WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
November 19, 2015

The Washington State Investment Board met in open session at 9:36 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Marcie Frost, Chair Arlista Holman Judy Kuschel Bill Longbrake George Masten Treasurer Jim McIntire Richard Muhlebach Bob Nakahara David Nierenberg (via teleconference) Representative Timm Ormsby Joel Sacks Jeff Seely
Absent:	Kelly Fox, Vice Chair Senator Mike Hewitt Stephen Miller
Also Present:	Theresa Whitmarsh, Executive Director Gary Bruebaker, Chief Investment Officer Ian Cameron, Chief Operating Officer Chris Phillips, 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 John Lynch – Contracts and Public Records Manager Beth Vandehey – Risk and Compliance Director Stacy Conway, Administrative Assistant Mary Lobdell, Attorney General's Office Lisa Won, Office of the State Treasurer

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

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

ADOPTION OF THE SEPTEMBER 17, 2015, MINUTES

Ms. Holman moved to adopt the September 17, 2015, minutes. Mr. Masten seconded, and the motion carried unanimously.

PUBLIC COMMENT
Bourtai Hargrove, Rhonda Hunter, Beverly Bassett, Patricia Holm, Dusty Rhodes, Mary Abramson, and Donna Albert shared with the Board their concerns related to climate change and requested the Board divest of its holdings in fossil fuels.

EXECUTIVE DIRECTOR'S REPORT
Ms. Whitmarsh introduced new staff members Chris Phillips and Ian Cameron, giving a brief description of their backgrounds.

PRIVATE MARKETS COMMITTEE REPORT
Mr. Masten reported that the Private Markets Committee met on November 5 to consider one tangible assets recommendation and one proposed policy revision.

Global Infrastructure Partners (GIP) Fund III, L.P. and Separately Managed Account

Mr. Masten moved, on behalf of the Private Markets Committee, that the Board invest up to $500 million, plus fees and expenses, in Global Infrastructure Partners Fund III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Further, that the Board invest up to $500 million, plus fees and expenses, in a Separately Managed Account, an entity to be created for WSIB infrastructure investments, managed by Global Infrastructure Partners, LLC, the legal form of which will be determined by WSIB counsel, subject to continuing due diligence and final negotiation of terms and conditions. Chair Frost seconded the motion.

He said the fund will target mid-stream energy and transportation assets in North America, Europe, and developed markets of Latin America and Asia. If approved, this will be the second time the WSIB has invested with GIP since 2012. The Separately Managed Account will be managed by GIP and structured as a fund-of-one, designed to have longer holding periods than GIP III investments.

The recommendation is based on the firm's unique operational focus; proven, stable team with deep sector expertise; experience with industrial joint ventures; rigorous, inclusive investment process; patient investing with downside protection focus; and expert advisory panel, the Separately Managed Account's unique longer-duration, income-focused assets, and customized governance provisions, and other factors relevant to the recommendation.

The above motion carried unanimously.

Real Estate Investment Program Policy 2.10.600 Revision
Mr. Masten explained that Board policies are required to be reviewed every 3 years to ensure they remain relevant and appropriate. The Committee reviewed the proposed technical changes to the Real Estate Investment Program Policy 2.10.600, intended to provide consistency in structure and format.

> **Mr. Masten moved, on behalf of the Private Markets Committee, that the Board approve the proposed revisions to the Real Estate Investment Program Policy 2.10.600. Treasurer McIntire seconded, and the motion carried unanimously.**

ADMINISTRATIVE COMMITTEE REPORT
Chair Frost reported the Administrative Committee met earlier this morning and had three action items and several information items for the Board.

Public Records Policy Exemption Review and Policy 2.00.250 Proposed Revision
Mr. Lynch introduced himself and said the proposed revision is in response to a motion made by one of the members at the October 20, 2015, Sunshine Committee meeting which would greatly limit our public records disclosure exemption under the law. He said the WSIB was able to present a persuasive argument that WSIB's exemption was critical and the motion was withdrawn; however, during discussions at the Sunshine Committee meeting there were questions about WSIB's policy, specifically about a paragraph that had been removed regarding internal rates of return for private equity. Mr. Lynch explained that the language has been reinserted into the revision presented today, clarifying language has been added to a paragraph in the policy that was construed by a member of the Sunshine Committee as affording the WSIB absolute discretion of what it would disclose or withhold from disclosure, and another line has been added, at the suggestion of the Attorney General's office, about the buy and sell information from a particular investment manager.

> **On behalf of the Administrative Committee, Chair Frost moved that the Board adopt the proposed technical changes to the Public Records Policy 2.00.250. Treasurer McIntire seconded, and the motion carried unanimously.**

3-Year Policy Review Technical Changes
Mr. Bruebaker introduced himself and said the revisions to Policy 1.10.100 are formatting and clarification only; the revisions to Policy 1.10.200 are formatting and clerical, as well as the addition and clarification of roles and the process for reporting updates; the revisions to Policy 2.05.600 are formatting changes; and the revisions to Policy 2.10.800 are formatting; removal of language referring to the program being new; the addition of a statement of care to be consistent with other program policies; the addition of language regarding new ideas to make the policy consistent with the specific language used in the original approval of the program; and the addition of a section about Board responsibilities to clarify roles.

> **Chair Frost moved that the Board approve the proposed technical changes to Board Policies 1.10.100, 1.10.200, 2.05.600, and 2.10.800. Mr. Sacks seconded, and the motion carried unanimously.**

Quarterly Budget Update
Chair Frost said Mr. Cameron reported that the appropriated budget has a projected balance of $605,000, about a 3 percent savings, and the non-appropriated budget has a projected balance of $74.9 million, which represents about a 19.4 percent savings.

Assistant Attorney General's Report
Chair Frost reported that the Administrative Committee received an update from Assistant Attorney General, Ms. Lobdell, regarding a court ruling relating to one of the Board's real estate investments.

GUARANTEED EDUCATION TUITION (GET) UPDATE
Treasurer McIntire explained that during the last legislative session there was debate about whether or not to lower tuition at the universities in Washington and what the impact would be on the GET program. With the Legislature voting to reduce tuitions and instructing the GET Committee to freeze the payout value of the GET program at its value prior to the reduction in tuition, the GET Committee was tasked to figure out how to avoid negative impacts to existing GET holders and complete a feasibility study of the creation of a 592 savings plan. He detailed the actions the GET Committee has taken to date in response to the legislative decision, including provisions for withdrawals, options under consideration for a 529 savings plan, and addressing current liquidity needs. Treasurer McIntire relayed that the current estimate by the Office of the State Actuary (OSA) is that the GET program is funded at 145 percent. The increase in funded status was primarily driven by the 25 percent reductions in tuition, which anticipates several years of no increase in the payout value.

Ms. Holman asked about the sustainability of the program without more contributions coming in. Treasurer McIntire responded that the program is adequately funded and the risk of the GET Committee not being able to meet its full duties is low. He shared some of the challenges of accurately pricing the GET units going forward.

Executive Director's Compensation
Non-Voting Board Member Discussion
Chair Frost stated that two additional items, the Executive Director's compensation and non-voting Board member candidates, were discussed in executive session at the Administrative Committee, and they will be discussed in executive session later in today's meeting.

2016 Recommended Board Education List
Chair Frost said the Administrative Committee reviewed the 2016 Recommended Board Member Education List, and attendance at Pacific Pension & Investment Institute (PPI) and International Centre for Pension Management (ICPM) conferences were added to the list. She said the list was not exhaustive, and Board members may pursue other opportunities with prior approval.

> **Chair Frost moved that the Board approve the 2016 Recommended Board Education List. Mr. Sacks seconded, and the motion carried unanimously.**

EDUCATION SESSION

Insights into the Non-Financial Analysis of Real Estate Investments

Mr. Muhlebach explained that when a person or fund invests in real estate often the analysis is focused primarily on the financial returns and the expected appreciation of the property. Although that analysis is critical in the decision, it is not the most important analysis to make when buying properties. He said buyers of real estate are buying a business, and each property needs to be analyzed just as any other business would be, giving comparison examples. He said his presentation will focus on some of the non-financial issues in evaluating real estate investments, including issues to be considered when investing in real estate in other countries.

Mr. Muhlebach discussed considerations for retail, office, and medical office properties, including the importance of location, demographics, trends, and associated risks, as well as important issues to think about when investing outside of the U.S. Many practices and laws do not exist in other countries, such as high construction standards, zoning regulations, title insurance, landlord tenant laws, state regulations to protect the public, licensing requirements, educated professionals, code of ethics, and emergency preparedness.

Mr. Muhlebach disclosed that he is personally involved in real estate operating company (REOC)-profile companies and shared some of the reasons that the REOC structure is desirable and why real estate development and investment company owners might sell their companies. He said there are several opportunities for real estate investments to be assets to their communities and neighborhoods, and discussed sustainability practices and the importance of maintaining properties and attracting good tenants.
Mr. Muhlebach said he has visited some of the residential and commercial properties in the WSIB portfolio, and the Board and staff can all be very proud of them. They are well-maintained and definitely assets to their communities and neighborhoods.

Discussion ensued around the things the Board can do in terms of exercising its due diligence, the necessity to ask tough questions of our partners and staff, efficiencies of medical offices and practices and changes in their operations, the trend of people working from home and the effect on residential and office space needs, and other considerations in analysis of real estate investments.

[The Board took a recess at 11:14 a.m. and reconvened in open session at 11:31 a.m.]

Key Risk Analysis Update – Forecast Follow-up from July Planning Session

Ms. Vandehey introduced herself and said that at the July 2015 Board meeting, the Board participated in an exercise examining the Key Risk Indicators and the Risk Appetite Statements, resulting in updates to the lists made by the WSIB's Enterprise Risk Management (ERM) team. The expanded list is now used during the semi-annual key risk analysis forecast. Although there were no changes made to the Risk Appetite Statements by the Board, the ERM team has been reviewing them, with the goal of presentation to the March 2016 Audit Committee meeting and approval at the subsequent Board meeting.

EDUCATION SESSION

State Actuary Update

Ms. Won gave an update on work done by the Office of the State Actuary (OSA), explaining that OSA is an independent legislative branch agency that provides key services, including calculating the pension contribution rates; preparing and certifying several actuarial reports, including the annual valuations of all the retirement plans; completing experience studies, such as the demographic experience study performed every 6 years; producing actuarial fiscal notes on pension bills; and every 2 years producing a report on financial condition, along with recommendations on economic assumptions for pension funding. She provided an overview of the clients served by OSA under the legislative branch, referring to the OSA website for more details, and shared an example of the interactive reports available on the OSA website.

Ms. Won discussed the financial condition, summary of findings, and funded status, stating that the funded status has declined since the last report; however, the underfunded retirement plans (e.g., PERS1 and TERS1) have a plan in place that targets full funding. She said the contributions required under the funding policy have been made, but affordability measures have experienced some volatility, and financial risks have improved since the last report on financial condition, due to changes to benefit provisions for new hires, the favorable court ruling regarding gain sharing and Uniform Cost of Living Adjustment (UCOLA), and the adoption of updated assumptions, which come with short-term costs but long-term savings.

Ms. Won described the two key reasons, apart from the change in methodology, for the decline in funded status since the last report two years ago: the phase in of the lower investment return assumption from 7.9 percent to 7.8 percent and the recognition of longer life spans. Ms. Won described a change in the reporting measure for the funded status which brings the method into alignment with the Governmental Accounting Standards Board required use of the Entry Age Normal (EAN) Actuarial Cost Method when reporting funded status for financial reporting. The OSA's reason for changing the methodology was to reduce the number of methodologies being reported. Discussion ensued around the difference between the Projected Unit Credit (PUC) method, which was previously used to estimate funded status, and the EAN method and the effect of the different methods on the funded status.

Ms. Won said Washington is listed as seventh in the nation based on a Pew Research Center report; last year Washington ranked third or fourth, and the majority of the reason for the decline is that Washington is out in front in recognizing longer life spans and mortality improvements. As other states come along, she thinks Washington will rise back up.

Discussion ensued about public perception of Washington's ranking, the PEW method of analysis, and the inconsistent results due to different assumptions, including mortality and return assumptions.

Ms. Won discussed the funding status of the retirement plans and the requirement of additional employer contributions to PERS1 and TRS1 plans to bring them to fully-funded status in 2027 for PERS1 and 2025 for TRS1; the adequacy and affordability of contributions; the effect of adopting the longer life span assumptions; the historical contributions made for PERS, SERS, and TRS; affordability; the growth of contributions as a percent of pay and as a percent of the state budget; and the effect of the asset smoothing method on stability.

Discussion ensued around the calculation of required contributions under the funding policy in the actuarial valuation.

Ms. Won reported that OSA completed its report on long-term economic assumptions over the summer and from that report determined all current assumptions are reasonable; however, OSA had two assumption change recommendations that were not adopted: a lower long-term rate of return and a higher system growth rate for the teachers' system, resulting from an analysis regarding the McCleary decision and its impact. She said all the supporting data is available in a comprehensive report on the OSA website.

Ms. Won said, although the funded status did drop our plans are still among the best funded systems nationally, pension plans require consistent stable adequate funding to remain affordable over the long term.

Ms. Won shared highlights of work done by OSA on the GET program and the Higher Education Supplemental Retirement Plan (HESRP). She discussed the status and key assumptions and methods in the valuation for GET and said if the program is permanently closed or terminated, the WSIB may change the program asset allocation, which could change the program's funded status.

Ms. Won explained that the HESRP is a supplemental defined benefit plan that provides a minimum retirement benefit to insulate individuals from retiring at a time when the market is low, and the institutions have funded the supplemental plan on a pay as you go basis. She discussed current legislation and work involved in taking on the actuarial assignment, as well as setting of funding policy and future contribution rates.

Discussion ensued around the HESRP contribution rates; benefit payouts under the plan; structure of the program; projected employee contribution rate versus employer contribution rates for all of the retirement plans, and how much of the increase is for the funding of Plan 1 liabilities; effect of investment rate of return assumptions; mortality assumptions; the effect of outperformance of investment returns on future contribution rates; the significance of new mortality assumptions; current experienced retirement age trends; calculation of the effect of pending litigation; and the process of setting contribution rates.

EDUCATION REPORTS

Council of Institutional Investors (CII) Fall Meeting

Mr. Longbrake said the CII meeting was very informative and that Ms. Whitmarsh did a very able job moderating a panel discussion on long-term investing. He discussed shareholder activism, women on public company boards, other pension plans' proxy voting standards, proxy access rules, corporate stock buy-backs, and a Colorado PERA study called "Bang for the Buck," comparing benefits to beneficiaries of defined benefit programs versus defined contribution programs, which concluded that, performancewise, defined benefit programs far exceed defined contribution plans. Chair Frost said there is a webinar on that study coming up in a few weeks.

Mr. Masten reported that there was a panel of chief investment officers from New York Commons, North Carolina, and Colorado, all with different governance and viewpoints about board structure, and he discussed some of the differences. Mr. Masten also said that a presenter from the Federal Bureau of Investigations spoke to attendees, reporting that they have made 104 arrests among management types in hedge funds, resulting in 103 convictions. He said he was disappointed with the number of trustee participants, but overall it was a good conference.

TPG Annual Investors' Meeting
Ms. Kuschel said the most interesting item was a presentation on the changing demographics and the effect of this change on investment decisions.

Mr. Nakahara reported on a presentation that included demographics of Japan, and he shared some of the relevant data. He said he appreciated all of the presentations around the portfolio companies, although he was hoping they might focus on some of the epic failures and what they might have learned from those.

PPI Executive Seminar and Roundtable
Treasurer McIntire said there was one segment on Japan and its economics, including the decline in demography and its attempt to implement structural reforms. He said the focus is on changing the culture around employment for women and entrepreneurism. Currently, it is considered a failure to sell a company. He said there was interesting discussion with private equity groups there, and he sees Japan as a great private equity place in 5 to 10 years, once they get serious about reforms. Treasurer McIntire said the second segment was more about global cities and the fact that half the world's GDP is produced by the 400 largest cities in the world. He found Tokyo to be a fascinating place; it is the largest city in the world, with 38.9 million people, and it is working well.

Mr. Nakahara discussed the history of Tokyo and its current infrastructure and said he agrees with the Treasurer's comments. He said the demographical change has allowed them to focus on robotics, biometrics, and artificial intelligence, giving an example of a hotel staffed entirely by robots.

Harvard Business School – Audit Committees in New Era of Governance
Treasurer McIntire reported that he attended an audit committee training at Harvard Business School and said that takeaways include: 1) it is not about the numbers, 2) the need to align reporting participation and oversight with critical dynamics of the business so you are paying attention to the right things and to act on questions that are raised, and 3) culture is critical, and developing that culture around the audit and ethics process really has to be managed from the Board level.

[Mr. Seely left the meeting at 12:30 p.m.]

PERFORMANCE REPORTS

Commingled Trust Fund (CTF)

Mr. Bruebaker said the CTF is down 2.80 percent for the three months ended September 30, 2015, but up 1.73 percent for the year. He said the equity markets are up 8.8 percent since the quarter ended on September 30, which is an annualized rate of 85.6 percent, although we don't annualize returns. The since inception, return for the CTF is 8.57 percent as of September 30, 2015, which is a good number.

Mr. Bruebaker discussed the Implementation Value Added (IVA) analysis, as follows:

Hurt by	Assisted by
Fixed Income underweight **-3 basis points (bps)** 0.68% *Index vs. -2.72% IVA return*	Real Estate overweight **5 bps** *0.61% Index vs. -2.72% IVA return*
Private Equity underweight **-3 bps** *0.88% Index vs. -2.72% IVA return*	Overlay outperformed **2 bps** *-1.7% Index vs. -2.72% IVA return*
Tangible Assets underweight **-3 bps** *1.86% Index vs. -2.72% IVA return*	

Manager Decision

Hurt by	Assisted by
Fixed Income **-62 bps** *-2.10% return vs. 0.68% index*	Private Equity **48 bps** *3.04% return vs. 0.88% index*
	Public Equity **12 bps** *-9.21% return vs. -9.52% index*

He said WSIB's investment portfolios continue to be positioned well for the long term. While performance continues to underperform the IVA benchmark, it beat the WSIB passive benchmark and the two TUCS universes in all five of the time periods. Public equities were down 9.21 percent for the quarter ended September 30, 2015, while private equity was up 3.04 percent. Compared to other public funds between $40 billion and $235 billion, WSIB's long-term investment performance continues to be top decile.

Mr. Bruebaker said he received the Report on State Pension Asset Allocation and Performance in September for the period ended June 30, 2014, from Cliffwater, a consulting firm founded by several people from Wilshire Associates. The report indicated the median state pension earned 7.3 percent; the WSIB earned 8.4 percent. The report also states that most state pension plans underperformed large endowments with assets greater than $1 billion; the WSIB outperformed the average large endowment by 30 bps. Also according to the report, the WSIB has the seventh best investment performance of the group of state pension plans, and that is with some of the top performers reporting some type of gross return rather than net as WSIB does.

Ms. Kuschel asked if it would be possible to identify who is outperforming the WSIB and what we could do differently.

Mr. Bruebaker responded that it is not the same funds each year, as the performance is dependent upon the specific asset allocations of the funds and the actual market performance of the asset classes.

[Mr. Sacks left the meeting at 12:50 p.m.]

EXECUTIVE SESSION

Chair Frost announced that the Board would go into executive session to discuss the performance of a public employee and non-voting Board members. She said the executive session was expected to last about 20 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 12:54 p.m.]

ADMINSTRATIVE COMMITTEE REPORT (CONTINUED)
Executive Director's Compensation
Non-Voting Board Member Discussion

[The Board reconvened in open session at 1:18 p.m.]

> **Chair Frost moved that the Board approve the compensation level for the Executive Director at $342,000 annually. Mr. Ormsby seconded, and the motion carried unanimously.**

There was no further business to come before the Board, and the meeting adjourned at 1:19 p.m.

Marcie Frost
Board Chair

ATTEST

Theresa J. Whitmarsh
Executive Director