WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
November 21, 2013

The Washington State Investment Board met in open session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Marcie Frost, Vice Chair Kelly Fox Arlista Holman Bill Longbrake George Masten Richard Muhlebach Bob Nakahara David Nierenberg (teleconferenced) Mike Ragan Joel Sacks Natasha Williams (teleconferenced)
Absent:	Treasurer Jim McIntire, Chair Senator Sharon Nelson 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 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 Allyson Tucker, Senior Investment Officer – Risk Management and Asset Allocation Diana Will, Senior Investment Officer – Tangible Assets Kristi Haines, Executive Assistant Mary Lobdell, Attorney General's Office Matt Smith, State Actuary's Office

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

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

ADOPTION OF MEETING MINUTES

> **Mr. Ragan moved to adopt the September 19, and October 11, 2013, meeting minutes. Mr. Sacks seconded, and the motion carried unanimously.**

PUBLIC COMMENT
There was no public comment.

PRIVATE MARKETS COMMITTEE REPORT
Mr. Masten reported the Private Markets Committee met on October 3 and November 14 to consider three private equity investment recommendations and one tangible assets investment recommendation.

EIG Energy Fund XVI, L.P.

> **Mr. Masten moved that the Board invest up to $200 million, plus fees and expenses, in EIG Energy Fund XVI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Ragan seconded the motion.**

Mr. Masten reported the fund, with an expected size of $6 billion, will invest in hybrid debt and structured equity focused on the energy sector by acquiring, holding, and disposing of debt and equity investments in energy, resource, and related infrastructure projects and companies on a global basis in North America, Western Europe, and Australia. If approved, the proposed investment would represent a new general partner relationship for the WSIB and would fall into the unidentified allocation in the Board-approved 2013 private equity annual plan. The proposed investment is consistent with the model portfolio. He said the recommendation is based on EIG's strong performance, experienced team, extensive industry expertise, projected opportunities, diversified and global investment strategy, downside protection focus, and fit in the WSIB's private equity portfolio, as well as other relevant factors.

> **The above motion carried unanimously.**

TCV VIII, L.P.

> **Mr. Masten moved that the Board invest up to $150 million, plus fees and expenses, in TCV VIII, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten reported the fund, with a target size of $2.5 billion, will be managed by Technology Crossover Ventures and focus on growth equity investments in the technology sector in North America with select investments in other geographies. The WSIB has invested in TCV since 1997 through Pathway and INVESCO. The proposed investment would fall into the unidentified allocation in the Board-approved 2013 private equity annual plan, and is consistent with the model portfolio. He said the recommendation is based on the firm's cohesive and experienced management team, consistent returns, differentiated proven strategy, deal flow, and attractive fit in the WSIB's private equity portfolio, as well as other relevant factors.

Mr. Ragan seconded, and the motion carried unanimously.

TPG Opportunities Partners III, L.P.

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

[Mr. Nierenberg recused himself from participating in any discussion of the recommendation.]

Mr. Masten reported the fund will make investments in special situations and distressed opportunities worldwide across the credit cycle, through two general strategies: Corporate Special Situations and Asset Special Situations. The WSIB has invested in TPG funds since 2000, most recently committing $200 million to TOP II in 2012 and $200 million to TPG Growth II in 2011. The proposed investment is consistent with the updated 2013 private equity annual plan shared with the Board in July and with the model portfolio. He said the recommendation is based on strong historical performance with the strategy, opportunistic approach to distressed investing, experienced team, access to TPG's operational capability, and attractive fit in the WSIB's private equity portfolio.

The above motion carried unanimously.

Olympic Sun, LLC

Mr. Masten moved that the Board invest up to $100 million, plus fees and expenses, in Olympic Sun, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Mr. Ragan seconded the motion.

Mr. Masten reported that Olympic Sun will pursue a low-risk investment approach by focusing on acquiring farmland for production of permanent crops and vegetable crops, both of which will be leased to farmers under a variety of lease structures. WSIB will own 98 percent of the equity, and UBS, will own the other 2 percent. UBS AgriVest will be the manager of the fund. He said the recommendation is based on the firm's experienced and disciplined team, strong track record, low-risk and income driven approach, an early mover advantage with respect to the agriculture asset class, and fit in the WSIB's tangible assets portfolio, as well as other relevant factors.

The above motion carried unanimously.

STRATEGIC ASSET ALLOCATION IMPLEMENTATION
Retirement Commingled Trust Fund (CTF) Asset Allocation Policy 2.10.050 Revision
Ms. Tucker presented the proposed Retirement CTF Asset Allocation Policy 2.10.050 revision, which reflects the modest modification to the long-term asset allocation strategy and its implementation plan the Board adopted at its last meeting.

> **Mr. Ragan moved that the Board approve the recommended changes to the Retirement CTF Asset Allocation Policy 2.10.050. Mr. Sacks seconded the motion.**

Mr. Masten said, if there were more than six voting members present, he would vote against the recommendation consistent with his vote at the September meeting. He said he does not see the point in the change; however, he will not "hang up" the vote due to absent members who supported it. Ms. Whitmarsh thanked the Board and staff for staying engaged in the arduous process of reviewing the asset allocation.

> **The above motion carried unanimously.**

EXECUTIVE DIRECTOR'S REPORT
Ms. Whitmarsh announced that Ms. Williams would be leaving her position at the Washington State Patrol at the end of the year and, as a result, would no longer serve on the Board. Ms. Williams described the reasons for deciding to leave state employment. She said the December 3 Audit Committee meeting would be her last official meeting. Vice Chair Frost thanked Ms. Williams for her perspective and service on the Board, and as serving as Chair of the Audit Committee.

Ms. Whitmarsh said Public Equity staff had a busy fall transitioning assets between managers and different mandates. All transitions went well.

For staffing, Ms. Whitmarsh announced Dorota Czub accepted the Investment Officer – Tangible Assets position, and would transfer from her current position in Fixed Income. Final interviews are being conducted for the Investment Officer – Risk and Asset Allocation vacancy. She announced the recruitment for a Data Steward has been difficult as it is a highly specialized position and hard to find individuals with those skills. Ms. Whitmarsh announced the departure of Lisa Grigg, Investment Officer – Fixed Income, who moved to Idaho with her family.

Ms. Whitmarsh said that Mr. Bruebaker's November 12 presentation to the Select Committee on Pension Policy was well received. Treasurer McIntire passed along a compliment from one of the Senate members who said he wished all government performed at the same level of excellence as the WSIB. She and Ms. Mendizabal met with the new executive director of the Retired Public Employees Council of Washington, Maria Britton-Sipe, who is a good advocate for the WSIB's work on behalf of retirees.

Ms. Whitmarsh noted that both Institutional Shareholder Services (ISS) and Glass Lewis (proxy voting services used by the WSIB) had been in the news a lot, as ISS is going up for sale. NASDAQ recently sent a letter to the Securities and Exchange Commission requesting more transparency from proxy advisory services in their rankings, benchmarking, and methodologies. The role of proxy services heating up, and there is a hearing scheduled for December in Washington DC on the issue. She said the Council of Institutional Investors (CII) is following the issue closely and keep staff informed.

Ms. Whitmarsh reported she accompanied Senator Mark Mullet and Scott Jarvis, Director of Financial Institutions, to meetings with WSIB general partners in the Silicon Valley. Senator Mullet and Mr. Jarvis were interested to learn what attracts companies to that area, since Washington has a lot of the same attributes. Mr. Sacks said he met with Senator Mullet a few days following that trip and he relayed the Senator was very impressed with the WSIB.

Ms. Whitmarsh reported on agency process improvement efforts, noting that several staff members have been trained on the LEAN process. For procurement, she noted the active emerging markets equity management search will be issued November 25, and a quiet period would begin. Any inquiries received should be referred to John Lynch, Contracts Manager.

[Ms. Williams was no longer in attendance via teleconference at 10:00 a.m.]

ADMINISTRATIVE COMMITTEE REPORT
Vice Chair Frost reported the Administrative Committee met earlier this morning.

Quarterly Budget Update
Mr. Moore reported the Fiscal Year 2014 appropriated budget has a balance of $760,000 (4.4 percent savings), and the non-appropriated budget has a balance of $21.6 million (6.2 percent savings).

Non-Voting Board Member Discussion
Vice Chair Frost said there are currently two non-voting Board member positions expiring. Open recruitment information is available on the WSIB's website, with materials due by December 9 to the Executive Assistant. Both Messrs. Seely and Nakahara were invited to reapply. The Administrative Committee will screen application submissions at its December 19 meeting, and candidates selected for interview will be invited to a special Administrative Committee meeting which will be scheduled in January. The Committee will then prepare to make its recommendation to the Board at the January 16 meeting.

2014 Recommended Board Education List
The Committee reviewed the 2014 Recommended Board Education List. Mr. Masten had one small edit to the list, and it will be brought for approval at the December Board meeting.

Assistant Attorney General's Report
Ms. Lobdell had nothing to report.

STATE ACTUARY UPDATE
Mr. Smith presented the State Actuary's annual update to the Board. He described the Office of the State Actuary (OSA) was created as independent, in-house pension actuaries and policy analysts to promote the security of public employee benefit plans. These programs have a present value of future benefits for current members totaling

$112.5 billion. Mr. Smith described OSA services and clients served. He said OSA works closely with the Attorney General's Office on pension litigation.

Mr. Smith provided an update on the Guaranteed Education Tuition (GET) Program's funded status, key assumptions, and asset allocation. As of June 30, 2013, the program is 94.1 percent funded with $2.7 billion in obligations and $2.6 billion in assets set aside. He said the funded status improved from the last measurement due to lower assumed tuition growth and higher than expected investment returns for the last fiscal year. He noted the fund is invested separately based on its risk profile, with the expected return of 5.5 percent lowered from 5.98 percent last year.

Mr. Nierenberg questioned why the program's 2015-2024 tuition growth assumptions were so high. Mr. Smith said the assumptions are not necessarily trying to predict what is going to happen, but must be built into the pricing of the program's guarantee. Based on GET's payout value, he said they are modeling the cost of future tuition at the most expensive in-state public school (University of Washington) and they are reasonable assumptions when you consider what might happen to state funding in the future. If funding goes down, tuition goes up. He said it is difficult to project, but he believes they are reasonable assumptions for pricing and valuing the program which includes a state guarantee. He said the assumptions are evaluated annually and he benefits from knowing what is happening at the Legislative level in regards to state funding for higher education. There have been significant policy changes in the area of higher education over the past twenty years. In response to Mr. Nakahara's question, Mr. Smith said the OSA's work is reviewed periodically by an outside actuary. OSA works closely with higher education institutions and legislative staff on modeling, and updates assumptions about tuition growth after institutions announce fall tuition.

Mr. Smith provided an update on state pensions, long-term economic assumptions, and system membership. He said he recommends long-term economic assumptions to the Pension Funding Council every two years. Mr. Smith said he continues to recommend lowering the assumed rate of investment return to 7.5 percent, and a phased-in approach to manage the short-term budget impact of that. Three steps of the phase-in are currently in law. He believes the 7.5 percent recommendation is reasonable based on simulated returns over both a 15-year (investment) and 50-year (actuarial) period using WSIB's capital market assumptions.

Mr. Smith said there are six open systems that include both defined benefit (DB) plans and hybrid (both DB and defined contribution [DC]) plans that cover all general government employees, excepting employees of the cities of Seattle, Spokane, and Tacoma. There are nearly 290,000 active members and 144,000 annuitants at June 30, 2012. Mr. Smith reviewed the participants' data and demographics among the various plans.

He said the present value of obligations compared to assets on hand, with a smoothing method applied to manage the impacts of short-term market volatility, represents a 101 percent funded ratio. This is unchanged from the last measurement when combining all systems together. Mr. Smith said what is most important is how each plan stands on its own. He said all open plans and Law Enforcement Officers and Fire Fighters' Plan 1 are at or above the target of 100 percent; the Public Employees' Retirement System Plan 1 and Teachers' Retirement System Plan 1 are below target. He demonstrated how sensitive plans' funding status is when different assumed rates of return are applied, and the change or sensitivity is not proportional in every system.

Mr. Smith discussed the risks and challenges ahead related to the Plan 1 unfunded liability, plans to get that back on track, and litigation risks. He said the Department of Retirement Systems' website has a lot of information on the status of current pension litigation.

Mr. Smith reported on changes in pension reporting of liability and funding status from the Governmental Accounting Standards Board and Moody's. He said different measures are used for different purposes and it is important to understand those and the resulting differences. He said the reporting changes are aimed at increasing comparability across plans.

Mr. Smith reported on recent activities and research of the Society of Actuaries relating to public pensions. He also discussed a risk assessment project performed by OSA. Vice Chair Frost said that shows recognition for both the OSA and WSIB in being pioneers and trying to create a way to do better risk analyses. She said "moving beyond expectations" is what risk assessment is all about.

[The Board recessed at 10:44 a.m., and reconvened in open session at 10:59 a.m.]
[Mr. Fox was in attendance at 10:59 a.m.]

BOARD REPORTS ON CONFERENCE ATTENDANCE
Council of Institutional Investors
Mr. Fox reported on the Council of Institutional Investors' Fall Meeting that he, staff, Ms. Williams, and Chair McIntire attended. He said there was great value in the presentations, one of which was presented by Ms. Whitmarsh. He said the most important component for him was the corporate governance information, which was extremely enlightening. He appreciates the WSIB's participation in CII and the opportunity to network throughout the conference. He strongly encouraged other Board members to participate.

International Centre for Pension Management
Vice Chair Frost reported on the International Centre for Pension Management's (ICPM) Discussion Forum. She said ICPM conducts the Forum a few times a year with an international group of attendees, including Canada, U.S., U.K., Korea, Australia, New Zealand, and the Dutch system. ICPM is a research group and a lot of reports are debated on during the Forum. Discussions included long-horizon investing, asset allocation, organization operations, investment options limits, automatic annuitization features in products, and the U.K. nest system. Ms. Whitmarsh said that the conversations of best practices and debates among the various countries represented give the best value to the discussion.

Callan College – Introduction to Investments
Ms. Holman attended Callan's Introduction to Investments seminar in October, along with 15 other attendees split equally between the west and east coasts. She said sessions included capital market theory, portfolio construction, asset valuation, performance measurement, and the fiduciary role. There was a review of investment policy and management structure, which she said was especially helpful as it helped her understand

managers' role and the various types of management depending on asset classes and approach.

QUARTERLY REPORTS

Quarterly Performance Update

Mr. Bruebaker reported on performance for the quarter ended September 30. He said it was a great quarter for returns, and for the one-year period. The CTF was up 4.45 percent for three-month period ended September 30, and 12.57 percent for the year-ended September 30. The equity markets are up 6.26 percent since quarter end. The since inception return was 8.72 percent as of the third quarter end.

He said performance against the implementation value added benchmark still struggles to outperform passive benchmarks. The asset allocation decision was positive by 4 basis points (bps), but performance was hurt by 4 bps due to being overweight in fixed income and by 6 bps due to cash. The return was assisted by 12 bps by being underweight in tangible assets and assisted by 3 bps by being overweighting to public equity. The manager decisions hurt performance during the quarter. Mr. Bruebaker said the portfolios are positioned well for the long-term, but will continue to lag passive benchmarks when public markets outperform.

Mr. Longbrake said he is beginning to hear commentary on the possibility of a developing stock market bubble and asked staff to consider scheduling an education session on the topic, including the dynamics of equity markets, where this might be leading, and problems the Board may need to consider.

OTHER ITEMS

There was no further business to come before the Board, and the meeting adjourned at 11:20 a.m.

Marcie Frost, Vice Chair
Acting Chair

ATTEST

Theresa J. Whitmarsh
Executive Director