

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
December 16, 2010

The Washington State Investment Board met in open session at 9:48 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
Steve Hill
William Longbrake
George Masten
Richard Muhlebach
Bob Nakahara
David Nierenberg (via teleconference)
Judi Owens
Mike Ragan
Representative Sharon Tomiko Santos

Absent: Judy Schurke
Jeff Seely

Also Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Victor Moore, Chief Operating Officer
Liz Mendizabal, Public Affairs Director
Steve Lerch, Research Director
Steve Draper, Senior Investment Officer – Real Estate
Tom Ruggels, Senior Investment Officer – Private Equity
Diana Will, Senior Investment Officer – Asset Allocation
Bill Kennett, Senior Investment Officer – Fixed Income
Phil Paroian, Senior Investment Officer – Public Equity
Kate Sandboe, Corporate Governance Officer
Kristi Haines, Executive Assistant

Steve Dietrich, Attorney General's Office

[Names of other individuals attending the meeting are listed in the permanent record.]

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

ADOPTION OF THE NOVEMBER 18, 2010, MINUTES

Treasurer McIntire moved to adopt the November 18, 2010, Board meeting minutes. Ms. Owens moved to amend a partial sentence on page 7, which she read aloud. Chair McElligott seconded the amended motion, and it carried unanimously.

PUBLIC COMMENT

There was no public comment.

COMMITTEE ASSIGNMENTS

Chair McElligott said he is not proposing Committee changes at this time, and had talked with each Committee Chair to ensure they are comfortable in their roles as there has been a lot of Committee turnover. He is recommending keeping each Chair in place. The Board will be examining some of its processes next year, which may result in changes.

Mr. Masten moved the Board retain its current Committee structure.

Mr. Ragan seconded, and the motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT

DRS Department-request Legislation

Chair McElligott said Mr. Hill had presented the Administrative Committee with a legislative proposal to have the WSIB select the default investment option for Plans 3. Chair McElligott said he has concerns with the proposal and is not comfortable moving ahead at this time. Mr. Hill described that under current law members entering Plans 3 who do not select an investment option are defaulted into the Total Allocation Portfolio (TAP). The Board had previously asked the Department of Retirement Systems (DRS) to work with WSIB staff to explore options for reducing the risks to the CTF associated with the TAP option. This proposal is one idea that DRS and WSIB staff jointly developed. Mr. Hill stated that if this Legislation passed, he expected the SIB select a target date fund closest to a person's retirement age as the default – but that this proposal would give the SIB flexibility in to make a choice that best fit plan members.. He believes selection of the default investment option for Plans 3 is an appropriate role for the WSIB due to its responsibility for selecting the investment options in Plan 3s. Treasurer McIntire noted it is sometimes useful for a body for which the authority is to be granted to not be the requestor of the legislation. He suggested that any legislative proposal to change the default option might require more stakeholder work before it is taken forward.

2011 Recommended Board Education

Chair McElligott noted the recommended Board education listing in the Board materials. He reminded members the Board Chair must approve all requests.

Mr. Ragan moved the Administrative Committee recommend the Board approve the 2011 Recommended Board Education listing. Treasurer McIntire seconded, and the motion carried unanimously.

Legislative Session Preview

Ms. Mendizabal said staff's focus for the legislative session will be to educate new members through meetings to address concerns and listen to suggestions. Staff also plans to meet with incumbent legislators, in addition to the Executive Director's planned presentations before the House and Senate Ways and Means committees.

Iran/Sudan Resolutions Renewal

Ms. Sandboe described the minor changes to the proposed Iran and Sudan Resolutions. The changes have been shared with concerned parties and they are satisfied with the proposals.

Chair McElligott noted the Administrative Committee had requested one change to item 4 of the Iran Resolution. The revised draft was distributed to members. Ms. Mendizabal said the drafts link the expiration of the resolutions to January 2014.

Mr. Ragan moved the Board adopt these proposed resolutions and renew its commitment to identify and encourage companies in which the WSIB is invested, that have business operations in Sudan or Iran, to curtail or cease their operations until peace and stability in those countries has been restored. Mr. Masten seconded the motion.

In response to Mr. Ragan's question, Ms. Mendizabal indicated the Sudan Resolution did not require the same revision as the Iran Resolution as it does not contain the exact same language.

The above motion carried unanimously.

Assistant Attorney General's Report

Chair McElligott described the Council of Institutional Investors (CII) had invited the WSIB to join in an amicus brief in support of a recent Securities and Exchange Commission (SEC) ruling relating to proxy vote access the Chamber of Commerce and Business Roundtable had challenged.

Mr. Dietrich said the rule mandates shareholders' access to proxy ballots to nominate a certain number of board positions. He said the rule was enacted last fall following authorization in the Frank-Dodd legislation allowing the SEC to do so. The SEC has stayed the rule pending the court's decision. He said signing onto the amicus brief is largely a symbolic gesture for the WSIB because the brief will be filed whether or not the WSIB decides to join. Other large state investment boards have joined, including California, Colorado, Wisconsin, and New York. The brief is intended to explain the interests of and help the court understand the position of public institutional investors. He said he and staff will be able to review two drafts prior to signing on, with the approval of both the Board and the Attorney General. The Solicitor General's Office has no issues if the Board chooses to move forward.

Treasurer McIntire moved the Board authorize the WSIB, subject to the approval of the Attorney General, to join an amicus brief in support of the new SEC Rule 14a-11 in the case known as Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission. Mr. Ragan seconded the motion.

Mr. Hill shared concerns he raised at the Administrative Committee that he is uncomfortable signing onto something the Board has not seen, and there is no information relating to impact on returns of the portfolio.

The above motion passed with Mr. Hill abstaining.

Other Items

Chair McElligott reported Mr. Hill had brought up the issue of the Board further examining its governance practices. Chair McElligott said he will appoint an *ad hoc* committee to look at such issues, and any member wanting to serve on the Committee should contact him. The Committee will bring information and recommendations to the Administrative Committee.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh reported the Private Markets Committee would meet on January 6 to review the Private Equity Annual Plan. The Public Markets Committee also meets in January, as does the Administrative Committee and Board. Ms. Whitmarsh will present the Strategic Plan in January.

Mr. Bruebaker reported staff had an issue during the latest public manager transition with JPMorgan's custodial services. A discussion ensued on the nature of the problem and the terms of the JPMorgan contract. Treasurer McIntire encouraged staff to let him know about issues with the custodial bank so he could assist with resolution. Mr. Masten said the issue should be considered during the next custodial bank procurement.

Ms. Whitmarsh reminded the Board the global non-U.S. investment manager search and cash overlay requests are still open procurements.

AUDIT COMMITTEE REPORT

Mr. Hill reported the Audit Committee met last week. It considered a new Investment Referral Process Policy 2.05.800. This policy provides a consistent approach with regard to investment opportunities received by the WSIB through various channels. If adopted, this policy would create a record and transparency in the handling of investment opportunities that come to the WSIB through Board members. The Committee also considered a revision to the Role of Investment Managers policy 1.10.200, that harmonizes it with the new referral process.

Mr. Hill moved the Board adopt both the new Investment Referral Process Policy 2.05.800 and the revised Role of Investment Managers Policy 1.10.200, as recommended by the Audit Committee. Treasurer McIntire seconded the motion.

Mr. Hill said that when members recommend staff talk with a certain investment manager, they will maintain a log which will be presented to the Audit Committee on a regular basis. Ms. Whitmarsh said this is a result of an Internal Audit suggestion, which arose in light of the pay-to-play scandals in some other states.

Representative Santos said she applauds the development of a policy to move in the direction of achieving standardization. She questioned the language under item 5 of Policy 1.10.200, and asked how one could ensure Board members "will" promptly refer managers. Mr. Hill agreed. He does not want to be obligated to refer every party that approaches him. Mr. Masten concurred. Ms. Whitmarsh said staff would re-work the wording so each policy harmonizes with the other.

Mr. Hill withdrew his motion.

Mr. Nierenberg stated the policy was done because of abusive practices elsewhere, and he does not believe the intent is to inhibit referrals that may be of merit. He said he has referred dozens of opportunities to staff. He asked staff to be careful not to overwrite the policies so they inhibit the flow of good ideas. Mr. Hill said the intent is only to be transparent.

Audit Committee Charter 1.00.130 and Internal Audit Charter 1.00.190 Revisions

Mr. Hill said the Audit Committee considered changes to both the Audit Committee and the Internal Audit Charters to reflect recent changes to the State Auditor's Office (SAO's) annual accountability

audit approach. The State Auditor will not be conducting annual accountability audits due to budget constraints but will instead focus on high risk areas and agencies to audit.

Mr. Hill moved the Board adopt the revisions to the Audit Committee Charter 1.00.130 and the Internal Audit Charter 1.00.190, as recommended by the Audit Committee. Treasurer McIntire seconded the motion.

Mr. Hill said the Committee heard presentations from both Internal Audit and the SAO. The SAO has selected four high-risk areas across the state for next year's audit and will not be conducting its annual audit of the WSIB. The Charters currently require the SAO to audit the WSIB every year, which is inconsistent with the SAO's changed audit selection process. He reported there was extensive discussion by the Audit Committee about its concern that adequate audit oversight be provided through other means, including Internal Audit and outside auditors. He noted the audit plan developed for next year will reflect this issue and the Audit Committee will receive a proposal to ensure the WSIB is properly audited to deal with whatever gaps were created by the SAO's new audit approach.

Mr. Ragan asked if the SAO would perform any future audit of the WSIB. Mr. Hill said he assumed they would if the WSIB falls into one of the SAO's audit categories. Ms. Whitmarsh said the WSIB has an 18-year history of clean SAO audits and she believes the annual audits enhance the agency's reputation. She noted the good news is the SAO does not consider the WSIB to be high-risk and Peterson Sullivan performs an annual independent audit of the Board's financial statements. However, the WSIB is high profile as it is responsible for a significant portion of state assets, and staff does not want any loss of transparency so the agency's good reputation continues.

Mr. Masten and Treasurer McIntire expressed their concern over the SAO's change in practice. Senator Brown pointed out the SAO's function is at the will of the Legislature.

The above motion carried unanimously.

Fiscal Year 2010 Independent Financial Auditors' Report / WSIB Annual Report

Mr. Hill reported the Audit Committee reviewed the WSIB fiscal year 2010 financial statement audit, independently performed by Peterson Sullivan PLLC. The auditor did not issue a management letter for new or repeat deficiencies in internal control and did not propose any adjustments to the 2010 financial statements.

Mr. Hill moved the Board approve the Fiscal Year 2010 Independent Auditors' Report, as recommended by the Audit Committee. Mr. Ragan seconded the motion.

Mr. Hill said the Audit Committee spent a great deal of time discussing the report and asked many probing questions.

The above motion carried unanimously.

ANNUAL REPORT

Mr. Hill said now that the Board has approved the Committee's recommendation to accept the Peterson Sullivan report on financial statements within the annual report, it is appropriate for the Board to approve the annual report in total.

Mr. Hill moved that the Board approve the WSIB 2010 Annual Report.

Mr. Masten seconded, and the motion carried unanimously.

[The Board recessed at 10:35 a.m., and reconvened in open session at 10:55 a.m.]

ECONOMICALLY TARGETED INVESTMENTS ANNUAL REPORT

Ms. Kruzel introduced the eighth annual report on Economically Targeted Investments (ETIs). The Board adopted its ETI policy in 2003, with a primary objective to produce investment return to pension assets with the possible collateral effect of assisting the regional economy or the economic well being of the state of Washington, its localities, and its residents. The policy calls for an annual reporting of activities. Ms. Kruzel said policy implementation remains focused on collaboration and relationships, including working with local and regional networks to foster deal flow in Washington, maintaining good relationships with organizations and fund managers, and serving as a resource for both regional firms and forums. Although deal activity has started to show some improvement, no new funds were raised locally this past year.

Ms. Kruzel reviewed the Washington exposure in the CTF. The year-over-year total exposure is up 3.25 percent, and the Washington total is nearly 2 percent of the CTF, while the state's GDP is only 0.6 percent of the GDP for the investible universe within which the WSIB invests. Within the individual assets classes, public equity investments in Washington is up over 17 percent, fixed income investments in Washington were down about 20 percent, and real estate was down about 6 percent. Private equity was up over 65 percent with \$23.9 million in new investments representing a \$42.9 million appreciation in value less \$6.2 million in distributions. She said there is \$153.2 million of private equity investments in Washington-based companies among 84 different funds with 45 general partners. The investments are diversified across 10 industries. Ms. Kruzel described the WSIB and general partners' investment contributions within Washington since 1992. The WSIB has fully realized \$116.6 million in Washington investments during that time period. That represents a return of only 74 cents for every dollar invested. Other private equity exited investments have realized a \$2.50 return for every invested dollar.

Ms. Kruzel reviewed the number of Washington, Northwest, and U.S. deals and dollars invested over the past fiscal year. Washington has taken the largest percentage of Northwest deals. She reviewed the annual poll of WSIB general partners. During 2010, 41 general partners looked at 1,611 deals. Twenty-seven of those general partners still have deals under consideration, and 10 general partners completed 20 deals. She noted that even the deals not pursued at least had access to a general partner.

Chair McElligott complimented Ms. Kruzel's report. Representative Santos asked to what extent there are proactive efforts to engage with minority and women-owned businesses and communities. Ms. Kruzel described the focus is on all groups raising money, and noted her contacts with the Women Angel group in Seattle. She welcomed any referrals or contacts Representative Santos could share. In response to Mr. Hill's question, Mr. Bruebaker said the portfolio is more than 100 percent overweight in Washington investments. Mr. Hill asked that future presentations include that data. Mr. Longbrake asked if any of the statistics are skewed by any individual deal. Ms. Kruzel said there is one, but she also examines the information without taking that specific deal

into consideration. Mr. Longbrake posed the question if a different risk standard is taken when it comes to Washington investments? Mr. Bruebaker said that he has been with the WSIB almost 10 years and during that time the WSIB has never compromised its standards to do a Washington deal. Treasurer McIntire complimented the presentation. He said it is important for the WSIB to communicate its efforts. He suggested the WSIB publicize the data but emphasize the goal is to make money and the assumed 8 percent rate of return. Ms. Kruzel said the WSIB is the only state with a dedicated research and outreach program of which she is aware. Senator Brown asked the Executive Director to present the information to the legislative economic development committees, so they become aware of WSIB policy and activities.

Ms. Whitmarsh said there has been a lot of recent interest from the life sciences and clean tech industries. She and Ms. Kruzel have participated in a number of meetings. Despite the fact the WSIB is initially approached by these groups for money, they are very satisfied with leveraging intellectual capital from WSIB contacts.

Chair McElligott commented on the poor track record of the returns. Ms. Kruzel said the majority of ETI investments are venture, which has not done well in the last decade and it is not surprising to see less than average returns. More small and mid-market buyout activity should strengthen returns and generate a higher number of jobs over a shorter period. Mr. Masten noted that losses probably date back to before the current standards were in place and he expects that still has an effect on the returns. Ms. Kruzel said she would further examine the data to try to identify where losses have occurred, to give insight to what may occur in the future.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on December 3, 2010, to consider the selection of the real estate consultant, participate in the 2011 Real Estate annual planning session, and discuss venture capital.

Real Estate Consultant (Category A) Finalist Decision

Mr. Masten moved the Board authorize the hiring of Courtland Partners, Ltd., as the WSIB's general real estate consultant, subject to final negotiations of the contract. Mr. Hill seconded the motion.

Mr. Masten said Courtland has been the real estate consultant for the past 10 years and has done satisfactory work. In going out with the procurement, a very limited number of consultants met WSIB's criteria as most of them had outside investments the WSIB does not allow. There were two finalists, with Courtland Partners scoring highest. He said it is important to retain them going forward.

The above motion carried unanimously.

Real Estate Annual Planning

Chair McElligott 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 executive session was expected to last about 10 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 11:25 a.m., and reconvened in open public session at 12:03 p.m.]

[Senator Brown was not in attendance at 11:51 a.m.]

Ms. Whitmarsh introduced Mr. Fabrizio Natale, newly hired Investment Officer – Private Equity.

Mr. Masten moved the Board adopt the confidential 2011 Real Estate Annual Plan that was presented and discussed in executive session. Mr. Hill seconded, and the motion carried unanimously.

Venture Capital Discussion

Mr. Masten said two years ago, after considerable discussion, the Private Markets Committee recommended to the Board that the WSIB discontinue its efforts to actively seek additional venture capital investments. The recommendation was made based on a number of factors, including a decade or more of disappointing returns for the industry, the WSIB's limited access to a relatively small group of top performing venture funds, and changes to the IPO market that make it more challenging for venture-backed companies to achieve liquidity in a reasonable time frame. The Board agreed with the Committee's recommendation, and moved to terminate its relationship with Pathway, which managed a venture capital separate account for the Board. The Pathway account was the Board's primary vehicle for investing in venture capital. The Board decided that future venture capital investments should be limited to funds managed by general partners with a demonstrated track record of first quartile performance. During several meetings held this past year the Board has re-examined its approach to venture investing.

Mr. Masten moved the Board maintain its current strategy of only investing in venture funds managed by general partners with a demonstrated track record of first quartile performance. Mr. Hill seconded the motion.

Representative Santos said she hopes the outcome of the motion will allow discussion to move forward. She said if the Board has not indicated any change of direction, she is uncertain why a motion is necessary. Chair McElligott said reaffirming the Board's position is timely as a lot of questions and inquiries are being received by staff.

The above motion failed, with Representative Santos and Ms. Owens abstaining.

NON-VOTING BOARD MEMBERS EVALUATION

Chair McElligott announced the voting members of the Board would go into executive session to review and discuss the performance of non-voting Board members. He said the executive session was expected to last about 10 minutes at which time the Board would reconvene in open session.

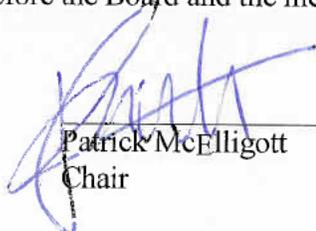
[The Board went into executive session at 12:05 p.m., and reconvened in open public session at 12:44 p.m.]

[Senator Brown was back in attendance via teleconference at 12:40 p.m.]

OTHER ITEMS

Mr. Hill asked the Chair and Executive Director to bring back to the Board a discussion around long-term potential liquidity risks to the CTF and a specific proposal to address that risk. He noted the solution he raised earlier in the meeting relating to the WSIB selecting the default option in Plans 3, but said the fundamental issue is risk to the CTF. Senator Brown agreed the Board has a fiduciary responsibility to come up with a solution. Mr. Ragan and Ms. Owens volunteered to examine the issue with staff. Ms. Whitmarsh suggested staff work with the members to bring a proposal back to the Public Markets Committee in February. Chair McElligott will also be involved, and asked staff to set-up a meeting with the volunteer group.

There was no further business to come before the Board and the meeting adjourned at 12:48 p.m.



Patrick McElligott
Chair

ATTEST



Theresa J. Whitmarsh
Executive Director