

**WASHINGTON STATE INVESTMENT BOARD**  
**Board Meeting Minutes**  
**June 16, 2011**

The Washington State Investment Board met in open session at 9:31 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Patrick McElligott, Chair  
Treasurer Jim McIntire, Vice Chair (via teleconference)  
Senator Lisa Brown (via teleconference)  
Steve Hill (via teleconference)  
Bill Longbrake  
George Masten  
Bob Nakahara (via teleconference)  
David Nierenberg (via teleconference)  
Judi Owens  
Natasha Pranger  
Mike Ragan  
Representative Sharon Tomiko Santos  
Judy Schurke  
Jeff Seely

Absent: Richard Muhlebach

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  
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  
Donna Ong, Assistant Senior Investment Officer – Fixed Income  
James Mackison, Director of Technology and Innovation  
Kristi Haines, Executive Assistant

Steve Dietrich, Attorney General's Office  
Scott Daniels, Conning Asset Management  
Susan Royles, Conning Asset Management  
Bill Song, Song Mondress PLLC  
David Adkins, BoardDocs

[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 MAY 19, 2011, MINUTES**

**Mr. Ragan moved to adopt the May 19, 2011, Board meeting minutes.  
Mr. Masten seconded, and the motion carried unanimously.**

### **PUBLIC COMMENT**

There was no public comment.

### **EXECUTIVE DIRECTOR'S REPORT**

Ms. Whitmarsh reported the Board Governance *ad hoc* Committee met last week to finalize priority topics for the July meeting, including guiding and assessing Board strategy and investment theory, organizational issues, assessing enterprise risk, and general Board operations.

[Treasurer McIntire was in attendance via teleconference at 9:35 a.m.]

Ms. Whitmarsh noted the July draft agenda was distributed to members, and is close to finalization. She reported the Governor signed the budget yesterday, which approved all funding requested and two FTEs for the WSIB—one Investment Officer-Tangible Assets and a Risk Analyst. She reported that Mr. Bruebaker had been interviewed by *Institutional Investor*, *Business Week*, and *Bloomberg*, but the interviews have not yet been published. Ms. Whitmarsh announced the quiet period for the custody bank services procurement is currently in place. It is a major procurement that typically draws significant interest from the banking industry. Should Board members receive inquiries, they should refer matters to Mr. John Lynch, Contracts Manager, to prevent quiet period violation. Proposals are due September 1, with finalist recommendations coming before the Board at its December meeting for a contract commencing July 1, 2012. Ms. Whitmarsh said legislation resulted in the WSIB becoming responsible for two new funds—one is a rainy day fund for industrial insurance. Ms. Schurke described the rainy day fund is a contingency reserve for monies over 110 percent of liabilities to be deposited within. The purpose is to improve transparency and set aside money to absorb future increases. She said it would not change investment practices other than moving excess monies into the new fund. In response to Treasurer McIntire's question, Ms. Schurke said the industrial insurance rainy day fund would be invested in the same manner as the other industrial insurance funds.

### **LABOR AND INDUSTRIES' INVESTMENT BELIEFS**

Mr. Bruebaker reminded the Board it adopted investment beliefs for the Commingled Trust Fund (CTF) in July 2009, which was important to document fundamental beliefs of the various investment aspects of that program. The proposed Labor and Industries' (L&I) investment beliefs have some different nuances. Staff worked closely with Ms. Schurke, L&I staff, and Mr. Daniels of Conning Asset Management over the past 2 years to develop the proposed investment beliefs to strike a balance between risk and return. He noted the CTF mandate is to maximize returns at prudent level of risk; however, L&I funds have a statute that mandates drivers other than total return. The investments take into consideration long-term liabilities with an emphasis on volatility.

Mr. Bruebaker presented the 14 proposed L&I investment beliefs contained within the Board materials, taking into consideration its mission, risk, asset allocation, active management, performance measurement, and organization core competencies.

He announced that Ms. Schurke fully supports the investment beliefs as does Conning Asset Management. Ms. Schurke thanked Representative Santos who initially asked for the development

of separate investment beliefs for the L&I funds. She appreciated the exercise, which provided an opportunity for staff and the consultant to think about how it invests and how it differs from the CTF.

**Ms. Schurke moved the Board adopt the investment beliefs for the Labor and Industries' funds. Representative Santos seconded, and the motion carried unanimously.**

#### **EMERGING MARKETS AND NON-U.S. DOLLAR-DENOMINATED FIXED INCOME**

Mr. Kennett and Ms. Ong presented information on emerging markets: definition, rationale for investments, outlook, risks, portfolio implications and portfolio holdings. They also discussed non-U.S. dollar-denominated fixed income: rationale, interest and inflation rates, determinants of exchange rates, holdings, Renminbi internationalization, and obstacles to investing in local markets in emerging countries.

[The Board took a recess at 11:20 a.m., and reconvened in open session at 11:33 a.m.]

#### **AUDIT COMMITTEE REPORT**

Mr. Hill reported the Audit Committee met on June 7. The Committee reviewed several items including, the independence of the Board's financial statement auditor, Peterson Sullivan; heard an Internal Audit report on cash flow management and presentation of the Audit Recommendations Status Report; received an update on progress of the Permanent Funds' asset allocation; received its first quarterly investment referral log as a result of new policy; and a report on the WSIB's proxy voting policy on reporting corporate political expenditures and contributions. Risk and Compliance presented the 2011 Risk Report, and reviewed risk appetite statements, qualitatively expressing risk tolerances for fiduciary, investment, strategic, governmental and environmental, operational, and reputational risk. The Committee suggested further refinements, and will take up the statements again in September before presentation to the Board.

#### **Conflict of Interest Policy 2.00.100 and Audit Committee Charter 1.00.130 Revisions**

Mr. Hill reported the Committee reviewed revisions to the Conflict of Interest Policy and Audit Committee Charter, to correct references of services the State Auditor's Office (SAO) no longer provide to the WSIB.

**Mr. Hill moved the Board adopt the revisions to the Conflict of Interest Policy 2.00.100 and the Audit Committee Charter 1.00.130. Mr. Masten seconded, and the motion carried unanimously.**

#### **2010 Conflict of Interest Policy Compliance Review – Auditor Appointment**

Mr. Hill said the Committee received a briefing recommending that the Board appoint Peterson Sullivan LLP to perform the calendar year 2010 Conflict of Interest Policy Compliance Review. This was a service previously provided by the SAO.

**Mr. Hill moved the Board appoint Peterson Sullivan LLP to perform the calendar year 2010 Conflict of Interest Policy Compliance Review. Mr. Masten seconded, and the motion carried unanimously.**

#### **Fiscal Year 2012 Internal Audit Plan**

Mr. Hill reported the Committee also reviewed the proposed 2012 Internal Audit Plan. A survey

was sent out to all employees as part of the plan development. There was discussion regarding the ability of existing staff to handle the increased workload created by the lower level of services provided by the SAO. It was noted Internal Audit staffing was adequate at this time.

**Mr. Hill moved the Board adopt the Fiscal Year 2012 Internal Audit Plan.  
Mr. Masten seconded, and the motion carried unanimously.**

## **OTHER**

Chair McElligott announced Representative Santos had been reappointed to the WSIB for another 2-year term.

[Mr. Hill was no longer in attendance via teleconference 11:42 a.m.]

### **2011 Risk Management Report**

Ms. Whitmarsh said the risk management report is given annually to the Audit Committee, but she asked for it to be presented before the Board to remind members how risk management is structured in preparation for the July discussion of risk. Ms. Vandehey reviewed the history of enterprise risk management (ERM), the risk culture within the agency and risk governance structure of the program. She reported that 20 percent of agency staff serves on ERM team. The risk framework includes key risks, with significant impact on the agency and its objectives, such as fiduciary risk, investment risk, and reputation risk. Ms. Vandehey described the purpose, members, and example discussions of staff committees that address risk, including the ERM, Risk Steering Committee, and Investment Committee.

Ms. Vandehey reviewed the evolution of WSIB's risk program development and how it compares to peer's efforts and leading practices. She noted the WSIB program incorporates Mr. Rick Funston's framework, and staff's efforts to incorporate its 10 survival and thrival skills.

Ms. Vandehey said the focus on the quantitative investment risk program is to develop ongoing risk measurement and *ad hoc* reporting and analysis. To date the staff has implemented the BarraOne market risk system, provided data warehouse concentration reports, and compiled 70 percent of real estate property and tenant holdings in Cougar, which is being scrubbed. WSIB staff also assisted in the creation of a national peer risk group association, with 70 members representing 55 funds comprised of institutional and pension fund organizations.

Ms. Vandehey said the July meeting would engage the Board in tactical level risk discussions for long-term strategic planning, focusing on organizational risks, investment risk, and fiduciary risk. Chair McElligott commented on Ms. Vandehey's long-term service and commitment to the WSIB's risk program.

Mr. Longbrake noted it would be valuable during the July meeting to look back at potential consequences of risk implications for the portfolios and categories within portfolios. Chair McElligott complimented the draft July agenda. He believes it will result in a well constructed discussion.

[Treasurer McIntire and Mr. Nierenberg were no longer in attendance via teleconference at 11:55 a.m.]

[The Board took a recess at 11:55 a.m., and reconvened in open session at 12:18 p.m.]

## **LABOR AND INDUSTRIES' FUNDS ANNUAL REPORT**

Mr. Daniels and Ms. Royles, Conning Asset Management, introduced themselves. They relayed that Conning Asset Management has a sole focus on insurance with a wide range of client resources to improve results. Mr. Daniels addressed the unique aspects of L&I, its business and labor stakeholders, and differences from private industries. L&I must meet long-term obligations, which conflict and poses challenges for investment staff. He said L&I wants low but stable premium rates. It also differs from retirement obligations, as L&I uses statutory or insurance accounting. He remarked that equities are marked to market, but investment grade bonds are not. Its investment time horizon can run decades, but premium rates and financial reporting are set annually—it also involves surplus management. He noted that insurance is a risk business, subject to benefit estimate effects and the surplus must weather the ups and downs.

Mr. Daniels noted that L&I objectives are to maintain solvency of funds, premium rate stability, ensure sufficient assets are available to fund the ultimate liabilities; and then to earn a maximum return at prudent level of risk. As of the first quarter ended 2011, the L&I portfolios had \$12 billion in assets, which rates Washington State within the top four state worker compensation funds and within the top ten private company worker compensation funds. Three quarters of the portfolio is comprised of fixed income investment grade bonds, with a significant portion in TIPs, and 13 percent equity.

Ms. Royles relayed that L&I fund performance is compared to a Comparable Market Index (CMI) . The WSIB has outperformed over the 3-year period and longer-term. The 1-year performance has lagged, which is in line with Mr. Kennett's earlier presentation and a result of a sensible conservative approach over the past year. Mr. Daniels said the WSIB's performance over the long-term exceeds 7 percent. He noted there are three L&I funds representing portfolios to meet different industrial insurance obligations.

Mr. Daniels reported that Conning meets quarterly with L&I and WSIB staff, provides industry updates, research access, education sessions, financial analysis modeling, peer analysis, and presentations to stakeholders. He also provided examples of special projects Conning has conducted on behalf of the funds.

Ms. Royles addressed Conning's peer analysis of L&I and comparable groups. Its allocation to BBB investment grade bonds is higher than peer groups, which is prudent and has resulted in higher yields. She noted that Washington State has longer reserve payout patterns principally due to lack of compromise and release.

A discussion ensued relating to net losses in the June 30, 2010, surplus. Ms. Schurke described how the recession caused prolonged claims within the L&I system. She said last year's rate setting was designed to help the economy, but the financial picture is slightly better this year. Ms. Schurke said legislative reforms will have impact in 2012. She noted current reserve levels are as low as she is comfortable with.

[Messrs. Nakahara and Seely were no longer in attendance via teleconference at 12:47 p.m.]

**FIDUCIARY TRAINING**

Mr. Bill Song presented refresher training on interplays of laws that impact board governance, trust fund standards, the distinction between voting and nonvoting members and where those intersect, and the prudence and loyalty duties and obligations.

[The Board took a recess at 1:44 p.m., and reconvened in open session at 1:53 p.m.]

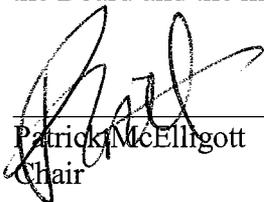
**OTHER ITEMS**

There were no other items to discuss.

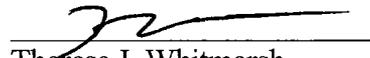
**BOARDDOCS TRAINING**

Mr. Mackison provided a demonstration of the BoardDocs automated Board packet web-based program. He also reviewed guidelines for use of iPads and BoardDocs. Members were assured that their individual notes were private. Discussion ensued on the levels of confidentiality between content areas. Decisions are pending regarding the use of the different content levels. The Board was reminded the goal is to be paperless by the September 2011 meeting. Chair McElligott asked to have Board and staff rosters posted within the BoardDocs library.

There was no further business to come before the Board and the meeting adjourned at 2:42 p.m.

  
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Patrick McElligott  
Chair

ATTEST

  
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Theresa J. Whitmarsh  
Executive Director