

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
April 19 2012

The Washington State Investment Board met in open session at 9:45 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

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

Absent: Judy Schurke

Also Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Victor Moore, Chief Operating Officer
Liz Mendizabal, Institutional Relations Director
Steve Draper, Senior Investment Officer – Real Estate
Bill Kennett, Senior Investment Officer – Fixed Income
Phil Paroian, Senior Investment Officer – Public Equity
Kristi Haines, Executive Assistant

Steve Dietrich, Attorney General's Office
Seth Masters, AllianceBernstein

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

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

ADOPTION OF THE FEBRUARY 16, 2012, BOARD MEETING MINUTES

Mr. Ragan moved to adopt the February 16, 2012, Board meeting minutes. Ms. Owens seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh reported the May Private and Public Markets Committee meetings are cancelled. She reported that EMFOF recently committed \$20 million in Peninsula Investment Group II, LP, a fund specializing in developing middle and lower income housing in Latin America. Recruitment difficulties continue in the search to fill the vacant Investment Officer-Real Estate and Senior Investment Officer-Risk Management/Asset Allocation positions. The telecommuting work site location is now open in Seattle. Ms. Whitmarsh reported on open procurements for which quiet periods are in place, including the risk consulting pool, recruitment services, audit service providers, and tangible assets consultants.

ADMINISTRATIVE COMMITTEE REPORT

2012 Salary Survey

Mr. Moore said the Board has authority within statute to set the salary range for the Executive Director, Confidential Secretary, and all Investment Officer (IO) positions. He said compensation levels and incentive compensation for investment officers are limited to the average of total compensation provided by state or other public funds of similar size, based upon a biennial survey conducted by the Investment Board, with review and comment by the Joint Legislative Audit and Review Committee and notice to the director of Financial Management, and the chairs of the House of Representatives and Senate fiscal committees of proposed changes to the compensation levels for the positions. The notice shall be provided not less than 60 days prior to the effective date of the proposed changes. He said McLagan conducted a salary survey among 10 public fund peers. The survey reveals that WSIB's pay levels are 42 percent behind its peers. Mr. Moore presented proposed IO salary ranges resulting from the survey; the top of the proposed ranges are equal to the peer average. The ranges have a 70 percent spread from the bottom to the top of each range, similar to other Washington State pay structures for non-classified staff (Washington Management Service and Exempt Management Service). Mr. Moore said the Board's adoption of the proposed ranges would put a salary schedule into place that reflects the law, and the decision of how employees move within the ranges is delegated to the Executive Director.

[Ms. Pranger and Senator Brown were in attendance via teleconference at 9:53 a.m.]

Chair McIntire moved the Board adopt the proposed salary ranges for Investment Officers, forward the proposed salary ranges and supporting documents to the Joint Legislative Audit and Review Committee, provide notice to the director of the Office of Financial Management (OFM) and the chairs of the House of Representatives and Senate fiscal committees, and provide an effective date for the new salary ranges of 60 days after notice is given to OFM and the fiscal committee chairs. Mr. Ragan seconded the motion.

Representative Santos said this decision is a very significant and necessary move forward for the Board to continue to provide the kind of safe and sound investment management services it has provided to the State and pensioners. She acknowledged and noted the good work of the Governance *ad hoc* Committee to communicate the work of the Board on a larger scale. She said her concern is not withstanding the legitimacy of the proposal, but the very real risk the Board's action could be misconstrued and misunderstood in a broader public arena. She said it is unfortunate the motion is coming at a time when the Board is trying to move forward to implement a strong communication plan with constituency groups. She requested the Chair and members of the Board, particularly those representing beneficiaries of the plans, take proactive steps to meet with significant public opinion

makers and decision makers. She said she will wholeheartedly support it, but she has some trepidation the Board is moving faster than the public can support it.

The motion carried unanimously.

Confidential Secretary Salary

Treasurer McIntire reported the compensation level for the Confidential Secretary is to be established by the Board. The Administrative Committee reviewed and discussed the current salary level.

Treasurer McIntire moved the Board affirm the annual salary level of \$71,556 for the Confidential Secretary. Mr. Ragan seconded the motion.

Mr. Masten clarified this has been the salary level for the past four years.

The motion carried unanimously.

Appointment of Governance Consultant – Funston Advisory Services LLC

Ms. Owens reported the Governance *ad hoc* Committee met on April 12 to re-examine proposed revisions to the Charter of the Board Chair per the Board's direction; review staff's progress on telling the WSIB story to various stakeholder groups; finalize recommendations for the Administrative Committee's review relating to Board independence, continuance, and competency; and determine next steps in organizing the Committee's remaining work assignments relating to Board operations.

The Committee would like to retain Mr. Rick Funston to assist the Committee with its remaining tasks and facilitate a governance discussion at the Board's off-site meeting in July. Mr. Funston prepared a proposal which was discussed by the Governance *ad hoc* Committee and distributed to the Administrative Committee and Board for consideration.

Ms. Owens moved the Board appoint Funston Advisory Services LLC as the governance consultant. Mr. Ragan seconded, and the motion carried with Mr. Masten voting no.

Board Member Position Description Adoption and Charter of the Board Chair 1.00.160 Revision

Ms. Owens said the Governance *ad hoc* Committee re-examined its proposed revision to the Charter of the Board Chair and has made some modifications. It is also re-forwarding a Board member position description for the Board's approval as there were no proposed changes.

Ms. Owens moved the Board adopt the Board Member Position Description and the proposed revisions to the Charter of the Board Chair 1.00.160. Mr. Ragan seconded, and the motion carried unanimously.

Board Education Policy 2.00.200 Revision

Ms. Owens reported the Governance *ad hoc* Committee recommends the Board create a mentorship program and has proposed revisions to the Board Education Policy 2.00.200 to document guidelines for the program.

Ms. Owens moved the Board approve the Board Education Policy 2.00.200 revision. Mr. Ragan seconded, and the motion carried with Mr. Masten voting no.

Assistant Attorney General's Report

Mr. Dietrich reported the Board was named as a defendant in a lawsuit filed in San Diego Superior Court. Terramar Retail Centers, one of the WSIB's real estate partners, is also named as a defendant. Mr. Dietrich believes the suit should not have been filed against the WSIB. He said he will work with Terramar's counsel to get the Board dismissed from the lawsuit and will update the Board if there are significant developments.

AUDIT COMMITTEE REPORT

Mr. Hill reported the Audit Committee met on March 6. The Committee received Internal Audit's report on travel expenditures. Overall, the WSIB is complying with state travel regulations. One recommendation was made to improve documentation for travel paid directly by outside sources. Management agrees with the recommendation and will work to improve the process.

The Committee also engaged in a discussion of the Enterprise Risk Management framework, listened to a presentation of quantitative investment risk tools available from the data warehouse and the risk system, and discussed additional types of risk metrics they would like to see such as extreme tail risk scenario analysis on the total portfolio.

Also at the March meeting, Mr. Lerch provided a brief overview of research examining the impact of shareholder activism (i.e., proxy voting) on stock prices.

Finally, the Committee received an internal audit report on real estate operating companies and discussed the Internal Audit Director's performance evaluation in executive session.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on April 12 to consider four investment recommendations.

FountainVest China Growth Capital Fund II, L.P.

Mr. Masten moved the Board invest up to \$150 million, plus fees and expenses, in FountainVest China Growth Capital Fund II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.

Mr. Masten reported the fund is a China-focused growth equity fund with a target size of \$1.25 billion, and will continue the strategy of investing in revenue-generating, high-growth businesses that require between \$50 and \$200 million of equity. FountainVest is an existing relationship for the WSIB, as the Board committed \$50 million to the predecessor fund in 2008. The proposed investment is consistent with the Board-approved 2012 private equity annual plan and model portfolio. He said the recommendation is based, in part, on the firm's strong performance, disciplined approach, focused and consistent investment strategy, solid and experienced team, and fit in the WSIB's private equity portfolio.

The above motion carried unanimously.

TPG Opportunities Partners II, L.P.

Mr. Nierenberg recused himself from discussion of the TPG Opportunities Partners II, L.P. investment recommendation.

Mr. Masten moved the Board invest up to \$200 million, plus fees and expenses, in TPG Opportunities Partners II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.

Mr. Masten reported the fund, with a target size of \$1.5 to \$2.0 billion, will invest in special situations and distressed opportunities worldwide. TPG has been a long-term investment partner of the WSIB. Since 2000, the Board has committed in excess of \$2 billion to six TPG-sponsored investment vehicles. The proposed investment is consistent with the Board-approved 2012 private equity annual plan and model portfolio. He said the recommendation is based, in part, on strong historical performance, an opportunistic approach to distressed investing, experienced team with extensive distressed investing expertise, access to TPG's operational capability, and fit in the WSIB private equity portfolio.

The above motion carried unanimously.

Principal Enterprise Capital Holdings, LLC

Mr. Masten moved the Board invest an additional \$500 million in Principal Enterprise Capital Holdings, LLC (PEC), subject to continuing due diligence and final negotiation of terms and conditions.

Mr. Masten reported PEC's strategy is to invest in real estate operating companies, consistent with the WSIB's primary strategy for real estate. The proposed follow-on investment is consistent with the Board-approved 2012 real estate annual plan. The WSIB has a longstanding relationship with PEC, having previously committed \$1.8 billion to the Partnership since it was established in 1999. He said the recommendation is based, in part, on the firm's history of strong returns, performing well through down cycles, and strength in underwriting.

Mr. McElligott seconded, and the motion carried unanimously.

Aevitas Property Partners, LLC

Mr. Masten moved the Board invest \$250 million, plus fees and expenses, in Aevitas Property Partners, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded the motion.

Mr. Masten reported Aevitas' strategy is to invest in real estate operating companies, consistent with the WSIB's primary strategy for real estate. The proposed investment is consistent with the Board-approved 2012 real estate annual plan. This will be the first recommendation for this group, which is a startup firm. Staff has had a professional relationship with the CEO of Aevitas, Glenn Aaronson, for many years and holds him in high regard. He said the recommendation is based, in part, on the quality of senior management, governance rights, and likely addition of portfolio diversification.

The motion carried unanimously.

[Mr. McElligott left the meeting at 10:15 a.m.]

DEFINED CONTRIBUTION EDUCATION SESSION

Mr. Paroian introduced the presentation on trends in defined contribution (DC) plans. He reviewed a survey conducted by Callan, one of the WSIB's general investment consultants. The majority of the funds surveyed were 401(K) plans and one-third of the plans had more than \$1 billion in assets under management and more than 10,000 members. The key findings of the survey were: plans taking steps to improve fiduciary position were primarily concerned with reviewing fees; sponsors expressed concern with respect to Department of Labor's draft participant disclosure regulation due to potential employee confusion; over half of the plans provide a retirement income projection for participants; over half of plan sponsors conducted an investment structure evaluation within the past year; plans are increasingly moving to passive options; after a period of rapid adoption, growth in automatic enrollment and automatic contribution escalation has stagnated at around 50 and 35 percent, respectively; and target date funds now make up about 70 percent of default investment options.

Mr. Paroian noted the change in menu options coordinated by the Department of Retirement Systems (DRS) and WSIB for the Plans 3 and Deferred Compensation Program reduced management fees in the equity only option due to adoption of passive funds. He said DRS also does a great job communicating with participants.

Mr. Paroian introduced Mr. Masters, Chief Investment Officer of Asset Allocation at AllianceBernstein, the target date manager for the DC plans. Mr. Masters presented information on broad trends across the DC industry. He said that more corporate plans are closing and freezing defined benefit (DB) plans and programs due to risk and complex accounting, which is creating a shift from DB to DC plans. Mr. Masters described how plans are moving to simplify options, lower costs, automate enrollment and contributions, focus on default investment, and examine in-house guarantees. He said WSIB is ahead of the curve on unbundling costs and staying abreast of regulatory changes and disclosing information to participants.

Mr. Masters described the objectives of target date funds are to maximize retirement savings while working and prolong savings through retirement. The main risks to the success of target date portfolios are that individuals will not save enough (shortfall risk), inflation, adverse market conditions, and underestimated longevity. He discussed the introduction of a real asset allocation to a traditional asset allocation to protect assets from inflation and a dynamic asset allocation component that is designed to dampen the volatility of target date funds.

In response to a question from Representative Santos on dynamic asset allocation, Mr. Bruebaker said if the Board would adopt this type of strategy for the Plan 3 and DCP target date funds, staff would work with DRS to employ it through AllianceBernstein. If the Board ever wanted to consider something similar for the Commingled Trust Fund, it would require additional staff resources. Staff is presenting the information as education only and not proposing the Board adopt a strategy.

Mr. Masters discussed how sponsors are considering secure lifetime income strategies within target date funds to protect against longevity risk.

Chair McIntire thanked Mr. Masters for the presentation and said the Board would continue to have DC discussions going forward.

EXECUTIVE SESSION

Executive Director Evaluation

Chair McIntire announced the Board would take a short recess and then reconvene in executive session to review and discuss the performance of a public employee. He said the executive session is expected to last until about 11:55 a.m., at which time the Board will reconvene in open session to consider a motion to accept the evaluation results, and then the meeting would likely adjourn.

[The Board briefly recessed at 11:37 a.m., and reconvened in executive session at 11:47 a.m.]

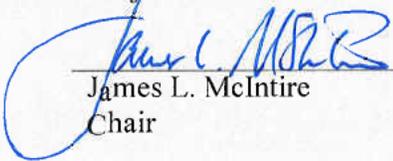
[The Board went into open session at 11:57 a.m.]

Chair McIntire moved the Board accept the Executive Director's performance evaluation as written. Mr. Ragan seconded, and the motion carried unanimously.

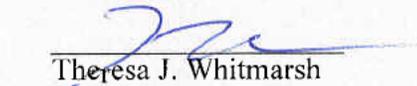
Chair McIntire said the Board is delighted with Ms. Whitmarsh's performance as Executive Director. She has really grown into the position and done a good job. Ms. Whitmarsh said it is her pleasure to serve the Board.

OTHER ITEMS

There were no further items to come before the Board, and the meeting adjourned at 11:59 a.m.


James L. McIntire
Chair

ATTEST


Theresa J. Whitmarsh
Executive Director