

## WASHINGTON STATE INVESTMENT BOARD

### Board Meeting Minutes

November 17, 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: Treasurer Jim McIntire, Chair (via teleconference)  
Mike Ragan, Vice Chair (Acting Chair)  
Senator Lisa Brown  
Steve Hill  
Bill Longbrake  
George Masten  
Patrick McElligott  
Richard Muhlebach  
Bob Nakahara (via teleconference)  
David Nierenberg  
Judi Owens  
Natasha Pranger (via teleconference)  
Judy Schurke

Absent: Representative Sharon Tomiko Santos  
Jeff Seely

Also Present: Theresa Whitmarsh, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Victor Moore, Chief Operating Officer  
Liz Mendizabal, Institutional Relations 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  
Kristi Haines, Executive Assistant

Steve Dietrich, Attorney General's Office  
Tara Blackburn, Hamilton Lane  
Mike Augustine, Hamilton Lane

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

Acting Chair Ragan called the meeting to order and took roll call.

### ADOPTION OF THE SEPTEMBER 15, 2011, MINUTES

**Ms. Owens moved to adopt the September 15, 2011, Board meeting minutes.  
Mr. McElligott seconded, and the motion carried unanimously.**

## **PUBLIC COMMENT**

There was no public comment.

## **EXECUTIVE DIRECTOR'S REPORT**

Ms. Whitmarsh reported the real estate and public equity annual planning sessions are scheduled for the December Private and Public Markets Committee meetings. The Audit and Board Governance *ad hoc* committees will also meet in December. She announced the real estate emerging market fund-of-funds program had invested \$15 million in Brazilian Real Estate Opportunities Fund II, which is a new relationship for the WSIB. The new investment options transition for the Deferred Compensation Program (DCP) and Plans 3 was completed and successful overall. A \$1.4 billion transfer of 50,000 member accounts defaulting to target date funds occurred on October 28. Mr. Hill said the new line up significantly improves and simplifies investment options. It provides better choices, which should improve beneficiary retirements. The Department of Retirement Systems (DRS) and WSIB dealt with some member correspondence but, given the number of accounts, there were relatively few issues. Mr. Hill complimented the team work among the DRS, WSIB, record keepers, and fund managers. He thanked Messrs. Paroian and Thatcher for their efforts.

Ms. Whitmarsh introduced new staff members Curtis Littlegreen, Investment Officer – Fixed Income; and Mahesh Kumar, Investment Data Analyst. She reported Ms. Will accepted the Senior Investment Officer – Tangible Assets position and Mr. Graves would join her in that unit. Recruitment is underway for Ms. Will's replacement in the Risk Management and Asset Allocation unit. Ms. Whitmarsh said she renamed the Public Affairs unit to Institutional Relations to reflect its role in corporate governance and performance reporting. She reported the custodial bank and securities lending procurement is in its final stages—the quiet period is still in place. Staff will present its recommendation at the December Board meeting. Annual strategic planning is well underway, which will include a long-range strategic resource plan.

## **COMMITTEE ASSIGNMENTS**

Treasurer McIntire recommended the Board assign Ms. Owens as Public Markets Committee Chair.

**Mr. McElligott moved the Board accept the Chair's recommendation to assign Ms. Owens as Chair of the Public Markets Committee.**

**Senator Brown seconded the motion.**

Treasurer McIntire said Vice Chair Ragan would continue as a member of the Public Markets Committee.

**The above motion carried unanimously.**

## **PRIVATE MARKETS COMMITTEE REPORT**

Mr. Masten reported the Private Markets Committee met on October 6 to consider two investment recommendations and receive notification of a completed secondary investment.

## **Apax VIII, L.P.**

**Mr. Masten moved that the Board invest up to €222 million, plus fees and expenses, in Apax VIII, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.**

Mr. Masten said this global buyout fund will have a target size of €9 billion and will seek to invest in companies with enterprise values between €1 billion and €5 billion, in one of five sectors: financial and business services, healthcare, media, retail and consumer, and technology and telecom. Up to 25 percent of the fund may be invested outside of Europe and North America. The WSIB has invested in three prior Apax 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 strong and experienced team, long-term track record, focused investment strategy, proactive deal sourcing, and global presence.

**The above motion carried unanimously.**

## **Actis Global 4, L.P.**

**Mr. Masten moved that the Board invest up to \$250 million, plus fees and expenses, in Actis Global 4, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.**

Mr. Masten said this pan-emerging markets small- and middle-market buyout fund has a target size of \$3.5 billion and will make equity commitments of \$50 million to \$150 million across multiple emerging markets, building a diversified portfolio by both geographic and industry sectors. This would be a new relationship for the WSIB and would increase exposure to emerging markets. The proposed investment is consistent with the Board's approved 2011 private equity annual plan and the model portfolio. He said the recommendation is based, in part, on the firm's strong performance; unique investment strategy; experienced team; sector focus; extensive global presence; adherence to environmental, social, and governance standards; and attractive fit in the WSIB portfolio.

**The above motion carried unanimously.**

## **Private Equity Secondary Purchase Notification – Southern Cross Latin America Fund IV, L.P.**

Mr. Masten reported, as provided under the Private Equity Investment Policy 2.10.700, staff had completed the purchase of a \$4 million commitment to Southern Cross Latin America Private Equity Fund IV, L.P. in a secondary transaction. The fund was organized to make value-oriented, control buyout investments in companies in Latin America, particularly Brazil, Chili, Mexico, and Argentina. The fund has made one investment at this point. The Board approved an investment of up to \$100 million, plus fees and expenses, in LAPEF IV in September 2010. Due to demand for the fund, the WSIB was only allocated a \$75 million commitment. He said this secondary purchase provided a means to increase the existing commitment to the fund and was completed at a purchase price which represented a discount to capital called to date.

## **ADMINISTRATIVE COMMITTEE REPORT**

Mr. Ragan reported the Administrative Committee met earlier this morning. Mr. Moore briefed the Committee on the WSIB's two-year approved spending plan for the current biennium, and agency spending as of the quarter ended March 31. Both the appropriated and non-appropriated budgets show an estimated year-end surplus.

### **Non-Voting Board Member Renewal**

Mr. Ragan said the Committee considered the application of Mr. Nierenberg for renewal as a non-voting Board member, and recommended reappointment.

**Mr. Ragan moved the Board reappoint Mr. Nierenberg for a three-year term from January 1, 2012, until December 31, 2014. Senator Brown seconded the motion.**

Mr. McElligott said Mr. Nierenberg is an asset to the Board, and he appreciates his frankness.

**The above motion carried unanimously.**

### **2012 Recommended Board Education List**

Mr. Ragan reported the Committee reviewed the 2012 Recommended Board Education List for 2012. The Board materials were updated with one additional conference recommendation resulting from Committee discussion.

**Mr. Ragan moved the Board approve the 2012 Recommended Board Education List. Mr. Masten seconded, and the motion carried unanimously.**

Ms. Whitmarsh said that, at the Board's request, staff had added conference descriptions and attendance recommendations based on Board position and/or Committee assignments to the 2012 list, but that conferences were appropriate for all members. Mr. Masten noted members envisioning leadership positions may want to consider attending conferences recommended for the Board Chair or Vice Chair.

### **Assistant Attorney General's Report**

Mr. Dietrich reported the Board will receive a \$1.5 million for settling its claims against the former Lehman directors and officers in the Lehman securities litigation. The settlement is subject to approval by the bankruptcy court and will be paid by the defendants' insurance carriers. Outside counsel will continue to prosecute the Board's remaining claims against the underwriters and the public auditor, Ernst & Young.

## **GOVERNANCE AD HOC COMMITTEE REPORT**

Ms. Owens reported the Governance Committee met on October 20 to discuss and prioritize governance issues raised by members and develop a timeline for completion. The Committee recommends it confine its work to governance concerns and task the standing Committees of the Board with other issues it identified. The suggested approach limits the scope of the Governance Committee to true governance issues and broadens the discussion of the many strategic issues to the Board so there is full participation in developing solutions. She said the recommendation is for the Governance Committee to address: stakeholder relations—developing and telling the WSIB story; Board independence, continuity, and competence; and Board effectiveness and

operations with anticipated timelines for completion of January, June, and December 2012 respectively.

The Committee asks the Board assign the Public and Private Markets Committees with addressing investment strategies by building discussions in the annual asset class plans, and for the Administrative Committee to address organizational strategies. The results of those discussions would then roll into the 2012 Strategic Plan. The Committee is also asking the Board to assign to the Audit Committee the task of determining how to structure risk discussions for the Board. She pointed out the specific ideas and concerns raised by the Governance Committee to date are in the Board materials.

**Ms. Owens moved the Board approve the Governance *ad hoc* Committee's recommendations for Committee work assignments and timelines for completion. Mr. Hill seconded, and the motion carried unanimously.**

### **COMMINGLED TRUST FUND EURO CURRENCY EXPOSURE**

Ms. Will said the Private Markets Committee members had expressed interest in learning more about the WSIB's exposure to the Euro. She said her presentation includes background information on the Euro, issues, Commingled Trust Fund (CTF) exposure, and hedging strategies. Ms. Will described the differences between the European continents, monetary union, and Euro zone; countries that received exemptions, those not joining, those not accepted due to economics, and guidelines required for joining the Euro alliance. The Euro zone represents 10 percent of the economy. The Euro began in 1999, and became a cash currency in 2002.

Ms. Will said currency is affected by three factors: economics, political conditions, and market psychology, for which the importance of each change at different ways in different times. She said currency affect is paired with other countries. Mr. Graves reported issues within the euro zone in commercial banking, central banking, and sovereign debt.

Ms. Will said the data warehouse indicates CTF exposure to be about \$4.1 billion between all the asset classes with the majority in public and private equity. She described there may be some exceptions, and the reported amount includes only those companies headquartered within the Euro zone. In response to Mr. Ragan's question, Ms. Will described the potential impact to investment valuations should they be redenominated from the Euro into another currency. Mr. Graves explained different ways to hedge currency exposure and Ms. Will discussed the current costs. Ms. Will then outlined three implementation options should the Board want to pursue currency hedging strategies: 1) internal management, 2) adding a mandate within current policy overlay manager's contract, or 3) initiating procurement for a new currency overlay manager. Members discussed the pros and cons and estimated costs of each option.

Mr. Masten said the Board had previously discussed currency hedging and concluded it is not cost effective. Mr. Bruebaker said staff was asked to research hedging strategies, but is not recommending it. Members agreed the discussion was worthwhile and thought provoking. Ms. Whitmarsh emphasized the difference between hedge funds as an asset class and hedging as a risk mitigation strategy. She said the Governance Committee requested the Board engage in risk discussions such as this currency risk discussion.

Mr. Longbrake commented that hedging is extremely expensive and not something that should be pursued unless needed for accounting stability. The WSIB is focused on the long-term. He

suggested the focus should be on underlying investments within the portfolio that depend on European markets. Ms. Will noted the contagion affect among European countries and the global economy.

[Senator Brown left at 11:02 a.m.]

Mr. Bruebaker said staff constantly reviews risk and is doing deep examinations of strategies not currently included in the current asset class mix, in preparation for the Board's 2013 asset allocation study. Chair McIntire supported Mr. Longbrake's suggestion that staff consider events within Europe and their affect on the U.S. He agrees that currency hedging is not a good strategy for the WSIB.

[The Board took a recess at 11:07 a.m., and reconvened in open session at 11:23 a.m.]

### **AAG TRAINING – CONFLICT OF INTEREST, ETHICS, OPEN PUBLIC MEETINGS ACT, AND QUIET PERIODS**

Mr. Dietrich provided annual training for Board members on regulations relating to use of state resources; gifts, meals and travel expenses; confidential information; insider trading; personal investments; employment after state service; the quiet period policy; the Securities and Exchange Commission's pay-to-play rule/campaign contributions; and recurring issues with the Open Public Meetings Act. Chair McIntire requested that Mr. Dietrich provide him with a definition of "covered associates" of subsidiary organizations.

[The Board took a recess at 12:00 p.m., and reconvened in open session at 12:20 p.m.]

[Mr. McElligott left at 12:03 p.m.]

### **QUARTERLY DISCUSSION OF MARKETS**

#### **Portfolio Discussion**

Mr. Bruebaker reported the CTF was down 6.7 percent for the 3-month period ended September 30, 2011. The equity markets are up 9 percent since September 30, 2011 as of this morning. He said the main concerns are U.S. and European debt. The since inception return for the CTF is 8.5 percent as of October 31, 2011. The implementation value added index underperformed in every period, hurt by both allocation and manager decisions.

#### **Fixed Income**

Mr. Kennett reported most of the fixed income funds experienced poor returns due to the short duration of the portfolios' treasuries (during a time that long-term did well) and non-dollar bonds. The retirement fixed income portfolio underperformed by 302 basis points (bps) for the quarter. The return of the portfolio was -0.14 percent, while the Barclays Universal Index returned 2.88 percent. Government securities underperformed by 393 bps due to duration, credit underperformed by 185 bps largely due to the appreciation of the dollar, and securitized underperformed by 134 bps due to duration. The portfolio was underweight government securities which was the best performing sector.

Mr. Kennett said market volatility is expected to continue due to the European crisis and uncertainty over the U.S. economy and budget. In the current quarter, the retirement fund has outperformed by 140 bps. He anticipates the portfolio will have ups and downs, but should have more good quarters than poor. Over the long term, the retirement funds could be negatively affected versus the index due liquidity issues, defaults, and should the dollar appreciate.

Mr. Kennett reported the Labor and Industries' (L&I) Accident, Medical Aid, and Pension Reserve Funds had returns below those of their Comparative Market Indices of 120, 25, and 137 bps respectively. During the quarter, the intermediate credit Bond Fund outperformed, as did the L&I TIPS portfolios as a whole. He said the Permanent Funds underperformed during the quarter by 45 bps due the short duration of treasuries.

Mr. Kennett anticipates implications resulting from the European sovereign debt and banking crisis, and slowing global growth. The U.S. has had strong non-residential investment in the past few months, but weak housing and labor markets. He said emerging markets continue to grow much faster than developed countries.

### **Public Equity**

Mr. Paroian reported the public equity markets had a difficult quarter. He said global equity was down nearly 18 percent for the quarter and 14 percent year-to-date as of September; however, markets were up 10 to 15 percent in October. Since then markets have been volatile. Mr. Paroian said the worst performing sectors were financials, materials, industrials, and oil and gas. The best performers were utilities, telecoms, and health care. He reported that global equity managers put into place in June are performing exactly as expected—protecting the portfolio on the downside, with emerging markets experiencing similar results. The CTF has outperformed the benchmark by 70 bps since June, 98 bps year-to-date as of October 31, and 68 bps on a rolling 12-month basis.

Mr. Paroian reported the new menu of investment options conversion for Plans 3 and the DCP occurred during a period of extreme volatility, with some rough initial performance. The equity options are up between 7 to 13 percent and all four of the passive options are tracking the index within 50 bps.

### **Real Estate**

Mr. Draper reported there continues to be a recovery in values within commercial real estate. Areas demonstrating the highest degree of improvement include debt and highly leveraged investments, high-quality properties, and emerging markets. The portfolio returned a net 15.7 percent for the 12 months ended June 30. The 10-year net basis return at quarter end was 8.7 percent.

Mr. Draper said the staff is paying close attention to opportunities that may arise from the banking crisis. The portfolio is approximately one-third non-U.S. investments at this time, which staff would like to increase with an emphasis on necessity retail and industrial and quality residential.

### **Private Equity**

Mr. Ruggels reported the net positive cash flow (distributions in excess of capital calls) trend in the private equity portfolio reversed during July and August, but is back to net positive during the months of September and October. Year-to-date, the portfolio is cash flow positive in the amount of \$770 million. He said initial public offerings (IPO) had shut down for a time, but the recent Groupon IPO and Dunkin' Brands secondary sale indicated the public markets may be opening a bit and could provide opportunities for future liquidity.

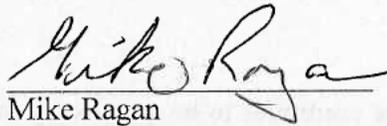
Ms. Blackburn introduced her associate, Mr. Augustine of Hamilton Lane. She reported the private equity deal volume slowed and credit markets tightened in the third quarter. Leveraged loan volume slowed considerably during the quarter, but year-to-date loan volume has already surpassed years 2008, 2009, and 2010. Ms. Blackburn said the average general partner holding time of underlying companies has been increasing and the fundraising environment has begun to improve somewhat.

Mr. Augustine addressed geographic and currency exposure. He said the WSIB portfolio is heavily weighted to North America, but has increased its exposure to Asia, Europe, and the rest of the world in recent years, and this international exposure will continue to grow. In response to Mr. Masten's question, Mr. Augustine confirmed his data was based upon where companies are headquartered.

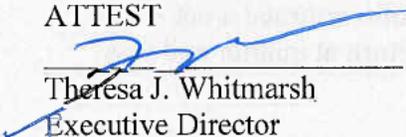
Mr. Augustine said the private equity since inception internal rate of return has increased each quarter over the past year, with a strong one-year return of nearly 26 percent. In response to Treasurer McIntire's question, Ms. Blackburn said she expects 2012 to be busy from a fundraising standpoint, and anticipates global managers to stay away from Europe. Mr. Ruggels said a portion of the private equity annual planning presentation will be dedicated to European-distressed opportunities. He added the reported emerging markets exposure is somewhat misleading and will continue to grow as current commitments are drawn down and more mature investments, which are largely in developed markets, are liquidated. Mr. Nierenberg encouraged Hamilton Lane to follow individual private equity investors leaving firms to launch their own business that WSIB can consider early on.

**OTHER ITEMS**

There was no further business to come before the Board and the meeting adjourned at 1:25 p.m.

  
Mike Ragan  
Acting Chair

ATTEST

  
Theresa J. Whitmarsh  
Executive Director