WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
June 16, 2016

The Washington State Investment Board met in open session at 9:44 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Marcie Frost, Chair Kelly Fox, Vice Chair Senator Mike Hewitt (via teleconference) Arlista Holman Bill Longbrake George Masten Stephen Miller Richard Muhlebach David Nierenberg (via teleconference) Representative Timm Ormsby Joel Sacks
Absent:	Judy Kuschel Treasurer Jim McIntire Bob Nakahara Jeff Seely
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 Kristi Bromley, Assistant Investment Officer – Risk Management and Asset Allocation Stacy Conway, Administrative Assistant Mary Lobdell, Attorney General's Office Mattias Bauer, RVK Ian Bray, RVK Scott Daniels, Conning Asset Management

[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 APRIL 21, 2016, MINUTES

Mr. Masten moved to adopt the April 21, 2016, minutes.
Ms. Holman seconded, and the motion carried unanimously.

PUBLIC COMMENT

The Board received public comment from Michael Pineschi and Jim Sullivan, UNITE HERE, and Pastor Willie Cherry regarding the Palms, which is owned by TPG and Leonard Green Partners. They shared their concerns about employee unionization, the effect of the sale of the Palms on its employees and the community, job stability, labor peace and fair treatment of employees, and timing of the sale and the effect on sale price and return on investment. They urged the Board to call upon TPG and Leonard Green Partners to do the right thing for workers.

The Board also received public comment from Russ Pfeiffer-Hoyt, Washington State School Directors' Association, regarding the Permanent Common School Fund. Mr. Pfeiffer-Hoyt expressed his concern that the focus on current income would come at the expense of growth necessary to maintain intergenerational equity, and he asked that the Board assure itself that the allocation proposed will provide the best long-term return to the Permanent Common School Fund.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh shared the anticipated agenda topics and speakers for the July Board meeting, which will be held July 19-21 in Walla Walla. She relayed information about the meetings she has attended and presentations she has made, including a presentation to the ABP in The Netherlands. She discussed the current status of the GET program, which raised an additional $40 million since the last Board meeting to fund refunds and tuition payments. She reported that, subsequent to a presentation made to the City of Bellevue by Phil Paroian, it is anticipated investment of this plan will move over to the WSIB. Ms. Whitmarsh introduced Chris Rulla, Investment Officer – Fixed Income; Jami Button, Administrative Assistant; and Trisha Swanson, Administrative Assistant - Receptionist. She informed the Board that a public comment signup option has been added to the website, the co-authored World Economic Forum white paper on gender diversity was the topic of a May article in *Private Equity International*, and the State Street Global Advisors contract for cash overlay services has been extended for an additional 5 years, as per the extension option within the contract.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported that the Private Markets Committee met on June 2 to consider three private equity investment recommendations and one tangible assets investment recommendation. In addition, Hamilton Lane provided a market update.

FountainVest China Capital Partners Fund III, L.P.

> **Mr. Masten moved that the Board invest up to $200 million, plus fees and expenses, in FountainVest China Growth Capital Partners Fund III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.**

The fund, with a target size of $1.75 billion, will invest in growth equity and middle-market buyout transactions in revenue-generating, high-growth businesses in China. The WSIB has invested in two previous FountainVest funds since 2008. This proposed investment is consistent with the Board-approved 2016 private equity annual plan and model portfolio. The recommendation is based on FountainVest's strong performance, solid and experienced team, disciplined approach, focused and consistent investment strategy, single-asset class focus, excellent fit in the WSIB's private equity portfolio, and other factors relevant to the recommendation.

The above motion carried unanimously.

Permira VI, L.P.

> **Mr. Masten moved that the Board invest up to €320 million, plus fees and expenses, in Permira VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.**

The fund, with a target size of €6.5 billion, will invest primarily in mid- to large-cap European buyouts with a focus on the consumer, industrials, financial services, healthcare, and telecommunication, media, and technology sectors and will also invest to a lesser extent in North America and Asia. The WSIB has invested in two previous Permira funds since 2006. This proposed investment is consistent with the Board-approved 2016 private equity annual plan and model portfolio. The recommendation is based on Permira's Europe-focused strategy, global investment mandate, strong historical performance, thematic sector approach, well-defined and streamlined investment process, and other factors relevant to the recommendation.

The above motion carried unanimously.

Fisher Lynch Co-Investment Partnership III, L.P.

> **Mr. Masten moved that the Board invest up to $700 million, plus fees and expenses, in Fisher Lynch Co-Investment Partnership III, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Fisher Lynch Co-Investment Partnership III will continue with the same strategy as utilized for prior funds, making co-investments in private equity transactions originated by private equity general partners. The fund will target leveraged buyout and growth equity investments in the $20 million to $75 million range. The WSIB has invested in two

prior Fisher Lynch funds since 2006. This proposed investment is consistent with the Board-approved 2016 private equity annual plan and model portfolio.
If approved, the WSIB will be the sole investor in the Fund. WSIB Policy 2.10.700 addresses investment diversification and indicates the WSIB "should not consider taking more than 25 percent of any single partnership, except in unusual circumstances." Mr. Masten stated that the Private Markets Committee believes this investment meets the unusual circumstances requirement, as it represents the Board's co-investment program and, although structured as a partnership, will be managed exclusively for the benefit of the WSIB.

The recommendation is based on Fisher Lynch's experienced co-investment team, lower-cost structure, investment focus, active general partner contact program, investment performance, and other factors relevant to the recommendation.

Mr. Sacks inquired about the WSIB's influence over this general partner. Mr. Bruebaker reminded the Board that the WSIB waived the 25 percent investment guideline in the last Fisher Lynch fund, and the WSIB is still a limited partner, unable to direct investments for legal reasons. He added the WSIB will have a strategic relationship with Fisher Lynch and has used them in the past to evaluate unrelated investment ideas on the Board's behalf. This commitment will allow the WSIB to do even more of that.

The above motion carried unanimously.

Alinda Infrastructure III, L.P. and Separately Managed Investment Vehicle

Mr. Masten moved that the Board invest $100 million, plus fees and expenses, in Alinda Infrastructure Fund III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Further, that the Board invest $300 million, plus fees and expenses, in a Separately Managed Investment Vehicle, an entity to be created for WSIB infrastructure investments, managed by Alinda Capital 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. Vice Chair Fox seconded the motion.

Alinda Infrastructure Fund III, L.P., a $4 billion fund, will invest in infrastructure assets in developed markets, and will target asset-based opportunities in the transportation, telecom, and energy industries in the U.S. and Europe. The WSIB has invested in two previous Alinda funds since 2006. This investment is consistent with the Board-approved 2016 tangible assets annual plan.

The separately managed investment vehicle will invest in lower-risk, asset-heavy assets that are smaller than Alinda Infrastructure Fund III investments, while providing for strong distributable cash flow across multiple economic cycles and longer holding periods. While the investments will not overlap with the main fund investments, the investment committee will be comprised of the senior-most partners within Alinda. This investment is also consistent with the Board-approved 2016 tangible assets annual plan.

The recommendation is based on Alinda's fit within the tangible assets framework, deeply experienced core team, strong track record balancing income and growth, experienced and effective portfolio management team, private-sector focus, cross-Atlantic thematic investment approach, application of technology to boost returns, and other factors relevant to the recommendation.

Senator Hewitt inquired about the Alinda's transition plan. Ms. Will explained that Alinda does have a succession plan in place and WSIB staff has met the individual who is assumed to be the leadership replacement; however, a replacement will not be appointed until necessary. She said staff knows the second line of management, has talked with analysts, and feels comfortable with the potential replacements.

Ms. Holman inquired about the previous funds' write-downs. Ms. Will said she did not have the numbers readily accessible; however, the returns for the funds are still positive, adding that Fund I is a bit below the preferred return and Fund II is still above. Staff believes they are both going to be in line with what was expected at the time of investment.

The above motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT
Chair Frost reported the Administrative Committee met earlier this morning. She relayed the quarterly budget update given to the Committee, stating that the appropriated budget has a projected balance of $984,000 (a 4.9 percent savings), and the non-appropriated budget has a projected balance of $70 million (an 18.2 percent savings).

Proposed 2017-2019 Operating Budget
Chair Frost said Mr. Cameron presented the 2017-2019 Proposed Operating Budget for the Committee's consideration and asked Mr. Cameron to share the proposal with the Board.

Mr. Cameron stated that the final proposal is the culmination of several meetings, beginning with the strategic planning process and including the compensation study completed by McLagen. He discussed the appropriated and non-appropriated budget requests, breakdown by category, and the relationship of the two; the process of arriving at the proposed budget, explaining that the themes are driven by full time equivalent staff, both existing and proposed; and budgeting challenges, including estimating costs that are based on future allocation decisions and a limited ability to capture underlying costs for the various asset classes, adding that a study is underway to try to capture this information. Mr. Cameron said capital market assumptions are very important to the process, and the proposed budget provides the ability for the WSIB to engage with consultants for additional research and areas in which it does not have the internal capacity.

Chair Frost moved that the Board approve the proposed 2017-2019 operating biennial budget. Vice Chair Fox seconded, and the motion carried unanimously.

Assistant Attorney General's Report

Ms. Lobdell reminded the Board that the WSIB filed litigation against Petrobras in 2015 related to the Petrobras scandal and the misrepresentations that the company made to the market. She relayed that over the last 6 months the WSIB has been engaged in discovery, which has been substantially completed, and trial is scheduled for September 19. She thanked WSIB staff for their assistance with this.

Ms. Lobdell also discussed another case filed by the WSIB in May 2015 against British Petroleum (BP), which involves misrepresentations about BP's safety practices in the Gulf of Mexico. She said the WSIB filed a separate action against BP and did not join the class action. The class action against BP was settled recently for $175 million; attention has now been turned to the individual actions and discovery has commenced.

Ms. Lobdell reported that Fortis, one of the first foreign cases in which the WSIB participated, announced a €1.2 billion settlement, which must now be approved by the Amsterdam court before the settlement can be finalized.

Ms. Lobdell gave an update on the amicus brief the WSIB signed onto on behalf of institutional investors in the North Sound litigation against Merck. She said North Sound sued Merck after opting out of the Merck class action. It filed its litigation, however, after the statute of repose expired. Contrary to the Second Circuit District Court and the Indy Mac case, the Third Circuit District Court held that the statute of repose was tolled. She explained that the purpose of the amicus is to encourage the Third Circuit District Court to adopt tolling.

Mr. Masten inquired as to the total amount the WSIB has at risk for each of these issues, to which Ms. Lobdell responded that she did not have the answer but would report back to Mr. Masten with the information.

Representative Ormsby asked where the Second and Third Circuit District Courts are located for the Merck class action suit. Ms. Lobdell said the Second Circuit District Court is in New York, and she would have to look up the location of the Third Circuit District Court.

Executive Session

Chair Frost reported that the Committee went into executive session to discuss the Executive Director's performance evaluation. She said information on this discussion will be shared with the Board later in today's meeting during the scheduled executive session.

AUDIT COMMITTEE REPORT

On behalf of Treasurer McIntire, Chair Frost provided the Audit Committee report.

State Auditor's Office – Fiscal Year 2015 Accountability Audit – Exit Conference

Chair Frost informed the Board that the Committee received a report on the State Auditor's Office Accountability Audit for the WSIB, and there were no findings or management letter items to report.

Chair Frost moved that the Board approve the Fiscal Year 2015 State Auditor's Office Accountability Audit Report of the Washington State Investment Board. Ms. Holman seconded, and the motion carried unanimously.

Fiscal Year 2017 Internal Audit Plan
Chair Frost stated that the Committee reviewed the 2017 Internal Audit Plan and the audit selections that were made using a rigorous risk assessment process.

Chair Frost moved that the Board adopt the Fiscal Year 2017 Internal Audit Plan. Ms. Holman seconded, and the motion carried unanimously.

Other
Chair Frost relayed that the Committee received an update on the status of prior audit recommendations. There were three audit recommendations followed up on in the last quarter; two recommendations were resolved over the quarter, and the corrective action on the outstanding recommendation is in process, with management anticipating full completion by June 30, 2016.

Chair Frost said the Committee received the internal audit report on the Cash Daily and Month Cash Movement, and the overall results were positive, with one recommendation to strengthen controls over the authentication of cash movement requests. She explained that management agreed with the recommendation, and corrective action has already taken place and been verified by Internal Audit.

Chair Frost reported that the Committee was provided with updates on the annual audit plan status, the investment referral report, and engagement terms for the Fiscal Year 2016 independent financial statement audit, as well as a briefing from the Executive Director on the process to terminate public equity investment managers, specifically the individuals authorized to sign termination letters.

PERMANENT FUNDS ASSET ALLOCATION STUDY
Ms. Tucker stated that she, along with Ms. Bromley and Messrs. Bauer and Bray from RVK, the consultants who conducted the asset allocation study on the WSIB's behalf, were presenting, for the Board's consideration, the results of the Permanent Funds Asset Allocation Study.

Ms. Bromley explained that the four higher education Permanent Funds, as well as the Common School Permanent Fund, were established at statehood through federal government land grants to help Washington's schools and colleges with bond repayment, capital development, and facilities maintenance. She said investment authority of the Permanent Funds came to the WSIB at its creation in 1981, and the funds were invested entirely in fixed income securities until fairly recently in their history. Ms. Bromley shared that the Common School Fund was the first to invest in U.S. equities, and the higher education permanent funds began investing in equities following the last asset allocation study, which was conducted in 2011. She explained that Permanent Funds are held in perpetuity for the benefit of the designated institutions and future generations, and they must balance the objectives of safety of principal, current income, and long-term stability of purchasing power.

Ms. Bromley reported that as part of the study, RVK and WSIB staff spoke with fund beneficiaries to review the investment objectives of the Permanent Funds and gather information regarding the use of the funds, as well as review the results of the asset allocation study.

Ms. Tucker stated WSIB staff supports the recommendation to diversify the higher education and public instruction Permanent Funds' existing 30 percent equity allocation by adding non-U.S. equities, explaining that should the Board approve the addition of the non-U.S. equities, staff will develop an implementation plan and bring it back to the Public Markets Committee and Board for consideration at a later date.

Mr. Bauer provided a brief review of the objective of the Permanent Funds and an overview of the WSIB's five higher education and public instruction Permanent Funds. He reviewed the distribution policy for the funds, which is net income adjusted for realized gains and losses; and the funds' investment objectives: safety of principal, current income, long-term purchasing power, and preservation of public trust.

Mr. Sacks asked if the four objectives are equally ranked or if they are in a priority order. Mr. Bauer said they are all equally important and not prioritized.

Mr. Bauer explained that the fund horizon for Permanent Funds is perpetual, and the recommendation of RVK is to retain the existing allocation of 30 percent in equities and 70 percent in fixed income, with the inclusion of non-U.S. securities in the 30 percent equity allocation. He discussed two implementation options: a "toe in the water" option with incremental increases and a global approach, which would include a higher allocation to non-U.S. securities.

Mr. Bray discussed the process undertaken in arriving at the recommendation, including discussions with beneficiaries and a review of cash flows. He noted that RVK utilized the Board-approved capital market assumptions for the study. He said the nominal return target reflects the effective hurdle rate of the Permanent Funds in order to attain the objectives listed in policy.

Mr. Bauer detailed the variance between implementation options, including anticipated returns and risk levels of each option, and stated that either option would be an improvement and would satisfy the nominal return target. He discussed the output of the Monte Carlo analysis, real life scenarios of what portfolios might return under normal market conditions, reiterating that either implementation option is better than the current strategic asset allocation. Mr. Bauer said the expected distribution of returns becomes tighter relative to the current target, giving more predictability in outcomes, which is accretive to stability in the portfolio and reducing some of the inherent volatility, and either option gives a reasonably strong probability of achieving the return target. He said there are important considerations for intergenerational equity, and the Permanent Common School Fund is likely the most vulnerable due to the nature of contribution sources of this fund. He cautioned that although DNR puts great effort in its assumptions, there are a lot of unknowns, and continued monitoring of the Permanent Common School Fund is deserved to assure it is on a sustainable path to achieve the returns projected and maintain intergenerational equity. In the event future realized contributions fall short of those forecasted by DNR, it may trigger the option to retain investment earnings or consider a higher-returning more strategic asset allocation.

Discussion ensued around the contribution and distribution estimates, return potential and associated risk, predictability of contributions and distributions, sources of contributions, makeup of corpus, renewable assets as funding sources, potential for actions of the legislature to affect distributions, and diversification opportunities in fixed income.

Mr. Bruebaker said diversification considerations will be part of the implementation process, as opposed to the current allocation recommendation, and the implementation recommendation will be presented to the Public Markets Committee and the Board at a future date. He confirmed that the WSIB has control of the implementation decision.

Mr. Sacks asked Ms. Tucker to comment on Mr. Pfeiffer-Hoyt's public comment remarks. Ms. Tucker said the issue is how to balance current income with growth of corpus, and is the Permanent Common School Fund giving up something by being invested in a dividend-oriented strategy versus the broader market. She noted that it probably depends on the time period observed. She explained that broader market exposure is desired if looking for capital appreciation over income growth, and one of the benefits of moving to non-U.S. securities is that it offers higher starting point in terms of a broad market index, picking up additional diversification and maintaining a higher income level at the same time. An internal implementation team will look at these options and bring a recommendation to the Board, adding in response to Mr. Sacks' question on timing, that the WSIB is leaning toward the global approach.

As a matter of disclosure, Mr. Miller stated that RVK is a consultant for the Washington Education Association, of which Mr. Miller is Vice President.

> **Vice Chair Fox moved that the Board approve the addition of non-U.S. equities within the total 30 percent allocation to equities for the five higher education and public instruction Permanent Funds. Mr. Sacks seconded, and the motion carried unanimously.**

[The Board took a recess at 11:07 a.m. and reconvened in open session at 11:23 a.m.]

EDUCATION SESSION

Labor and Industries Annual Review

Mr. Daniels, Conning Asset Management, explained the role of Conning Asset Management and the purpose of the Labor and Industries (L&I) portfolio, sharing that L&I is the second largest workers' compensation insurer in the U.S., and in the top 50 U.S. property casualty insurers. He said the L&I investment strategy is driven by its objectives, keeping premium rates low and stable, and it faces constraints in terms of capital, structure of liabilities, and insurance accounting, which has a large impact on asset management. He compared L&I to other insurance companies, discussing objectives, portfolios, structures, the importance of investment income, balancing of protection of capital and growth, total returns, risk tolerance, long term investment horizon competing with annual financial cycle, and rating agency considerations. Mr. Daniels detailed the impact of insurance industry accounting regulations, which dictate how investments are reflected on the balance sheet, and the disconnect between reporting and market reality, opining that accounting is driving investment decisions in the insurance industry. He clarified that L&I is not regulated by the insurance commissioner and not subject to the same requirements; although they are considered in the investment decision-making process.

Mr. Daniels stated L&I is constrained by its capital; at $1.2 billion, it wouldn't take much of a hiccup to cause an issue. He said capital is forecast to grow, and has been growing, which should give L&I more freedom for investment risk. Currently, staff is in the midst of an asset allocation study for L&I, and options will be presented to the Board in the future. Mr. Daniels described what would happen to the L&I portfolio if it was not faced with the constraints, considering changes to allocations and an economic approach to backing payments. He said it gives some insight into asset classes that may make sense in the L&I portfolio as an inflation hedge and for diversification.

EDUCATION REPORTS

OIC Climate Risk Summit

Chair Frost attended the OIC Climate Risk Summit on June 1. She said Commissioner Kreidler invited her and Ms. Whitmarsh to join with about 100 others in the insurance industry who are concerned with climate issues. As panel participants, Chair Frost and Ms. Whitmarsh discussed how the Board measures and pays attention to this risk, the creation of the Board's investment belief related to the issue, and how this investment belief impacts and effects staff and the Board. Chair Frost said she relayed to the group that the Board has a fiduciary responsibility, the legislative mandate is financial, and the WSIB does not divest, explaining the reasons why. Ms. Whitmarsh added that she gave some background about the WSIB, and she thought it was a good audience for the WSIB message, a good event to raise visibility, and seemed to be very well-received.

2016 ICPM Discussion Forum

Chair Frost attended the 2016 ICPM Discussion Forum held June 6-7, where she participated on a panel with a representative from the National Conference on Public Employee Retirement Systems discussing challenges in administering plan choices when there is more than one. She was able to give participants an actual example of two DRS Plan 3 retirees who had the same attributes, but a difference in timing of transferring out of the Total Allocation Portfolio, and the dramatic difference in annuitized retirement benefits, explaining that people are putting themselves at risk. Chair Frost also learned that academic research around U.S. households indicates 70-80 percent would not have $400 for emergency expenses. There is not much liquidity in retirement vehicles, and a new plan is being considered which would allow a portion of retirement savings to be liquid for emergencies, and the remaining allocated to an illiquid portion of the fund. She also relayed that there were discussions on eliminating leakage out of retirement accounts, U.S. discount rates, and U.S. pension plans in trouble, with a goal of the panel to show that it is not a one size fits all and there are differences in U.S. plans.

PERFORMANCE REPORTS

Commingled Trust Fund (CTF)

Mr. Bruebaker reported that it was a good quarter for investment returns; the Commingled Trust Fund (CTF) is up 2.05 percent for the 3 months ended March 31, 2016, but up only 2.02 percent for the year, and the equity markets are up 1.1 percent since the quarter end March 31, 2016. He shared that the since inception, return for the CTF is 8.56 percent as of March 31, 2016, and detailed the results of the allocation and manager decisions for the quarter, as follows:

Allocation Decision

Hurt by	Assisted by
Public Equity underweight: -3 basis points (bps) *0.39% Index vs. +1.56% Fund return*	

Manager Decision

Hurt by	Assisted by
Real Estate: -40 bps *+ 0.30% return vs. +2.91% index*	Fixed Income: 17 bps *+3.86% return vs. +3.07% index*
	Public Equity Income: 26 bps *+1.39% return vs. +0.39% index*
	Private Equity: 56 bps *+3.43% return vs. +0.81% index*

Mr. Bruebaker stated the WSIB investment portfolios continue to be positioned well for the long term. We outperformed the two TUCS universes in all five of the time periods reported and outperformed the Implementation Value Added benchmark for the quarter, year, and 5-year periods. He said public equities were up 1.13 percent for the quarter ended March 31, 2016, while private equity was up 3.43 percent. Compared to other public funds between $40 billion and $235 billion, WSIB's long-term investment performance continues to be top decile.

EXECUTIVE SESSION

Chair Frost announced that the Board would go into executive session to discuss the performance of a public employee. She said the executive session was expected to last about 30 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 11:56 a.m.]

ADMINISTRATIVE COMMITTEE REPORT (CONTINUED)

Executive Director's Performance Evaluation

[The Board reconvened in open session at 12:26 p.m.]

OTHER ITEMS

Discussion ensued around the WSIB's response to those who are providing public comment, specifically the issues conveyed by UNITE HERE representatives, the limitations of the WSIB as a limited partner, and the desire for additional Board discussion around environmental, social, and governance issues.

There was no further business to come before the Board, and the meeting adjourned at 12:36 p.m.

Marcie Frost 7/26/16

Marcie Frost
Board Chair

ATTEST

Theresa J. Whitmarsh
Executive Director