Equity and Real Estate allocations. Ms. Will commented that Private Equity is desirable, if the focus is on return. Vice Chair McElligott asked what affect inflation would have as the economy pulls out of recession. Mr. Bruebaker said staff had already considered an inflation-adjusted strategy, and would address that in the future proposed asset allocation implementation plan. Ms. Will added the potential for deflation would also be considered.

Mr. Bruebaker exampled various overrides to the resulting asset allocation mix to demonstrate the effects on allocations. He reminded members the modeling software has built in minimum and maximum amounts within each asset class. Ms. Will summarized that each asset class would be looked at for minor adjustments. The voting results indicate no major change in the current asset allocation. Mr. Rue said the results indicate no desire to ramp up Private Equity to 30%.

[The Board briefly recessed at 5:35 p.m. and reconvened in open session at 6:30 p.m.]

DINNER PRESENTATION: ECONOMIC OUTLOOK TO 2010
Mr. Ankrim presented his economic outlook for the second half of 2009.

[The Board recessed at 9:25 p.m. on July 14, 2009.]

July 15, 2009

[The Board reconvened in open session at 9:00 a.m. on July 15, 2009.]

Chair Gorton called the meeting to order and took roll call.

RISK DISCUSSION: SURVIVING AND THRIVING IN TURBULENCE
Ms. Vandehey introduced the risk discussion and Mr. Funston, who was asked to do a follow-up from last year's presentation of the 10 fatal flaws organizations face. Staff worked with Mr. Funston in preparation for this year's presentation to indentify key dependencies and business assumptions so members could participate in a *Black Swan* analysis exercise.

Mr. Funston reviewed what occurred in 2008, and market reactions to it. He reviewed his 2008 presentation to the Board, during which members rated 10 fatal flaw areas. At that time, members gave its lowest rankings on how well the WSIB managed the potential flaws of *failure to imagine failure* and *failure to consider speed.* He suggested that kind of assessment can be used for forethought. Ms. Will noted these considerations were taking into account by the Board in considering liquidity.

Mr. Funston said the purpose of the enterprise is how to get better intelligence to make superior decisions. The Board's challenge is to balance both compliance and competitiveness in dealing with uncertainty in order to survive and thrive, to identify the skills, processes, and tools to consider abnormal risk into the decision making process. Mr. Funston described risk as the potential for failure, or unacceptable difference between expected and actual behavior. He said it is important to take calculated and understood risks.

He identified the 10 Enterprise Survival & "Thrival"™ Skills as: (1) check your assumptions at the door, (2) improve your vigilance, (3) make the key connections, (4) anticipate potential causes of failure, (5) factor in velocity and momentum, (6) verify your sources, (7) maintain an acceptable margin of safety, (8) set your time horizons, (9) dare to take enough of the right risks, and (10) sustain operational discipline.

Members participated in an exercise during which they rated "How skilled the Board is today at…" on each of the 10 Enterprise Survival & "Thrival" ™ skills as: (1) *very poor*, (2) *poor*, (3) *fair*, (4) good, or (5) *very good.* Senator Brown was not in attendance for the exercise. Staff will prepare a report for the Board of the current results and compare it to last year's results. The question is: what will the Board do differently as a result?

Mr. Funston described white swans as thesis or key business assumptions, and black swans as the antithesis, or opposite of those assumptions. He said the synthesis is how to get the best of both worlds and build in strategic flexibility. He introduced key business assumptions staff developed for the Board to consider in its *Black Swan* exercise in considering the opposites of each assumption: what are the signs of a *Black Swan,* if there is evidence of signs the *Black Swan* is approaching, and what metrics to use in identifying and gather intelligence in the future. Members and staff participated in a roundtable discussion of ideas on how to better position the WSIB in the future. Most participants noted the importance of legislative and stakeholder communications.

[The Board briefly recessed at 10:47 a.m. and reconvened in open session at 11:00 a.m.]

Mr. Funston suggested the Board may want to consider discussing the ideas further at future meetings. Root cause and failure mode and effects analyses of external factors, process, people, facilities and equipment, and systems help to anticipate potential causes of failure, and then factor in velocity and momentum to consider how bad it can get, how fast it can get that bad, how fast could you recover, and what is the exposure. He suggested a crisis plan should be in place for all operations.

In closing, Mr. Funston shared the cost of failure and cost of risk management equates to the total cost of risk. He suggested one should consider the cost when there is failure versus the cost to prevent it. Members suggested it might be more meaningful to examine the small parts versus total failure, and probability factors. Ms. Whitmarsh said heat maps would aid such a discussion.

In response to Mr. Kaminski's inquiry about what other boards' best practices are, Mr. Funston suggested the WSIB examine DuPont.

[The Board briefly recessed at 12:02 p.m. and reconvened in open session at 1:42 p.m.]
[Senator Brown arrived at 1:42 p.m.]

ASSET ALLOCATION
Mr. Bruebaker suggested members may want to consider different overrides and/or scenarios within the model to examine the affect. A discussion ensued on the 8% return mandate—ensuring there is a thorough understanding of its impacts and communicating any concerns with legislators. Senator Brown suggested such conversations should be targeted to occur during the months of October or December. Mr. Smith said he would collaborate with WSIB staff while preparing his assumptions presentation for the Senate Committee on Pension Policy.

Senator Brown input her decision factor weightings to the model, the resulting asset mix was unchanged: 40% Global Public Equity, 22% Fixed Income, 12% Real Estate, 22% Private Equity, 4% Tangible Assets, and 0% Liquidity Plus.

Mr. Bruebaker said staff would come back in September with four or more different modeling scenarios for the Board's consideration.

Chair Gorton announced the Board would go into executive session to evaluate the qualifications of an applicant for public employment. He said the executive session was expected to last until 2:45 p.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 2:31 p.m. and took a brief recess at 2:55 p.m. It reconvened in open session at 3:07 p.m.]

***AD HOC* COMMITTEE REPORT**
Vice Chair McElligott announced the Ad Hoc Committee met earlier to discuss the Executive Director recruitment. After a discussion with the full Board, a recommendation will be made to the Administrative Committee to appoint Theresa Whitmarsh as the permanent Executive Director. The Committee would then make its recommendation to the Board at its next regular meeting in September.

BOARD GOVERNANCE
Ms. Whitmarsh introduced Mr. Ellis, who was invited back again this year to present board governance information to the Board. Mr. Ellis said he was asked to review the Board's investment beliefs and provide comment, and he would partially review last year's presentation for the sake of new Board members.

Mr. Ellis said the mission investment belief for a 15+ long-term time horizon differs from other boards. Relating to the investment beliefs surrounding risk, he suggested the real risks are within managers. It is important to watch character in selecting and monitoring managers. He said to pay close attention to managers' growth and mergers. With regard to the investment belief that it takes multiple competencies to fulfill the agency mission, Mr. Ellis stressed the importance of maintaining the organizational climate that makes WSIB a great place to work, measuring operational performance against benchmarks, carefully choosing new staff that blend well with existing staff, and ensuring training and time is dedicated for new members. Mr. Ellis shared three of his own personal beliefs, which are: (1) make a deliberate plan for bottom up governance and review it often, (2) select a strong leader, and (3) watch out for diminishing investment business and rising business management.

Mr. Ellis revisited his presentation from last year and shared his thoughts on how well the Yale Foundation fared through the economic downturn. He stressed that funds should focus on a strong defense, and then reach for returns. He asked if the Board's conviction remains or, knowing now what happened, would it have made any changes in portfolio structure, manager selection, liquidity analysis, or hedging? Mr. Ellis reviewed the Loser's Game theory that one wins if the other makes more mistakes. The responsibilities are to know your mission, define investment objectives, design a strategic portfolio, assure good management, and stay the course. He reviewed how managers and institutions can succeed and fail. He recommends the Board determine its real objectives, understand what it's trying to do and the tolerance level, avoid doing permanent harm, and continue doing more while avoiding "iatrogenic disease."

[The Board briefly recessed at 4:47 p.m. and reconvened in open session at 6:00 p.m.]

DINNER PRESENTATION: FINANCIAL REGULATORY REFORM

Ms. Yerger gave a dinner presentation on financial regulatory reform issues.

[The Board recessed at 8:25 p.m. on July 15, 2009.]

July 16, 2009

[The Board reconvened in open session at 9:00 a.m. on July 16, 2009.]

Chair Gorton called the meeting to order and took roll call.

CORPORATE GOVERNANCE PANEL DISCUSSION

Ms. Mendizabal introduced the corporate governance discussion. She said staff would present background information on how the program began, review the Board's proxy voting guidelines and how they help determine the position we take on various shareholder issues, and summarize the current activities and accomplishments. Panelists K.T. Rabin and Ann Yerger would discuss how the WSIB's level of involvement compares to our peers, preview upcoming shareholder issues and voting trends, and suggest ways the WSIB could expand the program if the Board chooses to do so.

Ms. Mendizabal reported the program was established in 2004, and proxy voting activities began in 2005. The program was established both on a belief that well-governed companies produce better results and proxies are plan assets, so voting them is a fiduciary duty. The WSIB hired Glass Lewis to develop proxy voting guidelines, provide research, and assist with voting decisions. Initially, program management was split between WSIB's Public Equity and Public Affairs units. It is now managed entirely within the Public Affairs unit, which is common industry practice.

Ms. Sandboe provided an overview of program goals, WSIB's proxy voting policy, and the most prominent governance issues, including executive compensation, majority voting, shareholder access, and election of directors. She reviewed highlights from the WSIB's proxy voting guidelines pertaining to the election of directors, auditors, mergers and acquisitions, and equity compensation and shareholder proposals. She also shared highlights from the 2008 proxy voting season.

In response to Mr. Magnuson's question, Ms. Sandboe explained that withholding votes sends a message to a board, even if the director is ultimately re-elected. There have been some successful results from withheld votes. Mr. Nierenberg said he believes company directors and owners who care about their reputation pay close attention to withheld votes. Ms. Rabin said the most important thing is to cast votes on directors and get the right board composition.

Ms. Sandboe described how the WSIB networks with other organizations to maximize its corporate governance and proxy voting resources. She suggested the Board may want to consider pursuing additional activities, such as more active engagement with directors, company management, policymakers; with Washington-based companies; seeking a CII leadership role; more Board involvement in proxy voting issues; and internal voting of international proxies.

Ms. Rabin's discussion focused on international proxy voting and how other pension plans manage their corporate governance programs. Ms. Rabin said institutions who take an active role in corporate governance fall into three categories: they subscribe to research services and passively vote their proxies, they vote domestic proxies and outsource international proxy voting, or they handle all proxy voting internally. She said the most common first step for institutions looking to expand their corporate governance activities is to selectively vote international proxies.

Ms. Rabin discussed changes taking effect this August due to the European Initiative (EU) on shareholder rights including access, publications, share blocking, registration, and executive compensation limitations. Other countries are considering matters such as independent directors, power of attorneys, removal of voting impediments, and voting confirmation.

Should the WSIB decide to take a more active role in voting international proxies, Ms. Rabin suggested the WSIB may want to consider selecting large companies to begin and refine processes, and add specific countries and/or markets over time. She believes expanding the program in that way makes sense with existing resources, while balancing priorities and exercising rights as a shareholder on behalf of beneficiaries.

Ms. Yerger reported she had benchmarked the WSIB corporate governance program against peers. She shared the Board should be proud of its program and staff, as it is considered a reasoned and well respected voice within the governance community. She suggested the program stay involved in governance issues, talk to other investors, and carefully evaluate proxy voting issues.

Ms. Yerger said the WSIB has several options if it wants to expand its program. Her view is the WSIB should get more involved with policy makers, collaborate with peers, and consider actions taken domestically. She said CII receives numerous requests to participate in groups, and she will funnel those through to the WSIB to determine its interest.

Mr. Nierenberg noted the issue of lending securities and timeliness in calling them back to vote proxies. He encouraged staff to continue learning about that and share ideas with the Board.

Treasurer McIntire said he would like a thorough review and discussion on the requirements and methods other funds have employed to step into global proxy voting including costs, needed resources, and a proposed timeline. Messrs. Petit and Ragan suggested the issue be examined more thoroughly by the Audit Committee, which could then make a recommendation to the Board. Ms. Whitmarsh said staff would research and bring the matter back for discussion. Mr. Nierenberg asked that all Board members receive the Audit Committee meeting agenda, in case they want to participate. Mr. Masten stated that he wanted to see the WSIB move slowly and judiciously and requested staff determine what additional activities, if any, can be done within existing resources and prepare a report to the Audit Committee for its consideration. Mr. Seely agreed.

Ms. Whitmarsh pointed out that engaging more actively in corporate governance is a Board policy issue. She would like direction on where staff should focus its time and resources. Ms. Schurke expressed an interest in continuing to work with CII and others on overarching governance issues. Ms. Whitmarsh proposed staff prepare a plan on how to incrementally expand the corporate governance program for the Audit Committee's review and possible consideration by the Board. Vice Chair McElligott and Mr. Hill expressed a desire to move cautiously and diligently in expanding the program. Mr. Petit emphasized the WSIB wants to be a reasoned and respected voice in corporate governance issues. Mr. Nierenberg suggested staff might want to develop a set of governance beliefs, similar to what was developed for investment beliefs.

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 will reconvene in open session.

[The Board went into executive session called at 10:39 a.m. and reconvened in open session at 10:44 a.m.]

> **Vice Chair McElligott moved that the Board authorize the law firm of Coughlin Stoia Geller Rudman and Robbins to dismiss the WSIB's remaining claims in the Enron securities fraud litigation. Mr. Masten seconded, and the motion carried unanimously.**

OTHER ITEMS

Chair Gorton announced this was his last Board meeting, as he is changing jobs and will move out of the School Employees' Retirement System. His resignation from the Board becomes effective August 1, 2009. He thanks members and staff for support during his tenure.

BOARD EVALUATION DISCUSSION AND FEEDBACK

Ms. Whitmarsh said the Board had asked staff to review best practice recommendations presented by Seattle University's Center on Corporations, Law & Society at the 2006 off-site planning session to see what was implemented. Recommendations were made in the areas of meeting management, strategy, fiduciary duty, operations, and new member orientation. Ms. Whitmarsh described how meeting management recommendations on agenda setting, time management, in-depth discussions, and meeting attendance were implemented. Consideration of a consent agenda was not implemented. Board strategy suggestions to develop investment beliefs, review organizational growth strategy, and information reporting systems were either implemented or are in process. For Board operations, staff now examines how the Board spends its time and members participate in a self-evaluation process. Adding the Seattle University's course on Corporate Governance was suggested for new member orientation. Staff has included that course on its annual recommended conference list since 2007. Staff said clarification is needed for the suggestion that the Board should define its minimum standard of care.

Ms. Whitmarsh reviewed the pie charts on how the Board spent its time during the July 2008 to June 2009 timeframe. She noted private markets investment activity was cut in half from the previous year. In response to Mr. Nakahara's question about the slight reduction in education activities, Ms. Haines explained that a new risk category was added to this year's time chart. Many of the risk activities were educational in nature, so were accounted for differently this year.

Mr. Kaminski suggested staff get best practices from other boards it interacts with, such as Microsoft. He would like to see a risk panel presentation comprised of members from other pension fund boards and foundations. He also requested staff order copies of Mr. Funston's book for members once it is released. Mr. Kaminski encouraged management to consider how to implement the internship program and brainstorm non-financial incentives, such as training opportunities for staff. Senator Brown suggested staff should consider scheduling a preview of the Legislative session at one of the Board's fall meetings.

OTHER ITEMS

Ms. Whitmarsh recognized the efforts of Ms. Haines and Ms. Repcik in coordinating the July planning session.

There was no further business to come before the Board. The meeting adjourned at 11:13 a.m. on July 16, 2009.

For P. McGELLIGOTT

Glenn Gorton
Chair

ATTEST

Theresa J. Whitmarsh
Acting Executive Director