WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
September 15, 2011

The Washington State Investment Board met in open session at 9:38 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Treasurer Jim McIntire, Chair Mike Ragan, Vice Chair Bill Longbrake George Masten Patrick McElligott Richard Muhlebach (via teleconference) Bob Nakahara (via teleconference) David Nierenberg Judi Owens Natasha Pranger Representative Sharon Tomiko Santos Judy Schurke
Absent:	Senator Lisa Brown Steve Hill 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 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 Kate Sandboe, Corporate Governance Officer Beth Vandehey, Risk and Compliance Director Celina Verme, Finance and Administrative Services Director Kristi Haines, Executive Assistant Steve Dietrich, Attorney General's Office Marcie Frost, Department of Retirement Systems Jody MacIntosh, CEM Benchmarking Inc. Tara Blackburn, Hamilton Lane

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

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

CHAIR/VICE CHAIR ELECTION
Mr. McElligott nominated Treasurer McIntire as Board Chair. There were no further nominations and Treasurer McIntire was elected Board Chair by acclamation.

Ms. Schurke nominated Mr. Ragan as Vice Chair. There were no further nominations, and Mr. Ragan was elected Vice Chair by acclamation.

ADOPTION OF THE JULY 19-21, 2011, MINUTES

> **Ms. Owens moved to adopt the July 19-21 2011, Board meeting minutes. Ms. Schurke seconded, and the motion carried unanimously.**

PUBLIC COMMENT
Mr. Dean Schwickerath, an elected official and community volunteer, provided comment related to the new investment options for Plans 3 and the Deferred Compensation Program (DCP). He said the information provided on the why the investment options were changed was inadequate, and he would have liked to see data on why the investments that replaced the other investments are better. He said it was unclear where to find history on new investments and difficult to determine why changes took place. Chair McIntire said the Board's concern was the broad range of choices created an opportunity for sophisticated investors, but believed a more limited selection would help the majority of participants make choices, rather than not choosing and defaulting into an investment due to lack of understanding the options available. Mr. Schwickerath agreed it is difficult to educate a large population with different backgrounds on what investment options are best for their own situation. Ms. Whitmarsh offered that Mr. Paroian, Senior Investment – Public Equity, and Ms. Frost, Department of Retirement Systems Deputy Director (DRS), were available to further discuss the options, decision making, and particular concerns. Mr. Schwickerath suggested that more detailed background should be available on the WSIB website. Ms. Whitmarsh said a white paper on the investment option changes is available. Board members thanked Mr. Schwickerath for his comments.

EXECUTIVE DIRECTOR'S REPORT
Ms.Whitmarsh reported the transition to new funds within the Plans 3 and DCP had taken place and staff had provided training and education to DRS service representatives on the changes and set-up an escalation process on inquiries that are to be handled at DRS versus the WSIB. The WSIB had received only a few inquiries, mostly favorable on the new funds. Ms. Whitmarsh said the Private Markets Committee would meet on October 6; the October Public Markets Committee meeting is cancelled; and the Governance *ad hoc* Committee is working to schedule its next meeting. Ms. Whitmarsh reported the presentation given by Mr. Martin Barnes at the July meeting on the debt supercycle was referenced and detailed in the August issue of *Bank Credit Analyst*. She reported staff is working with the State Actuary's staff on potential future cash flow analyses under various benefit proposals to educate members on long-term implications leading into the 2013 asset allocation planning. Mr. Curtis Littlegreen begins Monday as Investment Officer – Fixed Income. Recruitments continue for investment staff in Real Estate and Tangible Assets.

PRIVATE MARKETS COMMITTEE REPORT
Mr. Masten reported the Private Markets Committee met on September 1, to discuss the real estate and private equity annual plan updates and to consider three investment recommendations.

Green Equity Investors VI, L.P.

Mr. Masten moved the Board invest up to $300 million, plus fees and expenses, in Green Equity Investors VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Ragan seconded the motion.

Mr. Masten reported this North American focused middle-market fund will have a target size of $5 billion, and will seek to build a portfolio of 15 to 20 investments ranging in size from $200 million to $500 million, heavily weighted to consumer-related investments. The WSIB has invested in two prior Leonard Green funds. The proposed investment is consistent with the Board-approved 2011 private equity annual plan and the model portfolio. He said the recommendation is based, in part, on the firm's experienced and cohesive team, strong performance across multiple cycles, proven strategy, proactive deal sourcing, and sector expertise.

The above motion carried unanimously.

Endeavour Capital Fund VI, L.P.

Mr. Masten moved the Board invest up to $125 million, plus fees and expenses, in Endeavour Capital Fund VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.

Mr. Masten reported this lower middle-market private equity fund has a target size between $600 million and $675 million, and will invest in management buyout, growth equity, and recapitalization transactions in the Western United States. The WSIB has invested in three prior Endeavour funds. The proposed investment is consistent with the Board-approved 2011 private equity annual plan and the model portfolio. He said the recommendation is based, in part, on Endeavour's stable, experienced investment team; strong, consistent performance; successful, regionally-focused investment strategy; and excellent fit in the WSIB portfolio.

The above motion carried unanimously.

Alere Property Group

Mr. Masten moved the Board invest $200 million, plus fees and expenses, in Alere Property Group, subject to continuing due diligence and final negotiation of terms and conditions. Mr. Ragan seconded the motion.

Mr. Masten reported the Alere Property Group is a real estate operating company (REOC) specializing in the acquisition, development, and management of industrial/warehouse properties located primarily in Southern California. The company was established in 2003 and has been capitalized since inception by the WSIB through its investment in Principal Enterprise Capital (PEC). This recommendation was not directly anticipated when the Board approved the 2011 real estate annual plan in December 2010, but is strategically consistent with the discussion at that time regarding PEC. He said the recommendation is based, in part, on the company's exceptional leadership, strong performance through multiple cycles, proven and important strategy, and preferred real estate operating company structure.

The above motion carried unanimously.

Real Estate and Private Equity Annual Plan Updates
Mr. Masten said Messrs. Draper and Ruggels would present the annual plan updates later in executive session.

AUDIT COMMITTEE REPORT
Mr. Masten reported the Audit Committee met on September 7, at which time Internal Audit presented its report on contracts. The report made recommendations regarding the Contracts unit following established control procedures and dealing with amendments to contracts that were not signed prior to expiration. Management agreed with both recommendations and has implemented procedures to comply with the recommendations. Internal Audit also presented the Audit Recommendation Status Report. None of the three monitored recommendations were completely resolved in the third quarter, so monitoring will continue and reporting will occur at the next regular meeting. Internal Audit presented its Performance Measures and met or exceeded four of the five measures. The fifth item deals with the approved audit completion schedule. Of the six audits approved by the Committee for fiscal year 2011, the four highest risk areas were completed, with two audits to be rescheduled. Also, the Executive Director provided the Committee with the quarterly investment referral log, listing eight investment referrals for the third quarter. This is a new procedure put into effect where referrals coming from Board members are recorded and reported. Risk and Compliance presented the biennial Board Policy Compliance Review, reporting a very high degree of compliance with Board governance policies. One observation noted that, while Board members are encouraged to participate in outside education, not all Board members obtained external training.

Update on Global Proxy Voting Guidelines Policy 2.05.200 Regarding Political Contributions / Proxy Voting Revision
Mr. Masten reported the Committee reviewed revised Proxy Voting Guidelines regarding political contributions, amending the guidelines to a more specific, "principle-driven" policy. He said the revision is shown on page 10 of the blue-lined policy draft.

Mr. Masten moved the Board adopt the revised Global Proxy Voting Guidelines Policy 2.05.200. Ms. Pranger seconded the motion.

Chair McIntire noted changes made to the draft at the Audit Committee meeting to clarify the Board's intent to seek more disclosure about a company's political contributions. He believes it will be awhile before a uniform standard for disclosure is adopted. Mr. Masten said the policy also calls for disclosure of contributions made to trade associations.

The above motion carried unanimously.

Risk Appetite Statements
Mr. Masten reported the Committee reviewed the Board's Risk Appetite Statements and made some recommendations. Ms. Vandehey said the Risk Appetite Statements had been reported to the Board in June and are being presented again at today's meeting for the Board's adoption. She described each of the risk statements and how they tie into the key risk framework. The statements document the Board's risk appetite by describing the risk culture on how each risk is built or managed in the areas of fiduciary responsibility, investments, strategy, governmental environment, operations, and

reputation. The statements are also used as an additional guide beyond policies to help stakeholders understand the key risks faced by the organization.

Mr. Nierenberg noted the challenge in capturing investment risk within a few words on one page. He commented the benefit of having a diversified portfolio at times can be considerably less during short down drafts versus normal cycles. The WSIB equity portfolio can be impacted by trends and short-term traders. He said markets are moving faster and long-term investors are becoming outliers. He believes there are times when specific factors should allow for short-term solutions. Ms. Whitmarsh reported the Audit Committee shared parallel concerns and adjusted the investment risk statement. Mr. Longbrake discussed the concept of tail risk management, which he said should be researched for possible use when anomalies occur in the marketplace. Ms. Owens observed that staff time would be required to prepare for such circumstances and questioned whether the WSIB is currently in a position to pursue that or whether it needs to consider additional staffing. Mr. Longbrake acknowledged it would take time and sophisticated resources. Mr. Nierenberg proposed there may be outside providers, but said he would not prejudge whether such a program should be built from within or outside. Mr. Bruebaker said he does not believe in market timing, but staff continually challenges itself to do a better job of protecting the portfolio on the downside. Mr. Masten proposed the discussion occur when the Board examines its asset allocation. Mr. Longbrake said staff should routinely and intentionally watch for and anticipate market shifts that may expose the portfolio to risk. Representative Santos commented that timing itself is a risk factor that is not necessarily reflected in the risk statements, and she hopes the Board does not box itself too rigidly by specific words and meanings. She believes measuring, assessing, discussing, and understanding risks and what has changed in the current situation beyond the environment which existed when investment was first made will move the Board in addressing concerns raised by Messrs. Nierenberg and Longbrake.

Mr. Masten moved the Board adopt the Risk Appetite Statements.
Mr. McElligott seconded, and the motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT

Board Governance *Ad Hoc* Committee Report

Ms. Owens reported the Board Governance *Ad Hoc* Committee met on September 1, as a follow-up to issues raised at the July Board off-site meeting and to discuss how to address previously identified governance issues going forward. She said the Committee spent a great deal of time talking about how to tell the "WSIB's Story" to various stakeholder organizations so there is a shared understanding of issues currently facing the organization and what WSIB believes should happen to address issues going forward. Also, as directed by the Board, the Committee shared their views on whether or not the Governance Committee should become a permanent Committee of the Board. The Committee decided its next steps are to develop a list of "to do" items and prioritize that list. While members believe the work could continue for at least one year, the Committee is not recommending the Board create a permanent Governance Committee at this time, but suggests the group continue meeting on an *ad hoc* basis.

Quarterly Budget Update

Mr. McElligott reported the WSIB's appropriated budget was under spent by 14.6 percent. He complimented staff on holding down costs and for being responsible with beneficiaries' money.

The Committee also adopted its 2012 meeting schedule, and heard two items in executive session which will also be reported to the full Board in executive session under agenda items 15-c and 15-d.

[The Board took a recess at 10:39 a.m., and reconvened in open session at 11:00 a.m.]

COST EFFECTIVENESS MEASUREMENT ANNUAL REPORT

Ms. MacIntosh said the Cost Effectiveness Measurement (CEM) database incorporates data from 156 pension funds with $2.4 trillion in assets under management. The WSIB is compared with a custom peer group of 18 sponsors with $23.4 to $146.4 billion assets under management. The median is $49.8 billion compared to WSIB's $59 billion. The report compares the WSIB's policy return, value added, costs, cost effectiveness, and risk against both the U.S. and peer medians.

Ms. MacIntosh reported the WSIB's total 5-year total return (2006-2010) was 5.5 percent, which is above the U.S. median of 4.9 percent and peers median of 4.8 percent. The WSIB showed strong results in all years except 2009. The WSIB's policy return of 4.5 percent was very close to the U.S. and peer medians of 4.6 percent. The policy return is calculated on frequently used benchmarks. The WSIB's policy return was close to median due to two off-setting differences. The WSIB's fixed income return was higher than the U.S. average. The policy return achieved a positive impact from the allocation to private equity, which was at 23 percent versus the 4 percent U.S. average. Since 2006, the WSIB has reduced its allocation to public equity and increased alternative asset investments, such as real assets, infrastructure, and private equity. The U.S. median is higher in public equity and fixed income.

Ms. MacIntosh said the value added measurement reduces the policy return from total return. The WSIB's 5-year value added was 0.9 percent. She described the value added results by asset class. There was positive value added in fixed income and private equity, negative results within real assets, and stocks were flat.

Ms. MacIntosh reported the WSIB's 1-year asset management costs in 2010 were $427.9 million or 76.3 basis points (bps). The bulk of the costs were investment management fees. She described the cost trend over the past 5 years and contrasted CEM's methodology change in calculating private equity costs. She reported WSIB's costs have increased slightly, which was mostly driven by private asset classes that tend to be more expensive.

The benchmark cost analysis suggests the WSIB is very low cost, with a savings of 18.9 bps. The WSIB has a lower cost implementation style and paid less for similar mandates than peers. Implementation style is the manner in which the WSIB implements its asset allocation, including internal, external, active, and passive styles. The WSIB also pays less for external and internal management of funds, and for oversight of the programs. The WSIB appears in the upper left quadrant of CEM's cost effectiveness charts for both 1- and 5-year results, showing net value added versus excess costs.

QUARTERLY DISCUSSION OF MARKETS

Portfolio Discussion

Mr. Bruebaker reported the Commingled Trust Fund (CTF) was up 2.57 percent for the 3-month period ended June 30, 2011, and up 21.14 percent for the year. The equity markets are down 10.4 percent since the quarter end June 30, 2011, as the world worries about the U.S. and European debt crises. The since inception return for the CTF is up to 8.8 percent as of June 30, 2011.

The portfolio relative to Implementation Value Added underperformed for the quarter by 49 bps. The allocation decision hurt the portfolio by 23 bps due to overweighting in global. For the manager decision, the portfolio underperformed by 66 bps. The period since June 30 has been volatile in the equity markets.

Fixed Income

Mr. Kennett reported the retirement fixed income portfolio outperformed the Barclays Capital Universal Bond index by 6 bps for the quarter ended June 30. The outperformance was mostly driven by credit, emerging markets, and non-dollar bonds. The Labor and Industries' (L&I) funds had returns below those of the Comparable Market Index, due to the lack of long Treasuries in the WSIB portfolio and non-corporate credit; however, the TIPS portfolios performed well. Mr. Kennett reported the Monthly Bond Fund underperformed by 12 bps for the fiscal year.

For the current quarter, risky assets are not doing well, but Treasuries have performed magnificently due to a number of factors including a flight to quality and unwinding of the carry rate. The Monthly Bond Fund is outperforming for the fiscal year.

Mr. Kennett said his outlook for the future is that the global economy will deteriorate. There is serious risk of a downturn in Europe or the U.S., with low growth in both. The Fed funds rate is on hold until mid-2013. Mr. Kennett shared other potential Fed policies and revisions to the GDP. He discussed the U.S., Asia ex. Japan, and Europe growth rates forecasted for 2011 and 2012. He expects global growth to stay slow, interest rates to remain low, and, if there is a recession, it will be shallow. In response to a question from Mr. Masten regarding any impact from the natural disasters, Mr. Kennett responded it slowed growth somewhat but he does not believe it is significant. Mr. Longbrake pointed out that bonds may be a good place to invest.

Public Equity

Mr. Paroian reported the U.S. market was up 6.1 percent and global markets were up 4.6 percent for the first half of the calendar year. Public Equity is currently revising its policies for the retirement fund and Plans 3 and DCP for the Board's adoption in November, and is conducting a full benchmark review. The markets were up for the 1-year period ending June 30, in the U.S. by 32.4 percent and global by 31.3 percent. For the year-to-date as of September 13, the U.S. was down 6.2 percent, global was down 10.7 percent, and emerging markets were down 14.9 percent. The best sector was consumer staples; healthcare was flat; and industrials, materials, and financials were all down due to sovereigncy concerns in the major banks.

Mr. Paroian reported that public equity was slightly ahead of its benchmark in July due to the new slate of global managers added in the second quarter. Ten of the 14 managers have outperformed based on August numbers. One manager that had significant negative returns is invested primarily in energy. The manager employs a more focused strategy, which is the reason the manager was funded with a smaller mandate than the other global managers. The public equity portfolio is two-thirds passive with a tracking error around 1 percent. Staff expects the program will protect the portfolio on the downside but, with a large passive portion, the total portfolio will be heavily influenced by the performance of the broad markets. Mr. Paroian said that all of the new managers have been funded.

Mr. Paroian reported that all Plan 3 equity options are passive and continue to match their indices. The DCP funds did quite well. The DCP equity funds are a mix of four active and two passive managers. All but one outperformed for the 1-year but most of the active funds underperformed over the longer-term. Staff believes passive is the appropriate low-cost approach going forward. The Retirement Date Strategy funds underperformed for the quarter, primarily due to underperformance in the international equity component. The other funds are passive; and the Guaranteed Education Tuition program recently transitioned to passive global equity.

In response to Mr. Nierenberg's question about the percentage of the global portfolio that is within emerging markets, Mr. Paroian said it is between 13 and 14 percent. Staff is discussing anticipated growth in that area and getting information from the managers, data warehouse, and custodian to monitor it intensely given recent market declines.

Real Estate

Mr. Draper reported the real estate environment is not completely clear at this time, which can work to the WSIB's advantage. The 1-year return for the WSIB's portfolio was 12.6 percent for the 12 months ending March 31, 2011. More than 7 percent of the return was current income; Mr. Draper provided examples of strong income generation from the portfolio from the preferred property types of residential, necessity retail, and warehousing. The 10-year return was 8.7 percent and the 15-year return was 11.6 percent, and the portfolio appears to be on target to keep at or above its benchmark. The real estate market is continuing to recover, but is divided between sectors improving due to fundamentals or investor demand. Apartments, necessity-based retail, and emerging markets have been the strongest recovering sectors. Healthcare property has performed strongly through the economic downturn but is expected to weaken going forward. Staff continues to avoid investments that are highly sensitive to a weak economy, such as office space, malls, and fashion-based retail space. Mr. Nierenberg commented he believes the best years for healthcare properties have passed and he urged Mr. Draper to consider opportunistic monetization in that sector, with more of a shift toward private pay facilities. In response to Mr. Muhlebach's question regarding investing in troubled assets, Mr. Draper indicated that opportunities to invest in those types of situations have been limited, as the challenged properties one would actually like to own tend to get their financing difficulties worked out. He does not see significant opportunities in that market going forward.

Private Equity

Mr. Ruggels reported there has been a strong recovery in the private equity portfolio over the past 2 years ending June 30. During the past fiscal year, the WSIB received nearly $3.4 billion of distributions in the portfolio, which is nearly on pace with the activity during the market peak in 2007. This was facilitated by strong equity and debt markets that accommodated initial public offerings (IPOs), secondary stock sales and dividend recapitalizations Mr. Ruggels said the strong debt markets have allowed many companies to refinance debt and extend maturities relieving much of the concern about the "wall of maturities" in the near term. He reported that over the past couple of months the market environment has changed. Debt markets have become less accommodating, and extreme volatility in the public equity markets has dampened IPO activity. As a result, distribution activity has fallen off sharply since June. Mr. Longbrake asked Mr. Ruggels if he felt pressure to re-deploy money during periods of strong positive cash flow and if staff has any regrets or lessons learned from the number of commitments made during the last positive cash flow period in 2007. Mr. Ruggels said the portfolio has reached its 25 percent allocation target, and staff is trying to be methodical in maintaining its target allocation with a more steady commitment pace over time.

Private Equity

Ms. Blackburn reported there has been a lot more investment activity this year, which reached a high in the second quarter. The deal sizes are also larger, driven by dry powder, with a large portion of WSIB's portfolio oriented toward deals of that size. Most of the invested capital is going into

North America and Europe but global private equity funds are increasing activity in Asia, which represents 20 percent of fundraising. She said the WSIB is likely to see more activity in Asia and Brazil. Fundraising is expected to start picking up with mega funds expected to come back to market this year and next. Ms. Blackburn said many investors are maintaining or increasing exposure to private equity. Market terms have been shifting back in favor of limited partners in areas of management fees, distribution water fall, carried interest, clawbacks, and key person provisions.

Ms. Blackburn reviewed the WSIB portfolio returns, net cash flow activity, and value creation. The portfolio has returned 13.44 percent since inception, with a 1-year performance of 20.09 percent. She said that distributions are expected to slow and fundraising is expected to increase.

In response to Chair McIntire's question, Mr. Bruebaker said the WSIB has $7.3 billion in capital committed but not invested as of June 30. Mr. Ruggels said that amount only includes closed funds. Mr. Longbrake asked how much capital can be deployed in private equity before performance starts to diminish. Ms. Blackburn said she was unsure it could be quantified but returns would be expected to come down as more capital is competing for investment opportunities.

[The Board took a recess at 12:42 p.m., and reconvened in open session at 1:03 p.m.]

2012 MEETING SCHEDULE
Chair McIntire reported a year-at-a-glance calendar would be distributed to the Board for the 2012 Board and Committee meeting schedule.

Mr. Masten moved the Board approve the proposed 2012 meeting dates, as follows. Ms. Owens seconded, and the motion carried unanimously.

January 19	July 17-19
February 16	September 20
March 15	October 18
April 19	November 15
May 17	December 20
June 21	

EXECUTIVE SESSION
Real Estate Annual Plan
Private Equity Annual Plan
Assistant Attorney General's Report
Annual Succession Planning Discussion
Non-voting Board Member Evaluations

Chair McIntire announced the Board would go into executive session for items agenda 15a and 15b 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 Board would remain in executive session for agenda item 15c 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, and for agenda item 15d and the Non-voting Board Member Evaluations to review and discuss the performance of public employees. He said the executive sessions are expected to last until about 1:40 p.m., at which time the Board would reconvene in open session to adjourn.

The Board reconvened in open session, there was no further business to come before the Board, and the meeting adjourned at 1:46 p.m.

ACTING CHAIR

James L. McIntire
Chair

ATTEST

Theresa J. Whitmarsh
Executive Director