

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
December 17, 2009

The Washington State Investment Board met in open session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Pat McElligott, Chair
Treasurer Jim McIntire, Vice Chair
Senator Lisa Brown (via teleconference)
Steve Hill
Charlie Kaminski
John Magnuson
George Masten
Bob Nakahara
David Nierenberg
Judi Owens
Mason Petit
Mike Ragan
Representative Sharon Tomiko Santos
Judy Schurke

Absent: Jeff Seely

Also Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Liz Mendizabal, Public Affairs Director
Steve Lerch, Research Director
Steve Draper, Senior Investment Officer – Real Assets
Bill Kennett, Senior Investment Officer – Fixed Income
Tom Ruggels, Senior Investment Officer – Private Equity
Diana Will, Senior Investment Officer – Asset Allocation
Janet Kruzel, Investment Officer – Private Equity
Kristi Haines, Executive Assistant

Steve Dietrich, Assistant Attorney General

[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.

ADOPTION OF THE NOVEMBER 19, 2009, MINUTES

**Mr. Masten moved to adopt the November 19, 2009, Board meeting minutes.
Chair McElligott seconded the motion.**

Mr. Kaminski requested a revision on page 8, in the second paragraph, at the end of the last sentence, to include the words "...because of the point private equity is in its cycle."

The motion to adopt the revised minutes carried unanimously.

[Mr. Petit arrived at 9:32 a.m.]

COMMITTEE ASSIGNMENTS

Chair McElligott shared his recommendation to the Board to appoint Steve Hill as Audit Committee Chair. He announced Mr. Petit prefers to remain on the Public Markets Committee, rather than move to Private Markets. A revision to the Chair's Committee Assignments memo was distributed to members.

Mr. Masten recommended the Board approve the Committee assignments as recommended by the Chair. Ms. Owens seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

RECOGNITION

Chair McElligott announced that nonvoting member John Magnuson elected not to seek reappointment and would leave the Board at the end of his term, expiring December 31, 2009. Today is Mr. Magnuson's final Board meeting, after serving the Board for nearly a decade. Chair McElligott read a letter of appreciation for Mr. Magnuson into the record and presented him with a recognition gift. Ms. Whitmarsh acknowledged Mr. Magnuson's contributions to the Board, in particular his real estate expertise.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh provided her monthly report for December on Board governance, investments, meetings, public affairs, staffing, operations, and open procurements. She announced the Public Markets Committee would meet on January 5. The Private Markets Committee has compressed its Private Equity planning session into a day-long event on January 7, to include a working dinner. The Strategic Plan will be presented in January rather than December, to take into consideration any Board member comments on the Private Equity annual plan.

Ms. Whitmarsh introduced Allyson Tucker, newly appointed Assistant Senior Investment Officer – Public Equity. She announced Reggie Ross joined the Real Estate unit, and will be formally introduced at the January Board meeting. Finally, a data integrator has been hired to help with real estate data collection and its translation into the data warehouse. Ms. Whitmarsh reminded the Board of three open procurements and quiet periods for emerging markets managers, real estate compliance monitoring and reporting, and proxy voting and management services.

[Representative Santos arrived at 9:38 a.m.]

ASSET ALLOCATION IMPLEMENTATION PLAN

Ms. Will reported that, while the Board voted in September not to change the Commingled Trust Fund's (CTF's) asset allocation, some housekeeping policy changes are needed. Staff proposes changing the allowable cash range from two to three percent for liquidity needs. She said cash raised would be overlaid by Russell Investments, which would not create a cash exposure. Other policy revisions reflect year-end asset class target changes anticipated with the Board's approval of Public Equity, Real Estate, Tangible Assets, and Private Equity annual plans; a simple name change to the Public Equity passive benchmark created by a split of Wilshire and Dow Jones; and a change

in reporting frequency from monthly to quarterly.

Mr. Masten moved the Board approve the changes to the Retirement CTF Asset Allocation Policy 2.10.050. Mr. Ragan seconded, and the motion carried unanimously.

PUBLIC MARKETS COMMITTEE REPORT

Mr. Ragan reported the Public Markets Committee met on December 1 to consider fixed income policy revisions and the results of the enhanced index equity manager search. The Committee also reviewed the Public Equity 2010 annual plan.

Fixed Income Policy Revisions

Mr. Ragan said the proposed revisions to the Fixed Income Retirement Funds Policy and the Labor and Industries' Insurance Funds Policy are designed to prevent the forced sale of mortgage-backed, asset-backed, and commercial mortgage-backed securities that fall below investment grade in both the Retirement and Labor and Industries' funds. In addition, the revision eliminates the minimum duration requirement for the Supplemental Pension Fund and lowers the maximum duration from 2.25 to 2.00. During the crisis, only one fixed income security fell below investment grade forcing staff to sell although they would have preferred to hold on to the security.

Mr. Ragan moved the Board approve the proposed revisions to the Fixed Income Retirement Funds Policy 2.10.200. Ms. Owens seconded, and the motion carried unanimously.

Mr. Ragan moved the Board approve the proposed revisions to the Labor and Industries' Insurance Fund Policy 2.20.100. Ms. Owens seconded, and the motion carried unanimously.

Enhanced Index Equity Manager Search Results

Mr. Ragan reported staff recently completed a search for enhanced index equity managers, which included onsite visits to four finalist firms. While staff continues to believe enhanced indexing is a viable strategy, none of the four finalist firms (with one exception) generated strong support and high conviction from the evaluators. The evaluation team and the Chief Investment Officer determined that it was not optimal to continue the enhanced indexing program with just one manager. The one manager with whom the evaluation team had high conviction will be encouraged to participate in the competitive manager searches planned for 2010.

Mr. Ragan moved the Board approve the discontinuance of the enhanced index program and further direct staff to transition the U.S. enhanced index assets currently managed by BGI into the U.S. passive index, also managed by BGI, and to transition the non-U.S. enhanced index account currently managed by BGI into the non-U.S. passive index which is managed by SSgA. Ms. Owens seconded the motion.

In response to Chair McElligott's question about viable enhanced index managers and BGI's capacity in that mandate, Mr. Bruebaker said monies would be moved to BGI's passive account with the Board's approval of staff's proposal.

The above motion carried unanimously.

Public Equity 2010 Annual Plan

Mr. Bruebaker summarized the proposed Public Equity annual plan. He reviewed key investment beliefs adopted by the Board to maximize returns at a prudent level of risk; a preference for a broadly diversified portfolio; a belief in reversion to the mean, especially within public markets; and a belief in active management where there is sufficient capacity to put money to work.

Within the six-year plan, there is a goal to consider new markets and strategies. To that end, staff was added to the Public Equity unit to increase capacity to monitor exiting managers whom have our members' money at risk. Staff also intends to continue exploring emerging markets, frontier markets, global strategies, and ways to improve data and analytics through use of the data warehouse system.

Some considerations in developing the Public Equity annual plan are that liquidity is important, transparency is vital, public equity follows a unique public governance and procurement model from other asset classes, and the WSIB has finite resources. Mr. Bruebaker reviewed keys to success for the program to maintain a long-term perspective, develop an efficient and effective program structure, and select managers that will provide consistent, long-term performance.

Mr. Bruebaker reviewed issues staff considered in planning for public markets, such as market efficiency, global equity strategies, globalization and emerging markets, "hedge" funds, governance, and implementation.

Mr. Bruebaker briefly reviewed the history of the Public Equity program for the CTF. He said the Board went back into enhanced equities at the wrong time. He pointed out the home country bias and how it has evolved over time. The Board made a decision four years ago to go 50/50, and then a decision to move to market weight split two years later. There are other public pension funds following that move now.

Mr. Bruebaker reviewed the current CTF asset allocation. The Board has allocated its risk budget toward private markets. Because of this, public equity must remain liquid and the allocation is not intended to take on additional risks for higher returns.

For 2010, Public Equity plans to focus on less efficient spaces, broad mandates that make sense, concentrate on the portfolio as a whole, and concentrate on global equity and emerging markets. For the CTF, staff is recommending the Board approve a migration toward a broader, more flexible global structure, including passive U.S.; passive non-U.S.; active non-U.S. or global managers; and active emerging markets managers. For the other funds, including Labor and Industries, Guaranteed Education Tuition, Developmental Disability Endowment Fund, and Common School Fund, staff recommends continuing to use low cost commingled index funds for public equity exposure. Relative to defined contribution and deferred compensation programs, staff recommends conducting a comprehensive review of the options, working closely with the Employee Retirement Benefits Board and Department of Retirement Systems. Any changes would be brought to the Public Markets Committee and Board for approval.

Mr. Bruebaker reviewed 2009 Public Equity accomplishments and noted some of the 2010 initiatives. Mr. Nierenberg encouraged staff to consider unusual mandates to populate non-U.S. for global managers. Mr. Bruebaker confirmed this is staff's plan and the only strategy that will not be considered is active strategies focused solely on U.S. equities.

[Ms. Schurke arrived at 10:12 a.m.]

Mr. Nierenberg appreciated staff looking into hedging opportunities. He recommends the Board look for future situations when the pricing is right to insure asset value within public equity and fixed income mandates.

Mr. Ragan moved the Board adopt the 2010 Public Equity Annual Plan. Ms. Owens seconded, and the motion carried unanimously.

AUDIT COMMITTEE REPORT

State Auditor's Office Fiscal Year 2009 Accountability Audit Report

Mr. Petit reported the Audit Committee met on December 1 to review the State Auditor's Office Fiscal Year 2009 Accountability Audit Report. No audit findings were reported. This marks the eighteenth consecutive year the WSIB has had no audit findings.

Mr. Petit moved the Board approve the WSIB's July 1, 2008 – June 30, 2009, State Auditor's Office Accountability Audit Report. Mr. Hill seconded, and the motion carried unanimously.

Fiscal Year 2009 Independent Financial Auditors' Report

Mr. Petit reported the Committee reviewed the independent financial audit reports for the Board's Fiscal Year 2009 financial statements. The auditors concluded the financial statements were presented fairly, in all material respects.

Mr. Petit moved the Board approve the Fiscal Year 2009 Independent Financial Auditors' Reports. Ms. Owens seconded, and the motion carried unanimously.

Ms. Whitmarsh congratulated Kris Logan, Investment Accounting Controller, on her first set of financial statements after rejoining the WSIB last year.

Mr. Petit reported the Committee also received the State Auditor's Office 2008 Conflict of Interest Policy compliance review results. This was the first year the State Auditor's Office performed the annual review, which was previously performed by the Attorney General's Office. Minor exceptions were identified, and steps have been taken to ensure issues were resolved.

The Audit Committee also received the Custody Bank Operations Internal Audit report. The overall audit assessment was good. Five recommendations were made to strengthen controls. Staff and JPMorgan are working on resolution, and the Committee will receive updates. A status report on prior audit recommendations was also presented, with three recommendations resolved since September and another recommendation scheduled for completion by March 31, 2010.

Finally, the Committee received staff's 2009 Proxy Voting Report, and a 2010 Proxy Season Preview.

Mr. Petit said it has been his pleasure to serve as Audit Committee Chair and continue on as a member. He thanked staff for their assistance. Chair McElligott thanked Mr. Petit for serving as the Audit Committee Chair.

ECONOMICALLY TARGETED INVESTMENTS ANNUAL REPORT

Ms. Kruzel presented the seventh annual economically targeted investments (ETI) report. The Board refined its policy in 2003 to detail the program's objectives and broad parameters for considering ETIs. Staff continues to seek quality investments in accordance with established policies, statutes, and fiduciary duties. Policy implementation remains focused on network collaboration and maintaining relationship with regional fund managers. The WSIB serves as a resource for regional funds and forums, actively monitors Washington investment activities and opportunities, and assists regional entrepreneurs seeking funding. Additionally, staff evaluates approaches used in other states' ETI programs.

Ms. Kruzel said Washington-based investments are held within each WSIB asset class, but total exposure is down 22 percent from the prior year. That trend tracks the CTF market value decline of 24 percent over the same period. Washington investments are down 50 percent in Public Equity, which mirrors the market place; down 7 percent in Fixed Income due to a bond sale; down 5 percent in Real Estate; and down 35.7 percent in Private Equity due to the net effect of market valuation adjustments, new investments, and distributions. Washington investments comprise approximately 2 percent of the CTF.

Ms. Kruzel reported \$92.7 million in private equity investment value in Washington-based companies as of June 30, 2009. This amount is spread across 45 general partners (GPs) in 85 different funds, and diversified among ten industries. She described how WSIB's investments represent only a small portion of the total dollars invested by WSIB's GPs and other GPs into Washington companies, creating a significant impact beyond the reported WSIB investment amounts. There was \$20.3 billion invested in 3,171 Private Equity deals in the U.S. for the 12 months ended June 30, 2009; the Northwest captured about 3.3 percent of those dollars and Washington State accounted for 81 percent of the Northwest total. Washington has consistently accounted for the lion's share of Northwest deal flow over the years.

Ms. Kruzel said the seventh annual poll of 55 WSIB GPs was conducted to determine the number of Washington deals GPs are looking at and the disposition or status of those deals. During the 12 months ended September 30, 2009, 41 WSIB GPs looked at 1,626 deals in Washington; 19 deals were completed; and 1,100 deals were still in the pipeline. These results indicate Washington State continues to have interest from and access to GPs. Although there was a decline this year from the prior year, consistent with market conditions, deals are still getting done.

Representative Santos expressed an interest in getting additional details on deals considered, such as gender/minority-ownership, rural versus urban, and deal size. Ms. Kruzel welcomed the opportunity to work with Representative Santos on her suggestion.

Senator Brown thanked staff for the report and asked for it to be shared with Legislators, as there is a lot of public interest on the subject.

[The Board took a brief recess at 10:48 a.m. and reconvened in open session at 11:04 a.m.]

ADMINISTRATIVE COMMITTEE REPORT

2010 Legislative Session Preview

Chair McElligott said the Administrative Committee received a preview from Ms. Mendizabal of the 2010 Legislative Session. The main focus of the upcoming legislative session, which begins January 11, will be the state's \$2.6 billion revenue shortfall and how to deal with it in the supplemental budget. He reported that executive staff has already met with several Legislators and

will continue meetings throughout session to discuss issues concerning the WSIB and investment performance for the state's pension and other public funds managed by the WSIB. Staff will notify the Chair and report to the Board any budget changes and/or other proposals surfacing that could have a major impact on the WSIB and its fiduciary responsibilities.

Select Committee on Pension Policy Risk Study

Ms. Whitmarsh shared the Select Committee on Pension Policy (SCPP) may request the WSIB provide information and serve as a resource for a risk study the State Actuary is conducting. Staff is expecting a formal request letter from Representative Steve Conway, SCPP Chair. Staff plans to bring the request to the January meeting for the Board to provide parameters and clear direction to staff on its involvement.

2010 Recommended Conferences

Chair McElligott said the Administrative Committee discussed the 2010 Recommended Conference listing, which is abbreviated from prior years' listings. Staff eliminated some conferences based on quality and to limit travel, but gave consideration to educational needs. He shared Mr. Nierenberg's comments on the Board limiting member attendance at this year's KKR conference.

Chair McElligott commented the Recommended Conference listing represents what he would consider pre-approved travel, but asked members to exercise restraint due to the current economic environment.

Mr. McElligott moved the Board approve the 2010 Recommended Conferences listing. Mr. Ragan seconded the motion.

Mr. Kaminski said he appreciates cutbacks, but noted valuable opportunities such as Texas Pacific Group's annual meeting that he would like re-added to the list, due to its morning focus session on policy and strategy. Chair McElligott said members are welcome to request any training, but he prefers to retain that consideration rather than adding conferences on the recommended list.

The above motion carried unanimously.

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 Board also plans to discuss financial and commercial information relating to an investment in executive session since public knowledge 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 was expected to last about 20 minutes, at which time the Board would reconvene in open session.

[The Board went into in executive session at 11:10 a.m. and reconvened in open session at 12:08 p.m.]

PRIVATE MARKETS COMMITTEE REPORT

Real Estate Annual Plan

Mr. Masten moved the Board adopt the confidential 2010 Real Estate Annual Plan that was presented and discussed in executive session. Mr. Petit seconded, and the motion carried unanimously.

Tangible Assets Annual Plan

Mr. Masten moved the Board adopt the confidential 2010 Tangible Assets Annual Plan that was presented and discussed in executive session. Mr. Petit seconded, and the motion carried unanimously.

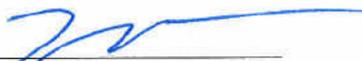
OTHER ITEMS

There was no further business to come before the Board and the meeting adjourned at 12:10 p.m.



Patrick McEligott
Chair

ATTEST



Theresa J. Whitmarsh
Executive Director