

**WASHINGTON STATE INVESTMENT BOARD**  
**Board Meeting Minutes**  
**September 15, 2016**

The Washington State Investment Board met in open session at 9:41 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Kelly Fox, Chair  
Judy Kuschel, Vice Chair  
Tracy Guerin  
Arlista Holman  
Bill Longbrake  
George Masten  
Treasurer Jim McIntire  
Stephen Miller  
Richard Muhlebach  
David Nierenberg (Teleconference)  
Representative Timm Ormsby  
Joel Sacks  
Jeff Seely

Absent: Senator Mike Hewitt  
Bob Nakahara

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  
Stacy Conway, Administrative Assistant  
  
Mary Lobdell, Attorney General’s Office  
Mike Heale, CEM Benchmarking

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

Vice Chair Fox called the meeting to order and took roll call.

## **OATH OF OFFICE**

Vice Chair Fox welcomed and administered the oath of office to Ms. Guerin, appointed by Governor Inslee as the Department of Retirement Systems Director, who will serve as an ex-officio member of the Board.

Ms. Guerin introduced herself and shared her work history and experience.

## **CHAIR/VICE CHAIR ELECTIONS**

Vice Chair Fox called for nominations for Board Chair.

**Treasurer McIntire nominated Mr. Fox to serve as Chair. There were no other nominations, and Mr. Fox was declared Chair by acclamation.**

Chair Fox called for nominations for Board Vice Chair.

**Mr. Masten nominated Ms. Kuschel to serve as Vice Chair. There were no other nominations, and Ms. Kuschel was declared Vice Chair by acclamation.**

## **COMMITTEE ASSIGNMENTS**

Chair Fox recommended that Ms. Guerin be appointed to the Audit, Private Markets, and Public Markets Committees and further Committee assignments be postponed until the February Board meeting.

**Treasurer McIntire moved to approve the Committee assignments recommended by Chair Fox. Representative Ormsby seconded, and the motion carried unanimously.**

## **ADOPTION OF THE JULY 19-21, 2016, MINUTES**

**Ms. Holman moved to adopt the July 19-21, 2016, minutes. Treasurer McIntire seconded, and the motion carried unanimously.**

## **PUBLIC COMMENT**

The Board received public comment from several members of the public concerned about climate change. Mmes. Bourtai Hargrove, Rhonda Hunter, Patricia Holm, and Rozanne Rants, together with Messrs. Bernie Meyer, Bob Zeigler, Charles Schultz, and William Copeland, urged the Board to divest from fossil fuel investments, citing low investment returns and volatility in the fossil fuel market, benefits of clean energy investments and sustainable investing, stranded assets, and current and anticipated climate conditions.

Testimonies from the group and research papers were distributed to the Board.

[Mr. Nierenberg joined the meeting by teleconference at 10:05 a.m.]

## **EXECUTIVE DIRECTOR'S REPORT**

Ms. Whitmarsh said there will not be any Board or Committee meetings held in October; the next meeting will be the November 17 Board meeting. She shared that Senator Reuven Carlyle inquired about the WSIB's performance compared to that of cities within the State, and Representative Liz Pike contacted her to discuss funding status. Ms. Whitmarsh reported that Bill Song, fiduciary counsel, is leaving his firm and going out on his own. He will keep the WSIB as a client, and Ms. Lobdell will work with him on a contract.

Ms. Whitmarsh informed the Board that the WSIB's compliance group is reviewing the current Personal Trading Policy and process, which is a bit cumbersome, and working toward an automated system. Staff will issue a Request for Qualifications and Quotation (RFQQ) and plans to bring a recommendation to the Board in November. Ms. Whitmarsh said that over the next month she will contact those who are actively using the system to get input.

Ms. Whitmarsh announced that John Lynch will retire at the end of September. She thanked him for his service, relaying that he has served the WSIB in contracts and public records for many years and is considered one of the best in state government.

## **PRIVATE MARKETS COMMITTEE REPORT**

Mr. Masten reported that the Private Markets Committee met on September 1, 2016, to consider one private equity investment recommendation and two tangible assets investment recommendations. In addition, the Committee reviewed the technical changes to the Tangible Assets Investment Policy and approved the 2017 meeting schedule.

### **Warburg Pincus China, L.P.**

**Mr. Masten moved that the Board invest up to \$200 million, plus fees and expenses, in Warburg Pincus China, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Treasurer McIntire seconded the motion.**

Mr. Masten said the fund, with a target size of \$2 billion, will invest alongside the global Warburg Pincus fund and its successors in China investments. The Board has had a 21-year partnership with Warburg Pincus, investing in nine previous funds since 1994. He explained that the China fund will use the same team and employ the same core strategy Warburg has used in China for the last decade. This proposed investment is consistent with the Board-approved 2016 private equity annual plan, as updated in July, and the model portfolio.

Mr. Masten stated that the recommendation is based on Warburg's strong reputation, stable and deep partner team, global presence, long-term solid performance, experience in China, excellent fit in the WSIB's private equity portfolio, and other factors relevant to the recommendation.

**The above motion carried unanimously.**

## **Resonance Industrial Water Infrastructure Limited**

**Mr. Masten moved that the Board invest up to \$100 million, plus fees and expenses, in Resonance Industrial Water Infrastructure Limited, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Kuschel seconded the motion.**

Mr. Masten said the fund, with a target size of \$500 million, will invest in industrial water recycling and treatment infrastructure in Europe and Asia. The strategy employs a build-buy-operate-transfer model under which investors and operators are economically aligned, and assets are transferred to the operator or customer at contract termination.

Mr. Masten explained that the recommendation is based on the fund's geographic diversification, the team's water sector expertise, alignment of contract life with the fund life, predictable income levels, and other factors relevant to the recommendation.

**The above motion carried unanimously.**

## **Homestead Capital USA Farmland Fund II, L.P.**

**Mr. Masten moved that the Board invest up to \$100 million, plus fees and expenses, in Homestead Capital USA Farmland Fund II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Kuschel seconded the motion.**

Mr. Masten shared that Homestead Capital USA Farmland Fund II, L.P. will invest in row and permanent cropland located throughout the Mountain West, Pacific, Midwest, and Delta regions of the United States. The \$400 million fund is expected to earn approximately 60 percent of the return in annual distributions. He said the fund will provide the WSIB's portfolio with exposure to row crops and will bring further diversification into the WSIB's permanent crop holdings through its small-to mid-market focus and targeted geography.

Mr. Masten stated the recommendation is based on the firm's portfolio construction, long-term hold, business model relying on regional farm managers, strong relationships in targeted regions, deep regional market knowledge, portfolio diversification, proprietary deal flow, ability to add value, and other factors relevant to the recommendation.

**The above motion carried unanimously.**

## **Tangible Assets Investment Policy 2.10.900**

**Mr. Masten moved that the Board approve the proposed technical revisions to the Tangible Assets Investment Policy 2.10.900. Vice Chair Kuschel seconded the motion.**

Mr. Masten explained that Board policies are required to be reviewed every 3 years to ensure they remain relevant and appropriate. As part of the 3-year review process,

technical changes have been made to the Tangible Assets Investment Policy 2.10.900 to provide consistency in structure and format.

**The above motion carried unanimously.**

### **PUBLIC MARKETS COMMITTEE REPORT**

Mr. Sacks reported that the Public Markets Committee met on September 13, with a full agenda of items for consideration, an update on the Permanent Funds implementation plan, and an excellent education session on Brexit.

#### **Education Session on Brexit**

Mr. Sacks shared that Phil Paroian, Senior Investment Officer – Public Equity and representatives from BlackRock and William Blair presented an education session on the recent Brexit referendum, including political, economic, and market implications. Mr. Sacks said this presentation reinforced the quality of partners that we have and our opportunity to get first-rate briefings on global events that impact discussions of the Board.

#### **Permanent Funds Implementation Plan**

Mr. Sacks relayed that Public Equity staff presented a proposed implementation plan for the addition of non-U.S. equity to the target allocation for the five higher education and public instruction Permanent Funds portfolios as approved by the Board at its June 2016 meeting. Staff recommended transitioning the equity portion of those portfolios from U.S.-only to global and intends to conduct a search for a portfolio manager, with completion anticipated by June 2017. He explained that staff will return to the Public Markets Committee and Board with a recommended manager at that time and will present any recommended revisions to the Permanent Funds policy to the Public Markets Committee and the Board in September 2017.

#### **3-Year Policy Reviews**

Mr. Sacks reported that staff presented proposed revisions to the Defined Contribution Plan 3 Funds Policy 2.11.100, which are technical in nature; the Deferred Compensation Program and Judicial Retirement Account Policy 2.13.100, which are primarily technical, with the exception of one material change to reflect the legislation for the auto enrollment of new employees in the Deferred Compensation Program; and the U.S. Treasury Inflation Protected Securities Fund Policy 2.14.400. He stated that due to lack of a quorum, the Public Markets Committee was only able to, by consensus of those Committee members present, forward the recommendation to the Board for approval.

**Mr. Sacks moved that the Board approve the proposed technical revisions to the Defined Contribution Plan 3 Funds Policy 2.11.100, Deferred Compensation Program and Judicial Retirement Account Policy 2.13.100, and the U.S. Treasury Inflation Protected Securities Fund Policy 2.14.400.**

**Ms. Holman seconded, and the motion carried unanimously.**

**Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500.**

Mr. Sacks said staff presented the proposed revisions to the Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500. These revisions and additions to the policy were made as a result of recent legislation that provided authorization for the State Treasurer, local governments, and institutions of higher education to invest in corporate notes along with commercial paper. He explained that statutes require these entities to adhere to the investment policies and procedures adopted by the WSIB, the revisions to this policy detail the guidelines for commercial paper and corporate notes investments by these organizations, and WSIB staff worked closely with the Office of the State Treasurer on revising the policy. Mr. Sacks stated that due to lack of a quorum, the Public Markets Committee was only able to, by consensus of those Committee members present, forward the recommendation to the Board for approval.

**Mr. Sacks moved that the Board approve the proposed revisions to the Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500. Mr. Masten seconded the motion.**

Treasurer McIntire asked for clarification about the reference to Standard & Poor's in the Corporate Notes Portfolio Guidelines section of the proposed policy. Mr. Kennett responded that the language incorporated was an attempt to clarify the intent with an example. Treasurer McIntire stated he does not want to single out the use of any one of the rating agencies, adding that the Office of the State Treasurer took out references to specific rating agencies 3 or 4 years ago. Mr. Kennett proposed the policy be amended to read "single A by all of the major rating agencies that rate the security" in paragraphs 2 and 6 of the Corporate Notes Portfolio Guidelines section of the policy.

Discussion ensued around the process for reviewing the amended policy, and it was determined that staff would make the amendments discussed and bring the revised amended policy back to the Board for approval later in the meeting.

**Mr. Masten moved that the Board table the motion. Treasurer McIntire seconded, and the motion carried unanimously.**

### **Recommendation of Retirement Strategy Funds as Default for Deferred Compensation Program**

Mr. Sacks detailed Public Equity staff's recommendation supporting the adoption of the Retirement Strategy Funds (target date funds) as the default option for new members of the Deferred Compensation Program (DCP) who do not make an election on their own. He said this is consistent with the default option for Plan 3 participants, and it places members who do not make a choice into a balanced, well-diversified fund with an asset mix that will be automatically adjusted for them as they move toward and through retirement. Mr. Sacks stated that due to lack of a quorum, the Public Markets Committee was only able to, by consensus of those Committee members present, forward the recommendation to the Board for approval.

Discussion ensued around the flexibility for participants to make changes to their investment options and contribution amounts, as well as the considerations for the specific target date fund an employee's contributed funds are defaulted into.

**Mr. Sacks moved that the Board adopt the Retirement Strategy Funds (target date funds) as the default investment option for the Deferred Compensation Program, which is supported by the Department of Retirement Systems. Ms. Holman seconded, and the motion carried unanimously.**

### **2017 Proposed Meeting Schedule**

Mr. Sacks advised the Board that the proposed Public Markets meeting dates for 2017 were presented; however, due to lack of a quorum, no action was taken, and the proposed schedule will be brought before the Committee for adoption at its next meeting.

### **AUDIT COMMITTEE REPORT**

#### **Calendar Year 2015 Conflict of Interest Policy Compliance Review Report**

Mr. Sacks reported that the Audit Committee reviewed the annual report of compliance with the Board's Conflict of Interest Policy, which was prepared by an independent Certified Public Accounting firm. The report contained exceptions regarding timely submission of the Statements of Financial Affairs; travel paid for directly by outside sources and trip documentation; personal investments – adequate disclosure on the Statement of Financial Affairs, the timely submission of requests, and the documentation of the approval; and policy certifications and training.

He relayed that WSIB management has indicated all issues have been addressed or corrected since the review.

**Mr. Sacks moved that the Board approve the Calendar Year 2015 Conflict of Interest Policy Compliance Review Report. Ms. Holman seconded, and the motion carried unanimously.**

### **Audit Committee and Internal Audit Charter Revisions**

Mr. Sacks stated staff recommended technical changes to the Audit Committee Charter, changing language in the Committee's Responsibility section to reflect that external audit reports are forwarded to the Board for *acceptance*, rather than *approval*. Revisions to the Internal Audit Charter were also recommended, adding the Core Principles for the Professional Practice of Internal Auditing as mandatory guidance for professional standards, as well as updating Internal Audit's responsibilities to include maintaining a quality assurance and improvement program and requiring annual reporting of the program's results.

**Mr. Sacks moved that the Board adopt the proposed revisions to charters 1.00.130 and 1.00.190. Ms. Holman seconded, and the motion carried unanimously.**

Mr. Sacks reported that the Committee received an update on the status of prior audit recommendations, with one audit recommendation followed up on in the last quarter and verified as resolved. He said the Committee also received the internal audit report on

Public Records Requests, which contained six recommendations to strengthen internal controls, ensure compliance with state rules and regulations, address key person risk, and ensure information is easily available to the public. Management agreed with the recommendations, and internal audit staff will follow up on the corrective action taken and report back at the next Audit Committee meeting.

Mr. Sacks relayed that the Committee also received the internal audit report on the Board's private markets back office service provider, Hamilton Lane Advisors, which did not include the private equity consulting services provided to the Board. Overall the audit results were positive, with two recommendations to further strengthen internal controls and monitor requests from WSIB staff. He said the Committee will receive a status on the resolution at its next meeting in November.

Mr. Sacks informed the Board that the Committee was also provided information on the internal audit performance measures and quality assurance reporting for Fiscal Year 2016, the annual audit plan status for Fiscal Year 2017, and the quarterly investment referral update. He said the Committee also met in Executive Session to review the Business Continuation Plan and to discuss the Audit Director's performance evaluation.

#### **ADMINISTRATIVE COMMITTEE REPORT**

Chair Fox reported that the Administrative Committee met earlier this morning, receiving a budget update from Ms. Verme, who reported that the appropriated budget closed the Fiscal Year with a balance of \$1.6 million (7.7 percent savings), and the non-appropriated budget closed the Fiscal Year with a balance of \$64.1 million (16.6 percent savings). He said the Committee also went into executive session to discuss the Executive Director's compensation and the non-voting Board member expiring term review and evaluation, and additional information would be shared with the Board in executive session.

#### **EXECUTIVE SESSION**

Chair Fox announced that the Board would now 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 stated that the Board also plans to review and discuss the performance of a public employee and Board members, as well as litigation matters with legal counsel that are likely to result in an adverse legal or financial consequence to the agency. Chair Fox said the executive session was expected to last until approximately 11:40 a.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 10:51 a.m.]

#### **ADMINISTRATIVE COMMITTEE REPORT (CONTINUED)**

##### **Assistant Attorney General's Report**

##### **Executive Director's Compensation**

##### **Non-Voting Board Member Expiring Term Review/Evaluation**

Chair Fox announced that the executive session would be extended for approximately 10 additional minutes.

[The Board reconvened in open session at 12:07 p.m.]

[Chair Fox left the meeting at 12:07 p.m.]

**Vice Chair Kuschel moved that the Board approve the offer of settlement in the Olympus Corporation litigation, subject to negotiation of final terms and conditions. Mr. Sacks seconded, and the motion carried unanimously.**

**Vice Chair Kuschel moved that the Board approve an increase in the compensation level for the Executive Director of 5 percent. Ms. Holman seconded, and the motion carried unanimously.**

**Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500 (Continued)**

**Mr. Sacks moved to take from the table the previous motion that the Board approve the proposed revisions to the Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500. Treasurer McIntire seconded, and the motion carried unanimously.**

**Mr. Sacks moved that the Board approve the Commercial Paper and Corporate Notes Investment Policy for the State Treasurer, Local Governments, and Higher Education Institutions Policy 2.05.500 as amended. Treasurer McIntire seconded, and the motion carried unanimously.**

[The Board took a recess at 12:15 p.m. and reconvened in open session at 12:40 p.m.]

**CEM INVESTMENT BENCHMARKING ANALYSIS**

Mr. Heale introduced himself and stated that his presentation would focus on a comparison of the WSIB to its peers on cost and return performance for the period ending December 31, 2015. He explained that the peer universe is comprised of U.S. public funds, with a focus on a relevant custom peer group, adding that because of the Freedom of Information Act, specific peer fund names are not disclosed in any reports; however, by design, the custom peer group is banded around by size in a best-fit scale, and 17 of the 19 funds are the same as those comprising last year's comparison.

Mr. Heale shared that the WSIB's 5-year net total return of 8.2 percent and policy return of 8.5 percent were both above the U.S. public median and the peer median. He said the differences in policy returns are due to differences in benchmarks and policy mix, explaining that CEM used a standardized private equity benchmark for the WSIB and everyone else in the report because benchmarks in private equity vary, and he discussed the impacts of a higher allocation to private equity, lower allocation to fixed income, and lower allocation to public equity on the WSIB's 5-year policy return.

Mr. Heale explained that the 5-year net value added of -0.3 percent was comprised of a positive impact from stock and real estate and a negative impact from fixed income, private equity, and tangible assets, and added that the WSIB had positive 5-year net returns in all major asset classes.

Mr. Heale stated that the WSIB's long-term net return of 8.1 percent was above the U.S. public median and the peer median, and the WSIB had positive 20-year value added and net returns in stock, fixed income, real estate, and private equity, explaining that tangible assets is excluded because long-term performance data is not available.

Discussion ensued around the historical comparisons of the WSIB to its peers, how the WSIB's differentiated strategy affects the comparison, the WSIB's consistent positive comparison results, real estate and private equity performance as compared to peers with smaller private equity programs, lean staffing at the WSIB as compared to other pension funds, and the survey comparison funds' smaller number of private equity partners.

Mr. Heale said total costs for 2015 were just under \$400 million, or 50.5 basis points, which includes all costs for asset management and support, excluding performance fees for private market asset classes. He explained that to determine reasonableness of the cost in relation to the WSIB program, a benchmark cost analysis was completed, which indicated the WSIB fund is low cost by 17 basis points, or \$136 million. Mr. Heale shared the reasons for low cost, including implementation style, less external active management, and use of direct fund investment, providing the specific savings for each, and he discussed the WSIB's cost effectiveness for the 5-year and 20-year periods.

Mr. Healed provided a comparison of risk levels, stating that the WSIB's asset risk of 11.7 percent is above the U.S. Public median of 9.9 percent because of a higher orientation to private equity.

Discussion ensued around the WSIB's percentile ranking and the WSIB's historical low cost structure of 16 basis points over the last 20 years.

Mr. Heale reported that the results of the peer comparison are very solid. He said the net value added, which is volatile in a short time period, is not as good; however, long-term results are outstanding as compared to peers.

Discussion ensued around the calculation of the value added, which Mr. Heale confirmed to be net of fees; the empirical long-term result data that is counter to many academic studies, due to the large pension fund part of the market; gains in private equity investments as compared to amount of fees paid; and importance of value proposition.

## **PERFORMANCE REPORTS**

### **Commingled Trust Fund (CTF)**

Mr. Bruebaker reported that the quarter ending June 30, 2016, was a mediocre quarter for investment returns, with the CTF up 1.52 percent for the 3 months ended June 30, 2016, and up only 2.65 percent for the year, adding that the equity markets are up 1.8 percent since the quarter end. He said the since inception return for the CTF is 8.59 percent as of June 30, 2016.

Mr. Bruebaker discussed the implementation value added (IVA), sharing that the IVA underperformed for the quarter, primarily due to the private equity benchmark, and informed the Board that there were errors in the IVA performance reported previously for the quarter ended March 31, 2016.

Mr. Bruebaker stated that the WSIB's investment portfolios continue to be positioned well for the long term, outperforming the two TUCS universes in four of the five time periods. He said public equities were up 1.37 percent for the quarter ended June 30, 2016, while private equity was down 0.49 percent. Compared to other public funds between \$40 billion and \$235 billion, the WSIB's long-term investment performance continues to be top decile, as detailed in the previous CEM comparison report.

Discussion ensued regarding the replacement of the since inception column with the 20-year data on the quarterly CTF update, which allows peer comparison, and the differences between the CEM report data, which is based on a calendar year, and the CTF update data, which is based on a fiscal year.

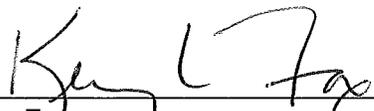
**OTHER ITEMS**

**2017 Board Meeting Schedule**

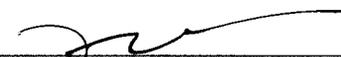
Ms. Whitmarsh presented the proposed 2017 Board meeting schedule, noting the Board planning meeting is scheduled for July 18-20, 2017, and the two-day Board meeting in December has been moved up a week to accommodate the holiday season.

**Vice Chair Kuschel moved that the Board approve its 2017 meeting schedule. Mr. Miller seconded, and the motion carried unanimously.**

There was no further business to come before the Board, and the meeting adjourned at 1:15 p.m.

  
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Kelly Fox  
Board Chair

ATTEST

  
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Theresa J. Whitmarsh  
Executive Director

