WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
November 19, 2009

The Washington State Investment Board met in open session at 9:37 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Pat McElligott, Chair Treasurer Jim McIntire, Vice Chair Steve Hill Charlie Kaminski John Magnuson George Masten Bob Nakahara David Nierenberg (via teleconference) Judi Owens Mason Petit Mike Ragan
Absent:	Senator Lisa Brown Representative Sharon Tomiko Santos Judy Schurke Jeff Seely
Also Present:	Theresa Whitmarsh, 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 Kristi Haines, Executive Assistant Steve Dietrich, Assistant Attorney General Jerome Tagger, United Nations Principles for Responsible Investment 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 McElligott called the meeting to order and roll call was taken.

OATH OF OFFICE – JUDI OWENS

Chair McElligott administered the oath of office to Judi Owens, who fills the remaining term of the School Employees Retirement System position effective October 22, 2009, through December 31, 2010.

ADOPTION OF THE SEPTEMBER 17, 2009, MINUTES

> **Mr. Ragan moved to adopt the September 17, 2009, Board meeting minutes. Chair McElligott seconded, and the motion carried unanimously.**

PUBLIC COMMENT

There was no public comment.

COMMITTEE ASSIGNMENTS

> **Chair McElligott moved the Board re-assign Representative Sharon Tomiko Santos from the Public Markets Committee to the Private Markets Committee, and assign newly appointed Board member Judi Owens to the Public Markets Committee. Mr. Ragan seconded, and the motion carried unanimously.**

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh provided her monthly report for November on board governance, investments, meetings, public affairs, staffing, operations, and open procurements. Plans at upcoming meetings include nonvoting Board member candidate interviews at the December 1 Audit Committee; discussion of the proposed 2010 Public Equity annual plan, consideration of Board policy revisions, and a report on the index manager search at the December 1 Public Markets Committee; and discussion of the annual plans for Real Estate and Tangible Assets at the December 3 Private Markets Committee. The 2010 Strategic Plan will be presented at the December 17 Administrative Committee and Board meetings. She said a recent *KING 5 News* report on the condition of the pension system has generated a number of legislative inquiries, despite the fact the WSIB was not specifically mentioned. Ms. Whitmarsh relayed her consistent message to legislators is the WSIB is a long-horizon investor and is well positioned coming out of this downturn. Other recent media interest surrounds the misuse of placement agents. Although the WSIB has had no problems, she asked Mr. Ruggels to comment on the matter during his quarterly private equity report.

Recruitment for the Chief Operating Officer (COO) will begin next week. Ms. Whitmarsh determined a chief financial officer component is needed and added it into the position qualifications. Going forward, the Research Director will focus on both research and policy, and report directly into the Executive Director.

Ms. Whitmarsh reviewed quiet period timelines for the enhanced index, emerging markets, and real assets compliance monitoring open procurements. All inquiries relating to the procurement should be referred to Contracts Manager John Lynch.

UNITED NATIONS PRINCIPLES FOR RESPONBLE INVESTMENT EDUCATION SESSION

Ms. Mendizabal introduced Mr. Tagger, chief operating officer for the United Nations-backed Principles for Responsible Investment (PRI), who shared information on six Principles developed by a group of international investors to serve as a framework for investment organizations interested in incorporating certain environmental, social, and governance (ESG) issues into investment decisions and processes over time. Staff invited Mr. Tagger to provide an education session to the

Board as a follow-up to the July planning session, at which members expressed a desire to learn details on the Principles, understand what it means to become a signatory, and learn how PRI signatories believe it adds value to their bottom line, and what assistance is available should the Board decide this is a path it wants the WSIB to pursue. Ms. Mendizabal said staff was not recommending or requesting Board action at this time.

Mr. Tagger shared the objectives of PRI and why organizations should consider joining. He said the PRI provides framework and a collaborative network for integrating ESG issues in investment practices. The Principles are grounded in fiduciary duty, participation is voluntary, and guidance and implementation support is available from PRI staff and PRI signatories. It recognizes that investors do not face the same issues at the same time, or in the same way. PRI is not about sacrificing returns, philanthropy, exclusion of stocks, or prescriptive/compliance-based standard.

He gave rationale for responsible investment, which is grounded in a belief the economy as a whole is affected by ESG issues.

The six PRI Principles are:
- Incorporate ESG issues into investment analysis and decision-making processes
- Be active owners and incorporate ESG issues into our ownership policies and practices
- Seek appropriate disclosure on ESG issues by the entities in which we invest
- Promote acceptance and implementation of the Principles within the investment industry
- Work together to enhance our effectiveness in implementing the Principles
- Each report on activities and progress toward implementing the Principles

Mr. Tagger said there are 600 signatories to PRI, including eight U.S. public pension funds. The PRI designates only a fraction of its resources to engaging signatories and mainly concentrates on implementation support through online forums, knowledge database, best practice work streams, and an annual reporting and assessment tool, which is the sole requirement for signatories at this time. He said two new requirements will be added in 2011 that involve baseline transparency and disclosure to publicly report PRI related activities, giving respect to regulations and confidentiality that govern rules for investors; and a move from voluntary contributions to a mandatory fee system.

Mr. Tagger pointed out that most signatories are in the initial stages of implementation, and PRI responds to numerous inquiries on next steps. He said investor signatories have not figured out all the issues but what is important is understanding that ESG issues matter.

Mr. Tagger responded to questions about the PRI board, annual budget, and governance structure.

Treasurer McIntire noted that no real causal relationship exists between the Principles and behaviors in terms of investment returns. He asked what the expected relationship is, and/or what research or data is available to suggest a correlation to performance and responsible management practices. Mr. Tagger said no research exists on the Principles, as they were created just three years ago and a track record must be established.

[The Board took a brief recess at 10:31 a.m. and reconvened in open session at 10:45 a.m.]
[Mr. Nierenberg was in attendance via teleconference at 10:45 a.m.]

Chair McElligott announced that today's Board meeting could not be recorded due to a temporary equipment failure resulting from a power surge caused by the local storm.

QUARTERLY DISCUSSION OF MARKETS

Portfolio Discussion

Mr. Bruebaker reported on the Commingled Trust Fund (CTF) performance for the quarter ended September 30, 2009. He said equity markets were up 66.63 percent since March 9, 2009. The CTF is up 8.34 percent since inception, and returned 9.94 percent for the quarter. The Implementation Value Added (IVA) benchmark, which he believes is the best comparison for performance, returned 11.37 percent for the quarter. The CTF underperformed for the one- and three-year periods, but outperformed the longer-terms periods. He said the fund lagged during the quarter because of WSIB's large allocation to private markets, which hurts the fund during downturns but helps when markets are good.

Performance was hurt by allocation decisions with an underweighting in equities, and overweighting in real estate and cash; but helped by underweighting in tangible assets and assisted by WSIB's overlay program. Manager decisions hurt by underperformance in private equity, but was offset by outperformance by WSIB real estate and fixed income managers.

Fixed Income

For the September quarter, the retirement fund's fixed income portfolio returned 6.15 percent versus 4.48 percent for the Barclays Universal index. The outperformance was 167 basis points. Much of the outperformance was due to the portfolio's overweight to credit. Sub-asset class index returns for the quarter were the following: governments 2.03 percent, credit 8.53 percent, securitized 3.22 percent. Within credit, the retirement portfolio outperformed by 82 basis points due to the industrials and non-corporates. The fund's government and securitized sectors also outperformed. For the calendar-year-thru November 18, the portfolio has returned 17.4 percent.

Although performance for the calendar-year-to-date has been excellent, the three large Labor and Industries' funds underperformed for the quarter. The underweight in credit, the underweight in financials within credit, and the short duration of fund Treasuries were responsible.

The fixed income portion of the five permanent funds has outperformed the Barclays Aggregate index for all reported time periods.

Real Estate

Mr. Draper reported the economic downturn has two affects on the real estate industry. It has created a scarcity in financing and has negatively impacted fundamentals. There has been recent lending activity to high quality properties and borrowers, although in lower amounts than the past few years. The news is encouraging, but financing has a long way to go and issues to work through before recovery. Foreclosures are not as prevalent as expected, as lenders are opting for restructuring loans rather than taking back properties. Mr. Draper said there is major risk in maturity defaults, which could result in investment opportunities. On the buy side, there is still a substantial bid/ask spread between buyers and sellers. Mr. Draper compared U.S. market conditions to Europe, Asia, and Latin America countries. He shared that the return results of the NCREIF index appear to lag the reality of the current real estate market. Mr. Draper reported that most of the portfolio is performing well and emphasized that investment manager selection matters. The REOC investment strategy has outperformed fund investments over the past 12 months by 32.7 percent. He noted that the economic events of the past year and a half created a perfect storm for the mezzanine finance strategy, resulting in the entire industry being deeply affected.

Public Equity

Mr. Paroian reported that equity markets are up strongly for the third quarter. Global is up 18.4 percent, U.S is up 16.3 percent, and non-U.S. is up 20 percent for the quarter. He said equities declined sharply until March 9, when the market experienced a turn-around that continued into the third quarter. Year-to-date returns are surprising---ACWI IMI and U.S. are up 36.4 and 26.3 percent, respectively, with European markets up even stronger. Emerging markets have returned 80 percent year-to-date. Geographic sub-sectors within the portfolio are under control, with a slight overweighting to U.S. Any future liquidity needs could shift this position to neutral. Small cap has been an extremely strong sub-sector, which is a challenge for WSIB managers. WSIB managers must have significant assets under management in order to handle the size of mandate that WSIB awards and that can make investing in the very smallest names challenging.

Mr. Paroian reported that WSIB's managers, in aggregate, are cautious in their market outlook, but opinions range widely from bearish to bullish. The WSIB portfolio is currently positioned with modest underweights in emerging market, financials, oil and gas, and industrials; and modest overweights in the U.S., telecom, consumer services, and health care.

Mr. Paroian said managers are investing with a long-term view in stable companies that provide upside with limited downside risk. The strategy gives staff confidence that managers are investing prudently, although such strategy kept them out of some of the riskiest names that had the most lucrative bounce back in the markets.

Private Equity

Mr. Ruggels said private equity themes reported at the September Board meeting have continued. Investment pace is picking up; with total draw-downs between January and May of 2009 at $371 million and at $693 million between June and October—an 87 percent increase between these 5-month periods. Additionally, general partners have announced significant transactions within the past few months. Debt financing is becoming more accessible, allowing deals to get done. Investment activity will likely continue to increase in 2010.

He reported that initial public offerings have been a recent source of liquidity for several private equity-backed companies. Strategic buyers have also become more active, providing an additional source of liquidity. However, Mr. Ruggels said he expects distributions to take a bit longer to return to normal levels.

Mr. Ruggels reported private equity recorded positive performance during the second quarter, following six consecutive quarters of negative returns. The net IRR was 7.6 percent. He expects the positive trend in performance will continue into the third quarter. He said the increase in value in the private equity portfolio is largely due to the significant rebound in the public equity markets since early March. He observed that general partners and portfolio company management teams have done a good job of managing costs during these difficult periods. However, top-line growth has been difficult to achieve, and will remain so until the economy recovers. Mr. Ruggels anticipates longer holding periods for portfolio companies in the current environment, which will have a negative impact on IRRs. However, deals done the next few years should be well positioned to produce attractive returns.

Per Ms. Whitmarsh's request, Mr. Ruggels provided information on placement agents. He made the distinction between legitimate placement agents, who provide an important outsourced marketing service to many private equity firms, and others, who use political and personal connections to attempt to influence decision makers. He said that the New York Common Fund scandal was not about placement agents, but about criminal activity of insiders. Mr. Ruggels said it is important not to "paint all placement agents with one brush." There are firms providing a valuable service. He pointed out the WSIB investment process is robust, staff and consultants providing the first line of defense, and the Private Markets Committee in place to consider investments for recommendation to the Board and supplemented by the investment expertise of nonvoting members. Treasurer McIntire said he appreciates the valuable approach staff provides in relieving Board members from prospective investments. He reported the National Association of State Treasurers' decided not to take a position on Securities and Exchange Commission proposed regulations related to placement agents, which appear to be a bit overblown. The Association believes placement agents provide a useful service under certain contexts.

In response to Mr. Petit's questions, Mr. Ruggels said the private equity market continues to deleverage and there has been progress in near-term financing. While there is still a lot of debt in some companies, efforts are being made to buy it down at discounts and push out maturities. The biggest companies tend to have the most attractive financial packages. Future market conditions may dictate whether companies will be able to survive. Mr. Ruggels said he is optimistic about future outcomes. In response to Mr. Kaminski's questions, Mr. Ruggels said he is aware of very few requests for extended investment periods. Investment periods during good market conditions last about 18 months to two years. The current pace is about four years. Mr. Kaminski suggested the Board discuss during its planning session whether it makes sense to expand private equity investments because of the point private equity is in its cycle.

Mr. Nakahara asked if current conditions could result in merger activity. Mr. Paroian said he anticipates consolidations, but is uncertain about mergers. Mr. Ruggels said we are already seeing a significant increase in M&A activity and he expects it will continue.

Mr. Bruebaker responded to Mr. Hill's comments about activities within Plan 3 and the Deferred Compensation Program and the Target Date Funds. Staff refers to the observed activities as "chasing the yield," which is a common behavior when markets fall. While the WSIB portfolio is doing fine, such activity can cause liquidity concerns. Staff plans to do a comprehensive review of each investment option, working closely with the Employee Retirement Benefits Board and Department of Retirement System. Mr. Bruebaker said, despite the rocky start the Target Date Funds had due to market conditions at implementation, staff believes these will be beneficial in the long-term. Mr. Paroian pointed out the distinction of the funds, which are set-up to manage through a retirement, rather than up to age 65.

Private Equity
Mr. Woolford commented on market pessimism last year, describing why the financial system was in disarray and liquidity was at a 10-year low. He compared WSIB commitment and distribution activities against Venture Economics, reflecting a bubble during the 2006-2007 period. The WSIB distributions fared better, which can be attributed to the WSIB's long-standing and successful private equity commitment. Mr. Woolford said that multiples are returning to 2003-2006 levels. While general partners are being careful not to exceed investment periods, debt represents a speed bump.

He concluded his report stating the U.S. economy has proven resilient, exits have emerged, high yield markets are supporting consideration of refinancing and restructuring, and operating improvements will provide leverage as the economy rebounds; however, the investment pace will likely remain restrained.

ADMINISTRATIVE COMMITTEE REPORT
Assistant Attorney General's Report
Chair McElligott 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 until about 12:30p.m., at which time the Board would reconvene in open session and adjourn.

[The Board went into executive session at 12:16 p.m. and reconvened in open session at 12:33 p.m.]
[The meeting adjourned at 12:33 p.m.]

Patrick McElligott
Chair

ATTEST

Theresa J. Whitmarsh
Executive Director