

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
April 17, 2014

The Washington State Investment Board met in open session at 9:46 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Treasurer Jim McIntire, Chair
 Marcie Frost, Vice Chair
 Kelly Fox
 Arlista Holman
 Judy Kuschel
 Bill Longbrake
 George Masten
 Stephen Miller
 Richard Muhlebach
 Bob Nakahara
 Senator Sharon Nelson
 David Nierenberg
 Joel Sacks
 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 – Tangibles
 Kristi Haines, Executive Assistant

 Mary Lobdell, Attorney General’s Office
 Dawn Cortez, Attorney General’s Office
 Scott Daniels, Conning Asset Management
 Mike Heale, CEM Benchmarking

[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 20, 2014, MEETING MINUTES

Mr. Masten moved to adopt the February 20, 2014, meeting minutes. Vice Chair Frost seconded, and the motion carried unanimously.

PUBLIC COMMENT

Mr. Mike Ragan thanked the Board for the hard work they do on behalf of beneficiaries.

Mdmes. Bourtai Hargrove, Donna Albert, and Messrs. Stew Henderson, Glen Anderson, and Bernie Meyer, Confronting the Climate Crisis, addressed the Board to call for divestment of the state's portion of the Commingled Trust Fund from fossil fuel companies and to offer employees the option of fossil free investments in the portfolio. Each spoke to their current state or former employment, and their concerns regarding the negative effects of fossil fuels (such as oil, coal, and gas) on climate change, affecting the environment for future generations. They distributed several handouts and commented on reports supporting their position, which were put into the permanent record. They noted other entities that have begun to divest and urged the Board to do so before stock prices start to fall as a result.

Chair McIntire thanked the group for their comments, suggestions, and concerns. He said the Board appreciates hearing from constituents, listens to issues, and takes matters to heart. He said the Board operates as fiduciaries under a statutory authority to achieve the highest return for prudent risk and takes the idea of prudence seriously. He noted the Board belongs to a number of organizations that focus on corporate governance, stranded assets, and other potential climate impact risks, and tries to take all available information into consideration. He said the Board would continue to review the group's comments and other inputs as it thinks about investment patterns within the portfolio and assesses risks as long-term investors. Chair McIntire said the Board has favored active and constructive engagement over divesture for several decades, pursuing corporate governance and other risk issues it sees associated with investments.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh discussed plans for the Board's July 15-17 meeting, which will include a deep dive into the history of Board decisions, how asset classes evolved and why the Board invests the way it does now, and investment beliefs that drive Board decisions. Staff has planned another session on behavioral finance with Mr. Arnie Wood, which will include case studies and break out groups, and a morning session on the topic of sustainability. In response to Mr. Sacks' request, Ms. Whitmarsh said staff would incorporate discussion of past investment situations the Board choose not to engage in and why.

Ms. Whitmarsh introduced Angela Liu, newly appointed Investment Officer - Fixed Income.

Mr. Bruebaker announced for the first time in its history, the WSIB now manages in excess of \$100 billion in assets.

AUDIT COMMITTEE REPORT

Mr. Sacks reported the Audit Committee met on March 4 to review an internal audit report on the Board's Stakeholder Reporting. The report contained one audit recommendation to expand the quarterly investment performance report review process to include independent verification of information obtained from investment staff. Management will takes steps to implement. He said the Committee received updates on: 1) status of prior audit recommendations, 2) annual audit plan status, 3) proxy voting results for 2013, 4) Sudan and Iran Resolutions, 5) quarterly log of investment referrals, and 6) Daily Valued Funds (DVF) annual report.

Daily Valued Funds Operations Policy 2.14.300 Revision

Mr. Sacks said the Committee is proposing revisions to the Board's Daily Valued Funds Operations Policy, 2.01.300, to include the DVF U.S. TIPS Fund.

Mr. Sacks moved that the Board approve the revisions to policy 2.14.300. Mr. Masten seconded, and the motion carried unanimously.

Mr. Sacks reported the Committee received an overview of the 2013 Enterprise Risk Management and Investment Compliance Program work. Hamilton Lane, the Board's private equity compliance consultant, explained their process for testing and provided private equity compliance results for the year. Hamilton Lane said the WSIB is very unique from other institutional investors and leads the way in monitoring to ensure it invests in a wise manner.

Financial Statement Audits – Scope of Services and Auditor Appointment

Mr. Sacks said the Board's financial statement audit service contract expired on December 31, 2013. The Committee reviewed the scope of services proposed for the upcoming fiscal year 2014 audit and discussed auditor independence. Staff would like to engage Peterson Sullivan LLP, based on the firm's audit experience, the qualifications of proposed auditors, and their understanding of the WSIB's financial reporting processes and controls leading up to the Board's transition to a new accounting book of record this fiscal year. The Committee supports staff's recommendation.

Mr. Sacks moved that the Board appoint Peterson Sullivan LLP to perform the fiscal year 2014 independent financial statement audits. Vice Chair Frost seconded, and the motion carried unanimously.

Conflict of Interest Policy Compliance Review – Scope of Services and Auditor Appointment

Mr. Sacks said the WSIB released a Project Work Request for an external audit service provider to perform the annual Conflict of Interest Policy compliance reviews. Based upon an evaluation panel's review of the responses and fees

proposed, staff would like to hire Peterson Sullivan LLP to perform the annual Conflict of Interest Policy compliance reviews for calendar years 2013-2016. The Committee reviewed the proposed scope of services and indicated the Audit Committee supports staff's recommendation.

Mr. Sacks moved that the Board appoint Peterson Sullivan LLP to perform the calendar years 2013, 2014, 2015, and 2016 Conflict of Interest Policy compliance reviews. Vice Chair Frost seconded, and the motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on April 3 to consider three private equity and two tangible assets investment recommendations.

Banc Fund IX, L.P.

Mr. Masten moved that the Board invest up to \$100 million, plus fees and expenses, in Banc Fund IX, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Frost seconded the motion.

Mr. Masten said the fund, with an expected size of \$550 million, will invest in U.S.-based financial services companies. The WSIB has invested in four prior Banc Funds. The proposed investment is consistent with the Board-approved 2014 private equity annual plan and the model portfolio. He said the recommendation is based on Banc Fund's stable and experienced team; strong historical performance; narrowly focused, differentiated investment strategy; and fit in the WSIB's private equity portfolio, as well as other relevant factors.

The above motion carried unanimously.

Menlo Ventures XII, L.P.

Mr. Masten moved that the Board invest up to \$100 million, plus fees and expenses, in Menlo Ventures XII, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Frost seconded the motion.

Mr. Masten reported the fund, with a target size of \$400 million, will invest in seed, early, expansion, and later-stage financings of companies with potential for significant growth. The WSIB has invested in ten Menlo Ventures funds since 1981. The proposed investment is consistent with the Board-approved 2014 private equity annual plan and model portfolio. He said the recommendation is based on the firm's historical performance, strong franchise, experienced team, venture focus, and fit in the WSIB's private equity portfolio, as well as other relevant factors.

The above motion carried unanimously.

FFL Capital Partners IV, L.P.

Mr. Masten moved that the Board invest up to \$200 million, plus fees and expenses, in FFL Capital Partners IV, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Frost seconded the motion.

Mr. Masten reported the fund will make investments in U.S. middle-market companies to finance buyouts, growth initiatives, and recapitalizations in the business services, consumer, financial services, and healthcare services sectors. If approved, a commitment to the fund would establish a new general partner relationship for the WSIB in a targeted investment strategy. The proposed investment would fall into the unidentified allocation in the Board-approved 2014 private equity annual plan and is consistent with the model portfolio. He said the recommendation is based on the firm's proactive investment approach, experienced team, deep industry expertise, strong performance, investment strategy, and fit in the WSIB's private equity portfolio, as well as other relevant factors.

The above motion carried unanimously.

U.S. Farming Realty Trust III, LP

Mr. Masten moved that the Board invest up to \$250 million, plus fees and expenses, in U.S. Farming Realty Trust III, LP, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Frost seconded the motion.

Mr. Masten reported the fund will invest in U.S. farmland dedicated largely to commodity row crops and in related on-farm midstream assets such as grain storage and processing. The proposed investment is consistent with the Board-approved 2014 tangible assets annual plan. He said the recommendation is based on the firm's strategy customized for the WSIB's objectives, experienced team with multi-generational history in farming, proprietary deal flow, research, focus on best practices, predictable cash flows, and fit in the WSIB's tangible assets portfolio, as well as other relevant factors. Mr. Masten added the firm gave the finest presentation on farming and did an outstanding job of making their case.

The above motion carried unanimously.

Fortress Worldwide Transportation and Infrastructure Investors L.P.

Mr. Masten moved that the Board invest up to \$100 million, plus fees and expenses, in Fortress Worldwide Transportation and Infrastructure Investors

L.P. and related investment vehicles, subject to continuing due diligence and final negotiation of terms and conditions, with the ability to invest an additional \$50 million in subsequent public or private capital offerings. Vice Chair Frost seconded the motion.

Mr. Masten said the fund will invest in and actively manage transportation and infrastructure assets. The proposed investment is consistent with the Board-approved 2014 tangible assets annual plan. He said the recommendation is based on the firm's dedicated team, strong performance in transportation and infrastructure assets, strong deal-sourcing relationships, specialized expertise across numerous transportation sectors, unique value-add approach, existing portfolio of high-quality assets, potential to own desirable assets perpetually, and fit in the WSIB's tangible assets portfolio, as well as other relevant factors.

Ms. Holman asked if there was discussion by the Committee related to any impact to the rail if the Keystone Pipeline is approved. Mr. Masten said, if the pipeline was approved, it would take time and the firms' assets would still be needed to transport various things by rail or truck regardless of whether or not it was built. The firm would be able to make this a good investment for the WSIB. Chair McIntire said an argument could be made that the demand exceeds the capacity.

The above motion carried unanimously.

EDUCATION SESSION

Labor and Industries Annual Review

Mr. Daniels provided an overview of Conning Asset Management, a financial services firm that specializes in insurance. Conning has assisted the WSIB with the Labor and Industries' (L&I) portfolio since the late 1980s. L&I is a substantial size business that provides workers compensation insurance to 2.5 million workers, is the third largest of 25 state workers' compensation funds, and seventh largest in the U.S., including private funds. The fund collected \$1.7 billion in premiums as of the fiscal year ended 2013, with \$12 billion in benefit reserves as of December 31, 2012. As of December 31, 2013, there was \$14 billion within the investment portfolio, which is divided into three major funds: accident, medical aid, and pension reserve. Investments represent 96 percent of the assets, and provided 25 percent of revenues plus \$266 million in unrealized gains as of fiscal year end 2013.

Mr. Daniels reviewed the factors that drive insurer portfolio decisions and customized strategy for L&I which provides support for long-term liabilities and cash flow to pay benefits every year. He described the regulatory environment and discussed the ratios of premiums, reserves, and investments to capital. L&I's objectives are to maintain the solvency of the funds, maintain premium rate stability, ensure sufficient assets are available to fund the ultimate liabilities, and, subject to each of these, to earn a maximum return at a prudent level of risk. He described the implications of the stock and bond investments, risk management,

and long-term returns. Mr. Daniels reviewed L&I's fixed income and equity asset allocation, and duration in each of the three funds. There are no alternative assets in the portfolio. He compared L&I's asset allocation to industry peers and described the comparable market indices that are helpful to measure performance but have some flaws. L&I's total return performance through December 31, 2013, moderately outperformed over the long-term.

In response to Ms. Holman's questions, Mr. Daniels said that L&I does not have a requirement for a set surplus level, although other states set levels for capitals due to their insurance regulations. He said low levels of capitals show that premiums are being kept low. Mr. Sacks said the current goal is to bring the contingency reserve up to 14 percent of liabilities. The surplus was over \$1 billion at the end of 2013.

A discussion ensued about the good management at L&I and about the investments that have provided protection to the L&I portfolio. Senator Nelson said and Chair McIntire agreed that legislators could benefit from some educational sessions.

[The Board recessed at 11:25 a.m., and reconvened in open session at 11:39 a.m.]

CEM Benchmarking

Mr. Heale gave a presentation on the CEM Benchmarking services used by the WSIB in analyzing its costs compared to peers. He commented the information analysis is provided on a regular basis and CEM offers other reporting services. He provided an overview of CEM Benchmarking's independent and objective performance and cost analysis using a global funds database consisting of U.S. corporations and public entities, European, Asia Pacific, and Canadian clients. WSIB services include comprehensive benchmarking report, internal staffing and activity cost comparison, supplemental limited partnership cost structure and benchmarking report, and a global leaders' service annual research project and conference. There are almost \$7 trillion aggregate assets among the 360 participating global funds. The performance results focus mostly on the U.S. universe and the cost analysis for WSIB is done using a custom peer group of 19 U.S. sponsors with median size assets of \$52 billion comparable to WSIB's \$65 billion as of 2012. Mr. Heale says the report focuses on: 1) policy return—the impact of WSIB's policy mix decision compared to other funds; 2) net value added—if implementation decisions are adding value; 3) costs—are they reasonable and managed; 4) cost effectiveness—does paying more get more; and 5) risk—how much was taken to obtain value added and what is the risk of the policy mix.

Mr. Heale said the key asset class difference between the WSIB and peer group are that WSIB has more overall equity, substantially less fixed income, and substantially more private equity and real estate. He said the private markets comparisons are challenging due to flawed benchmarks and volatile returns.

He said the benchmark costs analysis in 2012 suggests the WSIB was low cost by \$106.5 million or 17.2 basis points, mostly due to the WSIB's implementation style and what it pays for services. He described the 5-year cost effectiveness chart of

participating funds and WSIB's placement within it. He said WSIB's program is operated with fewer staff than expected and the cost per FTE is well below the global and U.S. medians, specifically for front desk staff.

Mr. Heale said that CEM evaluated the WSIB's long-term private equity performance in 2013 using a standardized public markets benchmark developed by CEM. WSIB's net return of 13.5 percent was above the 10.1 percent return from the global universe and above the 10.9 percent return for peers. He noted that WSIB adds an aspirational premium to its benchmark. Within real estate, WSIB's net return was 13 percent, compared to 8.4 percent for the universe and 9.5 percent for peers.

[Representative Santos arrived at 12:00 p.m.]

Mr. Heale said CEM is beginning to build the 2013 database and implement the research plan. It is engaged in ongoing discussions with WSIB staff focused on improving data comparability and the benchmarking analysis. He said the results for 2013 would be presented at the September Board meeting.

A discussion ensued on usefulness of using a single or adjusted benchmark within private equity for better comparisons, the variety of benchmarks used, self-reporting of performance, and regional adjustments to the data. Mr. Bruebaker said WSIB uses a stronger benchmark than any other fund. He pointed out that Mr. Moore is working with CEM to develop a better benchmark comparison.

[The Board recessed at 12:12 p.m., and reconvened in open session at 12:39 p.m.]

ADMINISTRATIVE COMMITTEE REPORT

Executive Session

Chair McIntire announced the Board would go into executive session to discuss litigation or potential litigation with legal counsel since public knowledge regarding the discussion would likely to result in an adverse legal or financial consequence to the WSIB. He said the executive session was expected to last until about 12:45 p.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 12:40 p.m.]

Assistant Attorney General's Report – Potential Litigation

[The Board reconvened in open session at 12:45 p.m.]

Mr. Masten moved that the Board approve the Assistant Attorney General's recommendation to join the class action litigation as discussed in executive session. Vice Chair Frost seconded, and the motion carried unanimously.

Investment Officer Biennial Compensation Survey

Treasurer McIntire said the Administrative Committee received a presentation from McLagan on the salary survey it performed for the WSIB and Mr. Moore presented the proposed salary ranges for investment officers. Mr. Moore responded to Board member questions about whether the survey includes health benefits, pension, and other benefit considerations; whether the statute addresses total compensation; whether there are geographical considerations; how long McLagan has performed the survey for the WSIB; and the time lapse the WSIB has experienced in filling vacant positions compared to peers and whether the survey looks at that or retention issues.

Treasurer McIntire asked how the constraints within the differing compensation classifications are considered. Ms. Whitmarsh said tools for classified staff, as compared to exempt staff, are limited. The WSIB uses promotions where warranted and it was one of the first agencies to gain approval for performance pay for classified employees, until that was put on hold by the Office of Financial Management (OFM); WSIB is waiting for the hold to be lifted. She said WSIB is generous with tuition reimbursement and training opportunities for classified staff, and they receive regular step increases.

In response to Mr. Miller's question about next steps, Ms. Whitmarsh said the WSIB's budget request would be built around the ranges, if approved, and staff would bring the budget back to the Board for approval in June. It then goes to OFM to put into the total budget, which goes to the Legislature for consideration and approval. The WSIB then takes the approved budget and has internal discussions with supervisors about whether compensation increases should be granted and, if so, the amount of those increases based on individual's performance and other factors.

Chair McIntire said there is dialogue with other agencies relating to retention issues and salaries compared to the market, and those are issues that WSIB needs to keep pace with. He said there's recognition in legislative agencies and elsewhere that there are key players who need to be properly compensated in order to retain them, and then appropriately replace them when they leave. Chair McIntire said he believes the WSIB statute has worked reasonably well and the Board should move forward.

Mr. Masten asked if the action needed to be taken now for budget purposes; to which Ms. Whitmarsh replied that it did. She noted WSIB is a global asset manager. The management team tries to be prudent and thoughtful in its compensation decisions and, even though the levels seem high compared to general state service, they are modest compared to WSIB's competition. To bring the talent to bear to deliver what the Board asks requires a certain level of talent and, at some point, there is a market reality. She said it is a challenge for the WSIB to build and retain a deep bench of talent to carry the organization through the next 10-15 years if it is unable to adequately compensate that talent.

A discussion ensued on the compensation challenge for all state employees and the difficult budgetary bind in which the legislature finds itself; the importance of having adequate internal capabilities at the WSIB to save on external fees; and the preference for continuing the current compensation practice of having a salary based rather than incentive based structure.

Mr. Sacks moved the Board adopt the proposed salary ranges (as provided in the permanent record) for Investment Officers, provide notice to the director of the Office of Financial Management 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. Ms. Holman seconded, and the motion carried unanimously.

Also at the Administrative Committee meeting, Vice Chair Frost reported the *ad hoc* Committee met on March 20 and April 4 to examine the non-voting Board member appointment procedures and review qualifications.

Assistant Attorney General's Report

Ms. Lobdell reviewed the British Petroleum (BP) litigation that WSIB joined in March. She stated that WSIB was a passive participant in an earlier class action that was filed in 2010. Because BP is located outside the U.S., the judge determined there could not be a certified class in the 2010 litigation and each plaintiff must file separate litigation to pursue their claims. The Executive Director and Chair approved the filing of separate litigation against BP. A contract was negotiated with Robbins Geller who is representing WSIB in this litigation. Ms. Lobdell said the amount of the loss was \$6.5 million, and the WSIB could potentially recover around 10 percent of that.

EDUCATION SESSION

Ethics in Public Services, Open Public Meetings Act, and Quiet Periods

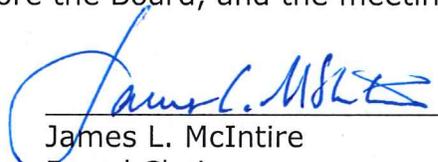
Ms. Lobdell provided training on state ethics laws and WSIB's Code of Conduct Policy 2.00.150, including use of resources; conflicts of interest (gifts, food/beverage, travel expenses, and entertainment); safe harbor and reporting requirements; confidential material, insider trading, and pay to play; and recusals. She reviewed the Open Public Meetings Act requirements relating to meeting conduct including: public notice requirements, quorum, email usage, executive sessions, and consequences for violations. Finally, Ms. Lobdell reviewed agency policy requirements relating to quiet periods during open procurements.

Ms. Whitmarsh said she highlights quiet periods in her monthly executive director report to the Board. If any Board member is approached by potential vendors, they must be referred to Contracts staff, and any violators would be excused from the procurement. Mr. Longbrake noted the importance of public perception.

Ms. Whitmarsh referred members to contact Ms. Haines with questions relating to travel ethics.

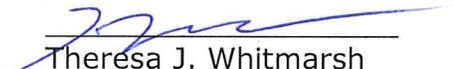
OTHER ITEMS

There was no further business to come before the Board, and the meeting adjourned at 1:50 p.m.



James L. McIntire
Board Chair

ATTEST



Theresa J. Whitmarsh
Executive Director