WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
July 19-21, 2011

The Washington State Investment Board met in open public session at 1:00 p.m. on July 19, 2011, in the Pavilion Room B at1320 Broadway Plaza, Tacoma, Washington 98402.

Present:	Patrick McElligott, Chair Treasurer Jim McIntire, Vice Chair Steve Hill Bill Longbrake George Masten Richard Muhlebach Bob Nakahara David Nierenberg Judi Owens Mike Ragan Representative Sharon Tomiko Santos Judy Schurke Jeff Seely
Absent:	Senator Lisa Brown Natasha Pranger
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 John Graves, Investment Officer – Asset Allocation James Mackison, Director of Technology and Innovation Kristi Haines, Executive Assistant Kristi Bromley, Administrative Assistant
	Steve Dietrich, Attorney General's Office The Honorable Madeleine Albright, Albright Stonebridge Group Keith Ambachtsheer, KPA Advisory Services Martin Barnes, Bank Credit Analyst Tim Mack, World Future Society Bruce Kasman, JPMorgan

July 19, 2011

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

ADOPTION OF THE JUNE 16, 2011, MINUTES

Ms. Owens moved to adopt the June 16, 2011, Board meeting minutes. Treasurer McIntire seconded, and the motion carried unanimously.

PUBLIC COMMENT
There was no public comment.

2011 STRATEGIC PLAN UPDATE
Ms. Whitmarsh introduced the strategic plan update for 2011. She said the next two day's discussion will focus on key stressors facing the Board from the perspective of governance and investment. She reminded the Board of the strategic framework, which sets out project work in the areas of value, support, and capacity, and that its success rests on the foundation of a skillful Board. The Board established a consensus view in 2007 that the general investment environment was becoming more complex and more competitive and that returns from traditional asset classes may be entering a period of cyclical decline. If so, achieving the 8 percent return objective would become more difficult. Based on that consensus view, the Board articulated a long-term path for the WSIB. From that framework, staff formulated a 6-year plan focused on the challenge of increasing staff, technical, and support resources to achieve the Board's goals. Ms. Whitmarsh reviewed the results of the past three biennial budgets, which provided for some staffing and increased international travel, but then took away salary increases for Investment Officers, froze all state staff salaries, cut half of an FTE in payroll, and called for furloughs (which WSIB was able to absorb in its budget). In the latest budget, salaries for all state employees were cut by 3 percent.

Ms. Whitmarsh said despite the financial markets and budget cuts, two goals are on track: 1) the risk management system is improving by integrating qualitative and quantitative analyses into processes and decisions; and 2) conviction has been maintained to stay with the investment strategy during periods when the strategy causes underperformance relative to peer institutional investors. Goals that are facing challenges are: increasing capacity to manage global funds, tangible assets, active marketable securities funds, other innovative vehicles, and the WSIB's ability to attract, develop, and retain skilled staff.

Ms. Whitmarsh reviewed the performance of the Commingled Trust Fund (CTF), noting the change in assets over time moving toward a larger allocation to global strategies. She discussed strategies identified in each of the asset class annual plans that staff believes will outperform in the future and progress on staff activities. Mr. Mackison provided a status update on the ongoing work being conducted in risk analytics. Specific country risk concentrations have been generated from the system. He noted a key staff departure that has impacted review of data loaded into the system. Reference checks are currently taking place for a replacement candidate.

Ms. Whitmarsh reviewed status on value initiatives involving asset allocation, implications to the CTF of pension reform options, and research and policy analysis. She and Ms. Mendizabal briefed the Board on upcoming pension stakeholder issues and the work staff has done to prepare to address those issues. Mr. Hill asked that staff send him a copy of the in-state investment white paper. Ms. Mendizabal will also share updated talking points on Economically Targeted Investments with all members. She noted a proposed policy revision will be brought to the Board for consideration this fall. A discussion ensued relating to the political nature of certain stakeholder issues and the balance the WSIB has tried to achieve in responding to media, constituents, and other external inquiries. Mr. Masten said the beneficiary groups should be those involved in the political debates. Mr. Hill questioned whether the WSIB's problem statement had been framed and communicated properly. A discussion ensued relating to the capital market assumptions adopted by the Board earlier this year and how those play into the State Actuary's recommendation on return assumptions. Treasurer McIntire noted the effect the Governmental Accounting Standards Board's recommendations may have on the process. Ms. Whitmarsh noted other support initiatives being monitored by staff within Guaranteed Education Tuition, Permanent Funds, Labor and Industries, and corporate governance.

Ms. Whitmarsh said that Messrs. Moore and Ambachtsheer, KPA Advisory Services, would delve deeper into capacity issues during the next agenda item and discuss two approaches to deal with constraints, including optimizing within constraints or seeking more autonomy. The work includes a survey of other pension funds. Mr. Longbrake pointed out an assessment of what constraints create real damage should be done before the Board presents its case to constituencies. Ms. Whitmarsh touched upon other capacity initiatives to maintain the WSIB's position as a low cost/high value-added investment management firm. Ms. Whitmarsh reported the Board's *ad hoc* Governance Committee formed earlier this year had examined governance issues and laid out discussion topics that Mr. Ambachtsheer would help lead the Board through later in the meeting.

ORGANIZATIONAL REVIEW – MAINTAINING WSIB EXCELLENCE

Mr. Moore introduced his discussion of the challenge of keeping the WSIB intact while dealing with state budget issues. Although the WSIB's costs are consistently lower than peers, the global investment environment is increasingly more complex and more competitive. It is becoming difficult to maintain or improve WSIB's position as a high-performing public investment organization in the face of ongoing budget challenges. Mr. Moore said compensation and organization differences pose a two-part problem. He reminded members of the salary freeze and cuts and health benefit and pension increases experienced over the last two budget cycles.

Mr. Moore reviewed the Board's statutory salary setting authority which allows compensation for the executive director, confidential secretary, and all investment officers including the deputy director for investment management to be established by the Board. The statute also calls for limits on the compensation levels and incentive compensation for investment officers and is subject to review by external state entities. Ms. Whitmarsh noted the Board had elected not to adjust compensation ranges following the 2010 salary survey due to economic conditions; however, if the Board had approved the ranges, adjustments would have been contingent upon the Legislature lifting the salary freeze and granting an appropriation. Mr. Moore said the 2010 salary survey revealed the WSIB is, on average, 22 percent below the median salary levels of its peers. He shared results from a compensation survey he performed with the California Public Employees' Retirement System, Oregon Public Employees' Retirement System, West Virginia Investment Management Board, Wisconsin Investment Board, B.C. Pension Corporation, and Ontario Teachers' Pension Plan that questioned whether those organizations were part of the civil service framework, if performance pay was a part of the compensation structure, which entity sets pay levels, and how the pay levels are determined. He said peer organizations are generally experiencing flat salary growth and increased turnover with employees moving between funds as a strategy for salary increases. In addition, a majority have incentive pay, and the larger the organization—the higher the pay.

Mr. Moore reviewed WSIB's annual appropriated and non-appropriated budget for Fiscal Year 2011. He relayed that just over 95 percent of WSIB's budget is non-appropriated, and offered a comparison to the Ontario Teachers' Pension Plan. Ontario has started managing more assets internally, which ultimately saves money. He noted the WSIB manages its Fixed Income program internally. Getting talent in-house significantly reduces costs and keeps more money within the program. In response to Mr. Masten's question, Mr. Moore indicated that Ontario's returns are comparable with the WSIB. Mr. Bruebaker noted the WSIB takes on more risk than Ontario. Staff also noted, in addition to the challenge of recruiting and retaining staff, new initiatives must wait for funding which limits WSIB's flexibility to respond to good opportunities, the budget environment is unpredictable, and revenues that go south can de-rail planned activities. Procurement constraints also present obstacles to organizational movement. Mr. Bruebaker gave the example of the time-consuming public procurement process that had to be followed for the public equity emerging markets managers. During the time it took to hire managers, emerging markets ran up 70 percent and WSIB lost out on that money. The peer survey revealed that WSIB is decidedly more constrained in operational controls relating to spending authority, procurement, and satellite offices. A discussion ensued on the emerging markets managers' procurement and how it differed from a standard public procurement. Mr. Dietrich said legislation could change policy and there are provisions for exceptions to the policy. Ms. Whitmarsh said staff is seeking direction from the Board on what governance initiatives they will support and what they will not. Mr. Moore said solutions range from a complete spin-off, such as the Canadian funds, to finding a way to get exceptions from some state restrictions because of unique circumstances. Mr. Hill said he does not believe the Board and staff have done a good enough job of articulating its story to policy makers relating to the risks to the state of not achieving a 7.5 or 8 percent return, WSIB's ability to maintain competent staff, and political impacts affecting the WSIB. Chair McElligott agreed the WSIB needs to find a different way of doing things. Treasurer McIntire noted some of the state processes are in place for good reasons and are sometimes beneficial. Mr. Longbrake noted a good, disciplined governance structure could assist the Board in this effort.

[The Board briefly recessed at 2:48 p.m., and reconvened in open session at 3:06 p.m.]

Mr. Ambachtsheer shared his intent to move the earlier conversation toward direction, conclusions, and decisions about what happens next. He reviewed the purpose/mission and role of the Board, fiduciary responsibilities, current challenges facing the WSIB, possible Board responses and how quickly to respond, how to go about choosing the appropriate response, implications, and steps to make the choice a reality.

He said challenges facing the WSIB include a changing socio-politico-economic investment environment; the changing design and management of pension systems; an organization model and a budget squeeze that has hampered the ability of the WSIB to respond to changes in environment; over-reliance on key executives and professionals; and the maintenance of institutional memory at the Board level. Ms. Schurke noted the challenges seem to be the same as those facing Labor and Industries. She suggested part of the discussion should involve identifying the constraints and their impact. Mr. Ambachtsheer said possible responses include doing nothing, tweaking the current organizational model, or changing the current model. The "tweaking the current model" approach strives for additional operational productivity enhancements/cost savings, a strengthening of the Board selection/development process, and the leveraging of cooperative strategies with like-minded investment organizations. The "change the model" option would identify the ideal organizational model assuming the Board had the freedom to do what it needed. In response to Mr. Seely's request for staff to provide examples of other constraints that are problematic, staff commented on its inability to move into Tangible Assets due to failed recruitments because of salary levels. Mr. Bruebaker noted he has mixed emotions about implementing performance pay. Ms. Owens noted a fundamental problem is the WSIB's pay structure is set up for an average level of compensation even though the WSIB tries to achieve above-average returns. Chair McElligott said one thing the Board could do is adopt the ranges. Mr. Seely noted if there is a good year of returns and money to pay bonuses, those should be paid. A discussion ensued relating to the salary statute, changes made since its initial implementation, and why performance pay was never implemented. A further discussion ensued on how to present to the Legislature the consequences of constraints and how to map it going forward. Representative Santos expressed her frustration with any proposal for the WSIB to become semi-independent of the state, as WSIB is a creature of the Legislature. The WSIB manages other state assets in addition to pension funds. She believes there will be some very critical eyes and questions put upon any proposal to dramatically change the organization or its way of doing business. The Legislature granted authority for performance pay and it was never implemented. She questioned the extent the Board or staff leadership has gone to tell the story about how all the moving pieces impinge on each other. She does not believe the Board is in any position to go to the Legislature and say it has exhausted every avenue to sustain performance and achieve the 8 percent return. Mr. Ambachtsheer pointed out the Board's discussion surrounded the tweak option, and asked their opinion of the change option.

[Mr. Nierenberg arrived at 3:52 p.m.]

Mr. Ambachtsheer said likely features of a change model could include: 1) arms-length charter to deliver clearly-defined services to clearly-defined client/beneficiaries; 2) authority to develop and implement the new organization's own strategic plans; 3) strong oversight by a Board with a requisite skill/experience set and "passion for the cause;" and 4) Board has approval authority for the new organization's budget, including compensation structure and levels and contracting/procurement rules/policies.

Ms. Whitmarsh noted the appropriation process is more of a challenge to WSIB than the salary setting authority, and staff is not proposing to implement a change in the salary setting process. A discussion ensued on the salary setting authority and the difficulty with its lagged timing. She relayed that staff had framed the challenge of operating in a complex environment with constrained resources but perhaps had not done enough. She also proposed that the problem statement may not be resonating with Legislative leadership. Staff had difficulty getting any meeting time with Legislative members during the past session. She said the Board needs to be supportive of moving forward when it is appropriate to do so.
Treasurer McIntire suggested that working through beneficiary organizations might be a more effective way of engaging the Legislature. Chair McElligott said groups need to understand that paying staff what they are worth will help keep contribution rates down. Less experienced staff means investment opportunities can miss the mark. Mr. Ambachtsheer said the Board needs to figure out the vision for the organization, key pieces of that, and reach consensus. Mr. Masten said the beneficiaries should be among the group of stakeholders. He believes the Board should work on raising salaries, rather than granting bonuses. A discussion ensued on timing when to go out to stakeholder organizations to discuss the problem statement. A further discussion ensued on how Canadian organizations were able to enact changes.
Treasurer McIntire suggested now is a good time to start for a proposal next biennium. He suggested it will take a good year to put together stakeholder discussions on how we operate, fund operations, and pay fees. He would like to see the WSIB give up performance pay and go for a different measure that creates a framework for the Board to manage compensation closer to the industry standard. Representative Santos concurred with pursuing the salary issue.

In response to Mr. Hill's question, Ms. Whitmarsh commented on the pros and cons of internal versus external management models relating to fee structures versus returns. Treasurer McIntire suggested the Board take part in the financial services industry evaluation done recently, get more involved in the community, and do outreach with other financial services to increase the inflow of talent.

The Board members reached consensus to do planning, preparation, and education prior to going forward with appropriation and compensation issues. Any structural change would need to be strategically thought through and discussed by the Board after doing further information seeking. Mr. Nierenberg suggested the Board examine what capabilities are most important to have in house, and what parts can be outside. Why have the WSIB's Fixed Income and real estate operating companies (REOC) strategies been successful, and are those approaches transferable to other asset classes? He suggested looking at WSIB, Canada, and Yale to get a sense of what might be appropriate to do.

Representative Santos said she would be very interested in moving forward and exhausting all means before the Board to improve salary levels. It needs to meet the expectations of people who have devoted their careers to public service, and she is very resistant to making the WSIB anything but a public entity. She noted the WSIB is fundamentally different than the private sector. Mr. Seely said while the WSIB is different, it competes with the private sector for its talent. He believes the Board should think about what to change over the longer term. Mr. Muhlebach said there could be opportunity costs in moving too slowly. Treasurer McIntire suggested a task force examine what the WSIB could do better and specifically deal with the salary challenge and how to get the message to stakeholders on what we do and how we do it in a broader context. Chair McElligott suggested the *ad hoc* Board Governance Committee examine the issue and bring a timeline back to the Board. Ms. Schurke requested a list of which members serve on that Committee.

[The Board recessed at 4:55 p.m., and reconvened in open session at 7:30 p.m.]

DINNER PRESENTATION – THE DEBT SUPERCYCLE: THE GORILLA IN THE ROOM

Mr. Barnes, Bank Credit Analyst (BCA), presented information on rising debt levels and what has affected debt. The term Debt Supercycle was coined by BCA to describe the process behind the secular rise in leverage throughout the U.S. economy during the post World War II period.

[The Board recessed at 8:45 p.m. on July 19, 2011.]

July 20, 2011

[The Board reconvened in open session at 9:09 a.m. on July 20, 2011.]

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

WSIB INVESTMENT STRATEGY – BUILDING ON SUCCESS

Mr. Bruebaker noted the WSIB's strategic competitive advantages with significant barriers to entry; history of implementing investment strategies in advance of the market; outstanding reputation within the investment community; and very talented Board and staff. He reviewed a chart of the net growth and net cash flows of the CTF showing a high of $64 billion in June 2007, the subsequent loss as a result of the financial crises, and the regaining of most of that value as of June 30, 2011. He noted the main driver of the negative cash flows was changes to contribution levels. Discussion ensued regarding cash flows and funding rates. Staff will provide the Board with the updated projections from the State Actuary's Office when those are available.

Mr. Bruebaker reviewed the CTF's annual investment performance from fiscal year 1993 to May 31, 2011, and reviewed CTF total returns from the beginning of the financial crises, through the recession, and the subsequent slow recovery through May 31, 2011. He also reviewed annualized returns of the CTF since inception and rolling 12-month net returns since 1993. The annualized return for the CTF since inception is 8.9 percent. Mr. Bruebaker reviewed a chart showing the CTF actual asset allocations, noting that the driving force behind the CTF's returns has been its private market allocations to private equity, real estate, and now tangible assets. He reviewed a periodic table of the CTF returns by asset class showing that for all years except 2008 either private equity, real estate, or both, returned above 8 percent.

Mr. Bruebaker went through a macro snap shot of each asset class within the CTF at June 30, 2001, and June 30, 2011, including total assets and U.S., non-U.S., and emerging markets allocations. He also reviewed highlights for each asset class over that period. The fixed income portfolio outperformed their index by 92 basis points per year over the last 10 years with the largest contributor to performance being credit in general and emerging markets in particular. The decision framework for fixed income investments involves macroeconomics, fundamentals, valuations, and judgment. The fixed income team focused on quality within the mortgage-backed securities sector and avoided subprime securities. At the macro level, the team utilizes interest rate anticipation strategies. The public equity portfolio has underperformed its index by 107 basis points over the past 10 years. In response to a question from Mr. Nierenberg, Mr. Bruebaker noted the primary contributing factors to the underperformance was the underweight to emerging markets and the performance of quantitative enhanced index managers. The Board approved the first step in eliminating the home country bias of the portfolio by moving to an equal weighting of U.S. and international exposure in September 2005. The public equity structure within the CTF has become more efficient with active management concentrated on global and emerging market equities. Over the past 10 years, the real estate portfolio has outperformed its benchmark by 101 basis points per year. The portfolio now has a greater focus on REOCs. Future growth of the portfolio is likely to be more than 50 percent outside the U.S. The private equity portfolio has outperformed its benchmark by 279 basis points per year over the past 10 years. The Board has many long-term relationships with high quality partners and has placed greater emphasis on portfolio construction and risk management through a rigorous annual planning process and Board-adopted model portfolio.

Mr. Bruebaker noted that staff will keep making continuous improvements in each asset class. Going forward, we will continue to deepen relationships with the best general partners available; prudently, but cautiously, increase investments in emerging and undervalued markets; refine investment strategies in creative and sensible ways to potentially limit downside volatility; undertake a more robust discussion of investment management of mature, closed pension plans versus active pension plans during the next asset allocation study; and capitalize on the information available from our data warehouse.

WSIB INVESTMENT STRATEGY – BEYOND THE BENCHMARK – PORTFOLIO COMPLETION STRATEGY

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 15 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 9:42 a.m., and reconvened in open session at 10:21 a.m.]

WSIB INVESTMENT STRATEGY – BEYOND THE BENCHMARK – WORK IN PROGRESS

Ms. Will reviewed some of the ongoing work being done as a result of the insights gained from staff research on benchmarks tied with its ability with the data warehouse to look at CTF holdings across all portfolios. Given staff's view that there are flaws in public indices and the CTF's high exposure to private markets, asset allocation staff is exploring other options for evaluating the CTF other than using public security indices.

Ms. Will reviewed the gross domestic product (GDP) weighted index theory, noting that GDP shows the true growth of the global economy while benchmarks reflect the financing of the global economy. Given the different ways sectors and industries are categorized within the different industry classification schemes, it is not easy to match up classifications between GDP (economic value schemes), maintained by government agencies, and capital market schemes, maintained by financial organizations. A major difference is the level at which classification is assigned. Economic value schemes look at a company's multiple process or production levels while capital market schemes look at the total company level and principal business activity. These differences lead to problems when trying to classify companies. Staff is working to identify the mismatch in growth of the economy versus the financing of public companies and to see if determining the volatility of changes will help identify bubbles. This has proven to be an intriguing area of research but it is more complicated and time consuming than originally thought. Key to going forward with this research is finding a data source that allows staff to composite all countries together in order to really understand what the global economy looks like and identify completion strategies for the CTF.

[The Board briefly recessed at 10:53 a.m., and reconvened in open session at 11:08 a.m.]

RISK MANAGEMENT: FUNCTIONAL COMPLEXITY
Mr. Tim Mack, World Future Society, presented his views on how the Board should assess risk threats, opportunities, and probabilities. He said the ultimate goal is a risk process that challenges assumptions, raises questions, introduces new and relevant information, evaluates and improves performance, and identifies so-called "weak signals" of impending threats and opportunities.

[The Board briefly recessed at 11:54 p.m., and reconvened in open session at 1:33 p.m.]
[Mr. Nakahara arrived at 1:35 p.m. and Mr. Nierenberg arrived at 1:36 p.m.]

Ms. Whitmarsh introduced the Honorable Madeleine Albright, former Secretary of State. She said Secretary Albright would share her insights as the Board goes through its afternoon discussion of global economic conditions.

U.S. GOVERNMENT DEBT – RISK FREE RETURN OR RETURN FREE RISK?
Mr. Bruce Kasman, JPMorgan's chief economist, shared his perspectives on ending the U.S. government debt addiction. His presentation included discussion of the debt phenomena within the developed world and its poor fiscal management over the past 30 years; the need for substantial budget cuts to stabilize the U.S. debt to GDP ratio even after allowing Obama's stimulus packages and Bush's tax cuts to expire; and the sensitivity of the U.S. fiscal path to economic growth, which is threatened by weak public sector demand, rising tax rates, and the financial sector response to a failure to stabilize debt. He commented on issues such as the impact of inflation on debt destruction and the relationship between rising debt and U.S. Treasury yields; and described how persistent high debt tends to be associated with low economic growth.

Chair McElligott questioned why those who are knowledgeable on the debt ceiling issue are not weighing in on the topic. Secretary Albright agreed those who understand the topic without political motivation and can explain it to people in language they can understand should do so. She also said she would like to see more emphasis innovation.

[The Board briefly recessed at 3:09 p.m., and reconvened in open session at 3:34 p.m.]

EUROPEAN MONETARY UNION – BREAKING UP IS HARD TO DO
Mr. Lerch presented the panel discussion topic regarding the European Monetary Union (EMU) and discussion of financial market implications if countries that are currently part of the EMU leave the union. Mr. Barnes and Mr. Kasman participated in the panel. The EMU is a group of 17 countries using the same currency and same monetary policies. The rationale behind the monetary union is that having the same currency and monetary policies reduces exchange rate variability making it easier to trade and invest across borders. The concept of the Euro was introduced in 1999 for accounting and electronic payments and the currency was introduced in 2002. Countries wishing to join the union must agree to deficit, debt, and inflation targets. The current EMU debt crisis stems from the lack of mechanisms in place to require member countries to maintain the deficit and debt targets. Given the large amount of cross-border loans by banks in the EMU, a default by one country would have a negative impact on the other member countries.

Another issue is that the common monetary policies of member countries create conflict among monetary union members: a country with a stronger economy has different monetary policy needs than a country with a weaker economy.

Mr. Lerch noted there has been a fair amount of discussion regarding whether countries would leave the EMU in order to gain control of their own monetary policy. Discussion ensued regarding the potential pros and cons for weaker or stronger countries to leave the union and the possible effects of any departure. While member countries have conflicting motivations for monetary policies and countries with stronger economies are not thrilled about having to bail out countries with weaker economies, there are very harsh consequences of any country leaving the EMU, including the undoing of some positive financial market effects.

Further discussion ensued regarding possible solutions to the threat of default by EMU members, including the possible bailout of those countries by other EMU members and the contagion effect if a country did fail. Secretary Albright noted the importance of thinking about history in terms of America's position and who our partners are. The EMU has brought disparate countries together that had a history of fighting each other. Financial and immigration issues have exacerbated ethnic conflicts and the strain on the EMU has resulted in the return of nationalistic policies. Secretary Albright noted that the U.S. is better off and safer with the EMU in place.

Other topics discussed included the likelihood of various countries leaving the EMU, social unrest, ramifications of various scenarios, the functioning of the EMU, and implications for the U.S. and the WSIB's investments.

[The Board recessed at 5:00 p.m., and reconvened in open session at 7:30 p.m.]

FUTURE OF THE GLOBAL FINANCIAL AND POLITICAL ORDER

Ms. Whitmarsh moderated a Q&A session with the Honorable Madeleine Albright to gain her perspective on regions around the world, including Central and Eastern Europe, the former Soviet Union, the Middle East, the Asia-Pacific region, and the United States. Secretary Albright then took questions from Board members and staff.

[The Board recessed at 9:00 p.m. on July 20, 2011.]

<u>July 21, 2011</u>

[The Board reconvened in open session at 8:36 a.m. on July 21, 2011.]

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

[Mr. Ragan arrived at 8:42 a.m., Treasurer McIntire arrived at 8:44 a.m., and Representative Santos arrived at 8:46 a.m.]

BOARD GOVERNANCE

Ms. Owens thanked the Board members that served on the *ad hoc* Governance Committee. She noted that the topics identified by the Committee were a great start and noted the importance of continuous governance improvement. She said that with staff's help, the Committee had retained Mr. Ambachtsheer to facilitate the Board governance discussion at the Committee's request.

Mr. Ambachtsheer shared his observations of the Board's organizational discussion from the first day of the off-site. He noted elements for a potential solution. The WSIB needs to tell its story, and its first step is to determine the story's key components. One component is what the organization needs to do to be successful in the new normal, and what gaps currently exist. The next step is to decide how to tell the story and how to deal with the challenges. He suggested that management arrange the work done thus far, determine how to tell the story to fit particular groups, and take a proposal to the *ad hoc* Governance Committee. The Committee should then decide whether the story is coherent and what to emphasize or deemphasize, and then take it to the full Board for buy-in prior to discussions with outside groups. Ms. Owens said she felt the Board needs to determine what makes the story politically feasible and doable. She did not believe the Board had reached consensus yet and it should devote a lot of discussion to it. Mr. Ambachtsheer questioned whether the current Committee structure can support the work that needs to be accomplished. Chair McElligott said his understanding is the Board had asked the *ad hoc* Governance Committee to first look at the compensation issue and come to the Board with a timeline to bring that forward and gain approval.

[Mr. Seely arrived at 8:52 a.m.]

Treasurer McIntire said he did not feel that process is completely divorced with discussion of Board independence. Representative Santos noted she did not believe there was Board consensus on whether change was needed. She feels the Board needs to begin with a buy-in around its vision and mission before talking about what structure should be. Mr. Ambachtsheer suggested the Board examine its history, its present state, and its future outlook, and then come forward not with solutions, but challenges ahead. Mr. Moore said the inside story is the problem statement, and the organization is contemplating change because something needs to be fixed. Mr. Hill said he feels the problem statement should be framed around increasing the probability the organization will achieve the expected return. Treasurer McIntire concurred. He said the conversation with stakeholders and Legislature should occur once the Board has thought through whether it is appropriate to redesign constraints in order to meet the problem statement. Mr. Nierenberg pointed out three issues: 1) recent searches have demonstrated a problem with WSIB's pay levels, 2) whether to bring some investment decisions in-house, and 3) how to deal with governance issues.

Mr. Ambachtsheer suggested the Board talk about its mission statement and what sets it apart from other organizations, how to achieve that mission, and its passion for the cause and how to maintain that. A discussion ensued on the current voting Board member selection process that is not under the Board's control. Mr. Masten recommended the Board focus on doing the best job it can within the structure, and support staff with the tools to bring good information to the Board, so that it can make the best decisions possible. Ms. Whitmarsh said the Board could give advice to appointing authorities on Board selection criteria and come up with desirable qualifications to make the process more effective.

The Board then discussed its role in investment strategy; the processes for setting the expected return rate, asset allocation and investment beliefs; risk appetite; and contribution rates. Mr. Hill shared his view that the WSIB's risk program is an area under construction—how the Board adds value is not very clear. Mr. Moore pointed out the risk program has both operational and financial components. Ms. Whitmarsh said the agency is still developing how quantitative risk tools can help the investment decision process. Mr. Nierenberg said he is comfortable that Fixed Income staff is considering risk in all areas. He questioned whether there is a way to become more proactive and mindful in other areas of the portfolio, which gets back to the governance question of how the Board spends its time and how it is organized.

Mr. Ambachtsheer introduced the concept of optionality, which is to what degree should the organization use levers to make exposure to levers and where that responsibility lies. Mr. Bruebaker commented the WSIB has a fair amount of optionality currently within its portfolio, in the form of rebalancing within established asset class ranges and using the Innovation Portfolio to look at investment opportunities that do not fit neatly into any of the established asset classes. Mr. Longbrake suggested the Board have discussions on each investment sector with a forward-looking emphasis. Mr. Masten said he believes the best approach is to continually try to improve the function of Board and staff. Mr. Ambachtsheer commented anything to maintain quality is worth doing.

[The Board briefly recessed at 10:12 a.m., and reconvened in open session at 10:26 a.m.]

Mr. Ambachtsheer suggested the Board have a standing Governance Committee to conduct discussions on Board quality issues on an ongoing basis, and then take its conclusions the Board for decisions. Chair McElligott directed the *ad hoc* Governance Committee discuss the suggestion and bring it to the Administrative Committee for discussion and recommendation to the Board at its September meeting.

> **Mr. Masten moved for the *ad hoc* Governance Committee to discuss the recommendation for the Board to form a standing Governance Committee and bring the matter to the Administrative Committee for discussion and a recommendation at the September Board meeting. Ms. Owens seconded, and the motion carried unanimously.**

Mr. Nierenberg said this creates an opportunity for the Board to transform itself. He would like to see the risk discussion broadened and suggested staff get a sense of what processes good organization have followed, what bad organizations have done, and what lessons can be extracted.

Mr. Hill said the Committee went through exhaustive brainstorming sessions on things the Board could do to improve. He believed it came down to three things the Board would discuss today: 1) consider using consent agendas; 2) is the Board doing enough with the risk issue; and 3) selection processes for the Board Chair, Vice Chair, and Committee assignments. He noted if he had to choose one of the three to focus on, it would be selection processes. He said he wanted the Board to spend time discussing that during its off-site.

BOARD EVALUATION DISCUSSION AND FEEDBACK
Chair McElligott announced the Board would go into executive session to review and discuss the performance of Board members and of the Board. He said the executive session was expected to last about 20 minutes, at which time the Board will reconvene in open session and adjourn.

[The Board went into executive session at 10:54 p.m., and reconvened in open session at 12:04 p.m.]

OTHER ITEMS
Chair McElligott thanked Mr. Ambachtsheer for his facilitation, staff for their great presentations, and administrative staff for organizing the entire program.

> **Mr. Masten moved for the Board to adjourn. Mr. Ragan seconded, and the motion carried unanimously.**

There was no further business to come before the Board. The meeting adjourned at 12:05 p.m. on July 21, 2011.

Patrick McElligott
Chair

ATTEST

Theresa J. Whitmarsh
Executive Director