WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
July 15-17, 2014

The Washington State Investment Board met in open session at 1:07 p.m. in the Cascade Locks A Room at Skamania Lodge, in Stevenson, Washington.

Present:

Treasurer Jim McIntire, Chair
Marcie Frost, Vice Chair
Arlista Holman
Judy Kuschel
Bill Longbrake
George Masten
Stephen Miller
Richard Muhlebach
Bob Nakahara
Representative Timm Ormsby
David Nierenberg
Joel Sacks

Absent:

Kelly Fox
Senator Sharon Nelson
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
Kate Sandboe, Corporate Governance Officer
Shawna Killman, Audit Director
James Mackison, Director of Technology and Innovation
Chris Green, Risk Officer
Kristi Haines, Executive Assistant
Kristi Bromley, Administrative Assistant

Mary Lobdell, Attorney General's Office
Timothy Geithner, Warburg Pincus
Steve Lippman, Microsoft
Mindy Lubber, Ceres
Ken Mehlman, Kohlberg Kravis Roberts
Cindy Rose, Aberdeen Asset Management
Heidi Soumerai, Walden Asset Management
Arnold Wood, Martingale Asset Management

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

July 15

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

ADOPTION OF MINUTES – JUNE 19, 2014

Mr. Masten moved to adopt the June 19, 2014, meeting minutes. Representative Ormsby seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

STRATEGIC PLAN UPDATE

Ms. Whitmarsh noted two primary goals for the July planning session. The first goal is focused around helping new members and the Board gain a shared understanding of WSIB history, decisions made and lessons learned, and create a foundation for moving forward. The second goal surrounds decision making and includes lessons learned during the financial crisis, behavioral finance considerations, and a discussion around sustainable investing and climate risk.

Ms. Whitmarsh reported on the agency's strategic plan, built around value, support, and capacity initiatives, which rests on the foundation of a skillful Board.

For value initiatives, staff is on track with its multi-year project relating to what the WSIB does that contributes to performance, and improvements have been made to the data warehouse and risk management tools. Staff is implementing the modest change to the Commingled Trust Fund (CTF) asset allocation to increase real estate from 13 to 15 percent, by taking 2 percent from private equity. There is also work around third-party interest in investing in non-qualified assets, and staff is exploring possibilities within the Labor and Industries' (L&I) funds. Staff has also been implementing the 2014 asset class plans and researching ways to incorporate sustainability into a risk analysis.

For capacity initiatives, staff is continuing projects to look at CEM Benchmarking survey results to improve its comparisons with peer groups and benchmarking; is working to relocate staff to Seattle permanently, and has brought in an organizational consultant to assist with leadership development and succession planning. Projects completed to date include real estate governance and internal risk review, the book of record conversion to the custody bank, development of the 2015-2017 budget, and the investment officer compensation survey.

For support initiatives, staff continues to leverage the international reputation of the WSIB to support high profile corporate governance initiatives, including Focusing Capital on the Long Term and work with the Millstein Center for Corporate Governance at Columbia University. Ms. Whitmarsh reported on an initiative she's launched with the World Economic Forum to address the lack of women in private equity.

For Board initiatives, staff efforts have been to orient and educate new Board members and work with the incoming and outgoing Board Chair to involve the full Board in asset class planning.

Mr. Longbrake noted the dramatic progress in extending WSIB's research. He asked about staff's continuing efforts to reach out to stakeholder groups and with legislators. Ms. Whitmarsh said, while the project to "Tell the WSIB Story" was completed in a previous year, it continues to be a major focus and staff has refashioned the message and moved to more of an operational push to reach out to legislators and community groups. Mr. Longbrake suggested that staff update the Board with materials, a schedule, and principal areas of focus so members can be in touch with constituencies to further the effort. Chair McIntire proposed that staff work to develop plans with individual members on the best approach to reaching out to stakeholders and improve WSIB visibility during the upcoming budget session. Ms. Whitmarsh said she would appreciate members' involvement as there has been very little uptake from constituent groups when staff reached out.

EXECUTIVE DIRECTOR'S MONTHLY REPORT TO THE BOARD

Ms. Whitmarsh reported that Ms. Bromley was promoted to Assistant Investment Officer – Risk Management and Asset Allocation after 15 years of service as the CIO's administrative assistant. This past year, Ms. Bromley earned a Claritas investment certification with the CFA Institute and achieved her BA through Washington State University. Ms. Stacy Conway was promoted to the Investments Administrative Assistant to support Mr. Bruebaker. Mr. Bruebaker was appointed to a 5-year term with the Financial Accounting Foundation Board of Trustees, which is a very prestigious honor.

Chair McIntire thanked staff for the work involved in putting together the planning session. He noted the meeting is the most important thing the Board does during the year.

TANGIBLE ASSETS INVESTMENT RECOMMENDATION – RESERVOIR RESOURCE PARTNERS, L.P.

Ms. Will noted the Board approved an investment of up to $100 million, plus fees and expenses, in Reservoir Resource Partners TE, L.P., subject to continuing due diligence and final negotiation of terms and conditions on June 19, 2014. The Board's external legal counsel Proskauer Rose LLP is recommending the WSIB go into the taxable fund instead of the tax exempt fund approved in June. The Assistant Attorney General has opined that this change, while in substance over form is the exact same investment the Board approved, is not a change that staff has the authority to make. Thus, staff is asking the Board to approve an investment of up to $100 million, plus fees and expenses, in Reservoir Resource Partners, L.P., subject to continuing due diligence and final negotiation of terms and conditions.

> **Mr. Masten moved that the Board approve an investment of up to $100 million, plus fees and expenses, in Reservoir Resource Partners, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Representative Ormbsy seconded, and the motion carried unanimously.**

INVESTMENT BELIEFS OF THE COMMINGLED TRUST FUND

Mr. Bruebaker said he would provide a general background on the importance of investment beliefs and review the Board's Investment Beliefs for the CTF. Ms. Tucker

would then review the Labor and Industries Investment Beliefs noting the differences between the two.

Mr. Bruebaker noted sound investment beliefs help stay the course during times of market uncertainty. Without strongly held investment beliefs to help stay the course, it is too easy to change directions at just the wrong time. Investment beliefs are the fundamental assumptions or principles upon which an investment program and its policies are premised. The Board's CTF investment beliefs, adopted by the Board in July 2009, explain why the Board manages the CTF assets the way it does. Additionally, investment beliefs are generally "discovered" slowly over time by successive fiduciaries; facilitate discussions on how the funds should be managed and help ensure consistency and discipline; and provide guidance, or a framework, to staff, consultants, managers, and Board members. Mr. Bruebaker said that a statement of investment beliefs captures the essence of an investment philosophy. They are the foundation of the entire investment program and drive how time and energy are spent. Investment beliefs ensure alignment of understanding between the Board and staff and aid in good governance and communication. Mr. Bruebaker noted without firmly held beliefs, investors will question the soundness of the investment program every time it underperforms the market; and even sound beliefs will look foolish for short periods of time. From a strategic perspective, developing a set of investment beliefs makes sense as an organization has to identify where and how it can add value to the investment process.

Mr. Bruebaker highlighted some of the challenges associated with developing a set of investment beliefs, including the difficulty in identifying one's beliefs in the first place and getting agreement among Board members, as well as distinguishing between desired beliefs and those actually held by the Board. In addition, human behavior is highly influenced by recent events and is driven more by loss than gains; sound beliefs are often counter-intuitive. Investment beliefs are only truly tested during crises.

Former State Representative Helen Sommers, after almost a year of discussions surrounding investment beliefs remarked, "Now that we've build this perspective and history, the challenge is to ensure its succession with future Boards." Mr. Bruebaker said the day's discussion was an important step designed to reinforce the foundation upon which the WSIB builds its investment portfolios and helps ensure its succession with future Boards.

[Mr. Miller arrived at 2:05 p.m.]

Mr. Bruebaker reviewed the Board's investment beliefs for the CTF, which focus on the mission of the fund and its long-term time horizon, risk, asset allocation strategy, active management, and performance measurement.

Discussion ensued regarding the thoughtful, considered approach the Board undertook in developing its investment beliefs and the solid culture they help maintain, and regarding the excess return a diversified portfolio provides relative to investment in passive equity. Mr. Bruebaker noted the WSIB's 10-year investment performance is in the top decile of public pension plans within the country. Such performance would not have been possible without active management and asset class diversification. The Board also discussed how important the investment beliefs are in helping it to stay the course and maintain its investment and governance discipline.

INVESTMENT BELIEFS OF THE LABOR AND INDUSTRIES' (L&I) FUNDS
Ms. Tucker noted that she would review the Board-adopted investment beliefs for the L&I funds, specifically addressing where the investment beliefs for the L&I funds differ from those of the CTF. The L&I investment beliefs, adopted by the Board in June 2011, were developed in cooperation among the WSIB, L&I, and Conning, the Board's consultant for the industrial insurance portfolios. She noted that because the investments are managed to back insurance operations as opposed to pension liabilities, there are differences in objectives and risk tolerances. The WSIB manages $14.4 billion on behalf of L&I, which makes L&I the WSIB's largest stakeholder after the retirement funds. Whereas the CTF's legislative mandate is to maximize return at a prudent level of risk, Washington's statute states that the WSIB shall establish investment policies for L&I designed to attempt to limit fluctuations in industrial insurance premiums. Accordingly, the mandate to maximize return at a prudent level of risk is subject to the first preference to maintain stable premiums. Another area of difference between the investment beliefs for the L&I portfolios and the CTF are those related to asset allocation strategy. L&I's asset allocation is considerably different than the CTF and reflects its objectives, risk tolerance, and unique circumstances.

Mr. Sacks noted the importance of a predictable income stream to L&I, which allows L&I to reduce the premiums it collects from employers. L&I and WSIB staff are beginning to look at whether other asset classes can offer the predictable income streams L&I needs in a manner consistent with the long-term nature of its liabilities.

[The Board recessed at 3:04 p.m., and reconvened in open session at 3:19 p.m.]

HISTORY OF KEY BOARD EVENTS
Mr. Bruebaker reviewed the structure of the state's investments before and after the creation of the WSIB. The WSIB's initial structure was somewhat similar to what it is today, although there have been a number of changes in the ensuing 33 years. The Board now has ten voting members, where it initially had nine. In addition, assets under management have grown from $4 billion to in excess of $100 billion, an increase of 2,475 percent.

Mr. Bruebaker reviewed key events and dates in the history of the WSIB. He noted the Board's first commitments to private equity and real estate operating companies, and strategies the Board employs to this day which have been very successful. Other key events included the authority to commingle the retirement funds, which was granted in 1982; changes in asset allocation over the years; determination to invest in U.S. equities passively; elimination of the home country bias in public equity; transfer of the Deferred Compensation Program to the WSIB; creation of the hybrid defined benefit/defined contribution Plan 3s; creation of the internally managed Innovation Portfolio and Real Estate Emerging Markets Fund of Fund Program, as well as the Real Estate Co-Investment Program; and continued refinement and improvement of the investment options within the defined contribution plans. Mr. Bruebaker also reviewed key staff changes over the years and growth of assets under management.

Ms. Whitmarsh noted the importance of the decisions the Board has made over its history, both strategies it decided to pursue, as well as those it decided not to pursue. Discussion ensued regarding the political climate of the early 1980s as well as the unique structure of the Board and the state's pension system, both of which have served the state, beneficiaries, and tax payers well.

HISTORY OF THE PUBLIC EQUITY PROGRAM AND ANNUAL PLAN UPDATE

Mr. Paroian noted that his presentation would cover the role of public equity in the CTF, provide a brief history of the public equity program, review lessons learned, provide an overview of the current portfolio and market outlook, and provide an update on the public equity 2014 annual plan. Public equity provides important benefits to the overall CTF portfolio. It has the second highest long-term expected return of all the asset classes, behind private equity, but maintains liquidity. There is also virtually unlimited capacity for investing in public equity if done so passively, an important option for a fund the size of the CTF. Public equity also provides portfolio diversification, with low correlation to fixed income and tangible assets, as well as capital appreciation and inflation protection. Additionally, dividend yield provides some current income for the portfolio. He reviewed the growth of total assets under management within public equity, asset allocation changes within the CTF showing the development of the program, and provided a brief overview of key dates within the history of the public equity program. Mr. Paroian reviewed the evolution of structure of the public equity program, which has been streamlined over time, and reviewed the current mandates for the global public equity program, as well as lessons learned. He reviewed the public equity assets under management, accounts, and active country and sector weights.

Mr. Paroian provided a market outlook for 2014, noting that developed markets are at higher valuations than at the beginning 2013 and while a slow growth recovery seems to be most likely, potential problems are numerous. He reviewed performance of the public equity CTF portfolio, noting outperformance for the 1-, 3-, and 5-year periods.

Mr. Paroian provide an update on the public equity 2014 annual plan, including manager monitoring and risk management, rebid of passive contracts, active emerging markets manager search, and the research of potential improvements in the Target Date Funds.

Chair McIntire announced the Board would go into executive session 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 executive session was expected to last until about 5:00 p.m., at which time the Board would recess until 6:30 p.m.

[The Board went into executive session at 4:22 p.m.]

HISTORY OF THE REAL ESTATE PROGRAM AND ANNUAL PLAN UPDATE

[Ms. Whitmarsh and Messrs. Bruebaker and Ruggels left at 4:38 p.m.]
[Mr. Nakahara left at 4:45 p.m.]
[Mr. Nierenberg left at 5:00 p.m.]
[The Board reconvened in open session at 5:07 p.m.]
[The Board recessed at 5:09 p.m., and reconvened in open session at 6:30 p.m.]

DINNER PRESENTATION

Financial Crises

Mr. Geithner shared his experiences throughout the financial crisis as the U.S. Secretary of the Treasury, and thoughts on how variables could affect the economy going forward.

[The Board recessed at 8:40 p.m. on July 15, and reconvened in open session at 8:40 a.m.]

July 16, 2014

Chair McIntire called the meeting to order.

[Ms. Lobdell was not in attendance.]

HISTORY OF THE FIXED INCOME PROGRAM, MID-YEAR REVIEW, AND MARKET OUTLOOK

Mr. Kennett said the role of fixed income in the retirement fund is to provide diversification and liquidity to a well-balanced portfolio. While fiscal year 2009 was the worst performance year for the CTF, 2009 had the best calendar year returns for the fixed income unit, showing the importance of diversification. He reviewed the decision-making framework for fixed income investments: macroeconomics; market and industry fundamentals, company analysis, security valuations, and judgment. The program consists of 11 portfolios managed by 9 staff within the fixed income unit. He provided a brief history of the fixed income program, noting the growth of assets under management, staff, and fixed income sectors in which the funds are invested, as well as the change in the percentage of the CTF invested in fixed income. Mr. Kennett noted the WSIB entered emerging markets within fixed income earlier than most funds—a decision that has been beneficial for the Board. Not investing in certain things has also helped performance over the years: sub-prime mortgages, and auto and airline companies.

Mr. Kennett provided a mid-year review noting that slowing global growth, record-setting equity markets, and falling interest rates in the U.S. and Europe were the top market stories in the first half of 2014. Geopolitical risks are higher than they have been but the risks do not appear to be reflected in most markets. Growth in global trade has trailed growth in global gross domestic product (GDP) for the last 2 calendar years for the first time since the early 1980s.

[Mr. Nakahara left at 9:00 a.m.]

The U.S. economy shrank at a 2.9 percent quarter-over-quarter annualized rate in the first quarter. Mr. Kennett expects second quarter growth to be firmly positive. In the U.S., pre-crisis employment levels have been surpassed but overall the recovery has been weak. The international environment is not as favorable as it used to be and countries dependent on commodities have not done very well. China's growth numbers are down but have stabilized. High levels of local government debt in China remain a major risk.

Mr. Kennett reviewed the global GDP forecast for 2014 and 2015; the Federal Open Market Committee's summary of economic projections for 2014, 2015, 2016, and the longer run; and a demographic based view of future growth. Discussion ensued regarding the education index portrayed in the demographic view and the importance of education to a country's future.

Mr. Kennett reviewed risks, which included China's growth prospects, rising geopolitical risks, policy uncertainty, rising risk of deflation in Europe, protectionism, and social instability due to rising income inequality. He reviewed the market environment for bonds noting his belief that interest rates should head higher and reviewed 10-year government bond yields, investment grade spreads, and yield curve changes over the last 12 months.

Mr. Kennett reviewed the goals and performance of the retirement and L&I's fixed income portfolios. The portfolios outperformed over the 1-, 5-, and 10-year time periods.

Discussion ensued regarding European and Australian bonds, as well as investment strategy, with Mr. Kennett noting that the portfolios have higher credit allocations than the indices and lower interest rate risk. The portfolios are also underweight mortgages. Emerging markets are still attractive, although it is important to be selective. Further discussion ensued regarding India and China.

[The Board recessed at 9:58 a.m., and reconvened in open session at 10:19 a.m.]
[Mr. Nakahara and Ms. Lobdell returned at 10:19 a.m.]

Chair McIntire announced the Board would go into executive session 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 executive session was expected to last until about 12:00 p.m., at which time the Board would reconvene in open session and then recess until about 1:20 p.m.

[The Board went into executive session at 10:21 a.m.]

HISTORY OF THE TANGIBLE ASSETS PROGRAM AND ANNUAL PLAN UPDATE
HISTORY OF THE PRIVATE EQUITY PROGRAM AND ANNUAL PLAN UPDATE

[The Board concluded its executive session at 12:20 p.m. and took a recess. It reconvened in open session at 1:29 p.m.]
[Mr. Longbrake returned at 1:33 p.m.]
[Mr. Miller returned at 1:37 p.m.]

REBALANCING INVESTMENT PORTFOLIOS
Ms. Tucker noted that rebalancing of investment portfolios was one of the important asset allocation activities. The Board is responsible for setting investment policy, the foundation of which is the strategic asset allocation that the Board sets incorporating a number of assumptions. The Board, through its asset allocation review process, ultimately selects the target mix of assets that are expected to best meet the objectives of the fund over time. Over the long term, the expectation is that higher risk asset classes will have higher returns. She noted that, if the WSIB simply bought and held our portfolio and had no cash flow requirements, the higher risk assets would eventually meaningfully cause the portfolio to take on more risk as those assets grew faster than other investments. Rebalancing is the activity that brings deviations from target allocations closer to target. Doing so brings the portfolio back to the expected and accepted level of risk and return assumed when the strategy was approved. In this way, rebalancing is a risk management tool in that it encourages the WSIB to buy low and sell high. Rebalancing supports investment discipline by focusing on target allocations. It also supports diversification by providing a mechanism to stop top-performing asset classes from taking over the portfolio.

Ms. Tucker reviewed the different rebalancing approaches: the tolerance band approach, which is dominant within the investment industry and is the approach the WSIB employs, the calendar approach, active rebalancing, and portfolio overlay approach.

Ms. Tucker noted the Board's investment belief, stating that asset classes are generally subject to reversion to the mean, supports the Board's rebalancing approach. Ms. Tucker reviewed the CTF asset allocation policy, which, in addition to setting the strategic targets and ranges, addresses rebalancing activities. The WSIB engages in rebalancing when deviations from targets drift outside of the established ranges. Day-to-day rebalancing activities are driven by cash flow management and the need to raise or invest cash flow will be the continuous rebalancing factor. Infrequent rebalancing activities are driven by changes to strategic asset allocation, as well as significant equity market moves.

Ms. Tucker reviewed factors to consider when evaluating rebalancing approaches. Costs must be considered, which include transaction, monitoring, and execution costs. Portfolio and market conditions are other factors to consider, including deviation from target, market momentum, and risk. Willingness and ability to rebalance must also be considered. These two factors are dominant in times of stress and, in times of crisis, as easy as it sounds to move assets from the better-performing asset class to the worse-performing one, it is not easy.

Ms. Tucker concluded noting that rebalancing is essentially a risk management tool that works by trimming the highest-performing and often riskiest portfolio and investing in a less risky asset class. The purpose is to maintain the Board's approved risk/reward profile. Staff continuously manages asset allocations through cash flows, which can vary from negative to positive within the CTF itself. The WSIB uses a tolerance band approach, which leads to infrequent, larger rebalancing activities. This is probably a superior approach because it reduces costs and allows for market momentum. Finally, times of stress will likely cause major deviations from target allocations. This is when rebalancing is hardest to implement because of the fear of what is to come.

BEHAVIORAL FINANCE

Mr. Wood gave a brief introduction of himself and his presentation on behavioral finance including, what makes us who we are, how we think, and where the rationality for the choices we make comes from. He said rationality assumes that we update new information, re-assess risk probabilities, and then select alternatives sensibly. He said that people are not rational, and behavioral sources of systemic errors in judgment come from: 1) Making predictions, 2) peer pressure, 3) risk perception, and 4) principals and agents. He discussed how confidence, expectations, intuition, confirmation, representations, predictions, perceptions, loss aversion, cognitive dissidence, the structure of managers and client relationships, and committee composition can influence decision making.

He said it is important to rate and evaluate the amount of time boards spend on tasks, and to spend the most time on unknowable, important issues. He suggested that board chairs should: prioritize an agenda mindful of time allotted; engender diversity members; assign responsibilities for meeting preparation; use probabilistic odds for possible solutions; invoke secret ballot on polarizing issues; keep a thorough history of decisions; develop a "what might go wrong" culture; require annual report cards by members; and maintain impartiality, fairness, and focus. Ms. Whitmarsh noted that many of these suggestions have been incorporated into process and the Board annually reviews how it spends its meeting time.

[The Board recessed at 2:47 p.m., and reconvened in open session at 3:08 p.m.]

The Board split into two groups to review case studies on asset allocation and investment managers. The Board reconvened as a group to discuss each case study. Relating to the asset allocation case study, Mr. Wood noted the importance of governance policies, the powerful WSIB staff, and how ahead of its peers the WSIB is in the governance area. He said WSIB has a culture that allows people to ask questions. Mr. Masten noted that it could be because WSIB's mandate is solely on investing, and not administering the funds. Mr. Nierenberg commented on the linkage between WSIB's ethics and investment policy. Relating to the investment manager case study, discussion surrounded the timing on manager terminations, key person risk, performance, and the importance placed on qualitative versus quantitative relationship dynamics. Mr. Wood asked how fees are considered. Mr. Bruebaker said one of the stated investment beliefs surrounds management selection and costs. The WSIB knows it will pay fees and it pays less than counterparts as it is very diligent about fee negotiations, but it is more about the net return.

[The Board recessed at 5:10 p.m., and reconvened in open session at 6:30 p.m.]

DINNER PRESENTATION
Sustainability
Mr. Ken Mehlman gave a presentation on how KKR has integrated sustainability efforts into their business processes and within communities.

[Ms. Kuschel left at 8:45 p.m.]
[The Board recessed at 8:45 p.m. on July 16, and reconvened in open session at 8:34 a.m.]

July 17

Chair McIntire called the meeting to order at 8:34 a.m.

SUSTAINABILITY IN A RISK FRAMEWORK
Panel Discussion
Ms. Whitmarsh introduced the Sustainability Panelists Mindy Lubber, Ceres; Cindy Rose, Aberdeen Asset Management; Heidi Soumerai, Walden Asset Management; and Steve Lippman, Microsoft.

Chair McIntire said the issues around climate change are significant and there are a number of challenges. His goal is to try to understand how the Board thinks about climate change and sustainability in risk and risk analysis. Staff has asked for help from the partners that manage WSIB funds.

Ms. Lubber introduced the discussion on climate risk and what people and the investment community are doing to make a difference. She said the terms sustainability and ESG (environmental, social, and governance) are interchangeable. In 2014, integrating sustainability into the capital markets is common place but nowhere near having made sufficient progress. She said sustainability needs to be integrated into investment analysis—climate, water, and supply chain risks, in balance with other risks, that meet the current needs of beneficiaries to achieve competitive records. Ms. Lubber said that 89 percent of studies show that companies with high sustainability records outperform. Companies are changing their standards of best practices and benchmarks to see how they are doing with governance issues, such as sustainability. Investors are expecting

CEOs to set goals around sustainability and be strong with disclosure, so data is getting better every year so that integrated reporting can be achieved in the future and sustainability risks can be reported the same as other financial risks. Ms. Lubber said there is an investor network on climate risk developing standards of best practice that examine financial and fiduciaries issues to improve performance, improve companies, and engage in conversation.

Ms. Rose discussed Aberdeen's bottom-up investment style. She said that sustainability goes together with long termism. She said that investors want statements of belief and many companies are taking the same road that WSIB is on today with education and engagement.

Ms. Soumerai discussed how Walden's management style impacts its investments. She noted that Walden is the sustainability division for Boston Trust. When Walden does its due diligence, the financial and sustainability analysis are done simultaneously. Before recommending a company for the portfolio, Walden does a materiality matrix and among the items discussed are the negatives (risks) or positive ways that sustainability impacts the investment. Ms. Soumerai noted that sustainability issues can indicate issues with management such as oversight, labor practices, and within the supply chain.

Mr. Lippman said that Microsoft has a citizenship and public affairs team that meets twice a year. Proxy voting and quality reporting are discussed at most meetings, as investors and stakeholders often ask about these topics. He said Microsoft started a carbon neutrality commitment in 2013, and has met that commitment over the past 18 months.

Ms. Lubber said the best strategy for investors to engage with investors is truly about collaboration and partnership. While there has been a push to divest, she noted that divestment may not be the most effective option because investors give up their rights by losing their voice within companies. Ms. Soumerai said that Walden files resolutions on behalf of the WSIB and could present on those efforts.

Chair McIntire said his interest surrounds disclosures and standards around that. Ms. Rose cautioned that measurements tend to focus on one thing and investors must take a holistic view. For example, measuring carbon on a portfolio does not tell you about the individuality of holdings. Investors should require managers to perform due diligence on portfolio holdings and report back, regardless of the asset class.

A discussion ensued regarding where sustainability issues are addressed in annual reports and integrated reporting. Mr. Nierenberg pointed out that WSIB's primary mission is to make money for beneficiaries, and he would not want to see any resources diverted for anything other than that. Keeping that in mind, he suggested the WSIB look at public policy, what Washington State is doing as an example, get engaged on disclosure requirements, use KKR as a benchmark and find out what other managers are doing, examine options for the passive portfolio, and look at what others are doing in a larger context and leverage the work of other organizations. Ms. Lubber said the WSIB should study, analyze, and determine how to manage sustainability as it would any other risk. It should address the issue in its proxy voting guidelines and have annual presentations.

Chair McIntire raised the question of what degree the Board sees use of investing in alternative energies as a diversification tool, how sustainability fits into evaluating a

portfolio and the risk in evolving technology, and how much time and money companies might put into this area.

[The Board recessed at 10:30 a.m., and reconvened in open session at 10:44 a.m.]
[Ms. Lobdell arrived at 10:44 a.m.]
[Representative Ormsby arrived at 10:50 a.m.]

A discussed ensued about renewable energy, large companies' plays and successes, pension fund efforts, what managers are doing, and public policy.

[The Board recessed at 10:29 a.m., and reconvened in open session at 10:45 a.m.]

Asset Class Sustainability Efforts Panel Discussion

Private Equity

Mr. Ruggels noted the presentation from Mr. Mehlman of KKR and said that KKR has established a high standard relative to the amount of resources dedicated to sustainability that other private equity firms should aspire to, although that does not mean other private equity firms are not focused on sustainability issues. He said that, in general, European firms are way ahead of U.S. partners. He said 13 WSIB partners are signatories to the United Nations (UN) principles of responsible investment and many of those are European. The Private Equity Growth Capital Council has developed guidelines for responsible investing, similar to those of the UN. Eleven of WSIB's private equity partners are signatories to that, with a bit of overlapping. He noted KKR and TPG are on signatories on both. He said private equity partners are focused in this area to varying degrees. He said staff has not looked at sustainability efforts as a screening selection, but certainly sustainability issues could be looked at during due diligence. WSIB is looking for good stewards of capital, and how partners behave reflects upon us. General partners will deliver on what limited partners are interested in.

Public Equity

Mr. Paroian said the majority of public equity is passively managed but certainly every active manager has a future focus. Staff spends a lot of time talking with existing and potential managers inquiring about company engagements, and how they address a variety of risks including assessing sustainability and climate risk. He noted a new subscription tool that drills down into holdings to look at carbon footprints, supply chain, etc., that helps to generate a conversation with the manager about what is noticed in reporting and what steps are being taken related to risks.

Fixed Income

Mr. Kennett showed a video on the efforts of the World Bank to help poverty stricken areas of the world and efforts within sustainability. He said identifying sustainability risks is not as easy as it may seem.

Tangible Assets

Ms. Will said that, within tangible assets, there is a 20-year timeline to get your money back out of the investment. In looking at sustainability risks, she looks at whether or not WSIB will earn back its investment in that time frame and are there risks that would not allow the investment to pay out during that time frame. She said there are many other risks to be considered alongside of sustainability issues.

Real Estate

Mr. Draper said the real estate partners take the subject of sustainability very seriously. Their focus is on economic benefit or return enhancement. Mr. Draper addressed three areas with regard to sustainability: what staff is doing, what the obstacles are, and what is still being researched. He said sustainability is an integral part of the strategic, tactical, and risk consideration thought process of the real estate team. Staff seeks investments in things that will always be relevant. Strategic examples are urbanization or re-urbanization and affordable housing. Tactical examples are cost reduction around energy or water. Risks examples surround the cost of sustainable efforts, sea level projections, retrofitting costs, LEED certification, and solar power.

[Mr. Nakahara left at 11:34 a.m.]

Sustainability Investment Belief Discussion

Chair McIntire presented a draft investment belief for the Board's consideration that classified climate change as a risk that, if properly disclosed by companies and investment partners, could be incorporated into the due diligence and risk assessment process. A discussion ensued about ensuring the Board keeps the focus on the risk concerns as fiduciaries, the global nature of the sustainability challenge, the resource requirements to move forward with any implementation of an investment belief, climate riks disclosure challenges, stakeholder communications and politics surrounding the topic, and whether sustainability can be or is already addressed within WSIB's Enterprise Risk Management process.

Chair McIntire said he would like the Board to spend time at its September meeting to further discuss the draft investment belief, and have staff spend time thinking about what they may do differently as a result of adopting the investment belief.

OTHER ITEMS

There were no further items to come before the Board, and the meeting adjourned at 12:13 p.m.

James L. McIntire
Chair

ATTEST

Theresa J. Whitmarsh
Executive Director