

**WASHINGTON STATE INVESTMENT BOARD  
Board Meeting Minutes  
June 15, 2017**

The Washington State Investment Board met in open session at 9:31 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Members Present: Kelly Fox, Chair  
Treasurer Duane Davidson  
Arlista Holman  
Judy Kuschel, Vice Chair  
Bill Longbrake  
Yona Makowski  
Stephen Miller  
Richard Muhlebach  
George Zinn (Teleconference)

Members Absent: Tracy Guerin  
Senator Mark Mullet  
David Nierenberg  
Representative Timm Ormsby  
Mary Pugh  
Joel Sacks

Also Present: Theresa Whitmarsh, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Chris Phillips, Institutional Relations Director  
Bill Kennett, Senior Investment Officer – Fixed Income  
Steve Draper, Senior Investment Officer – Real Estate  
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  
Patrick Martinell, Assistant Senior Investment Officer –  
Risk Management and Asset Allocation  
Stacy Conway, Executive Assistant  
  
Henry McVey, Kohlberg Kravis Roberts

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

**1. CALL TO ORDER**

Chair Fox called the meeting to order at 9:30 a.m. and took roll call.

**2. ADOPTION OF THE APRIL 20, 2017, MEETING MINUTES**

**Ms. Holman moved to adopt the April 20, 2017, minutes. Mr. Miller seconded, and the motion carried unanimously.**

### **3. PUBLIC COMMENT**

Mr. Todd Bloom stated that he was at the meeting to discuss the Washington State Investment Board's (WSIB's) policies and practices relative to the hiring of U.S. veterans. He shared his personal background and raised several questions regarding the WSIB's hiring practices.

Chair Fox responded that he had full confidence that WSIB staff is following all directives, and he assured Mr. Bloom that staff would follow up to provide him with answers to all of the questions he posed.

### **4. EDUCATION SESSION**

#### **Macro Overview-Paradigm Shift**

Mr. Bruebaker introduced Mr. McVey, Kohlberg Kravis Roberts (KKR), who explained that he works on the macroeconomic as well as risk areas for KKR and said he would share an overview of global macroeconomic indicators. He discussed the structural economic changes of growing populist movements of the UK and the U.S., the impact of China entering the World Trade Organization, and the introduction of the internet.

Mr. McVey discussed the wide dispersion between asset price inflation and real economy inflation, opining that globally there is a paradigm shift occurring in fiscal policies, deregulation, domestic agendas, and heightened volatility spilling over the currency markets to the interest rate and other markets. He discussed post crisis returns, projecting lower future returns across most asset classes; U.S. and European gross domestic product (GDP) growth, interest rates, and inflation, opining that it is a generally positive story; and U.S. outperformance over Europe in recent years.

Ms. Makowski asked if technology includes solar. Mr. McVey responded that the European technology sector does not include solar energy; in Europe, these types of projects are deemed to be in the infrastructure bucket.

Mr. McVey discussed China's economy; nominal GDP and housing inventory; earnings per share growth in the U.S. and Europe; opportunity for more de-conglomeratization and shift to a more regional model; changing consumer behavior - beginning to favor experiences over things; bottoming out of emerging markets; remaining constructive on the illiquidity premium; and embracing dislocation that is creating the significant opportunities to both buy and sell.

Mr. Miller asked if there is any global region in which wages have been improving or that are better positioned for wage growth. Mr. McVey said Asia will continue to grow faster, which will manifest in higher nominal wages. U.S. wages are growing as well, but healthcare and rental costs are growing one to two times faster. In Europe, immigration policies are worrisome with massive populations in Africa and the Middle East.

Ms. Kuschel asked about risks associated with deregulation in the financial industry. Mr. McVey responded that the pendulum has gone from one extreme to another with credit availability going into auto and student lending. He said the concern isn't about

the stability of financial services, but there is concern about too much extension of credit at a time when wages are not growing, referencing high auto delinquencies with low unemployment rates. Mr. McVey expressed other economic concerns including liquid credit and reductions in implied default rates; the large amount of oil inventory on the market; and China's macroeconomic conditions, specifically its capital account reliance on its current account and the expectation of its debt to GDP ratio to hit 300 percent in 2018.

Mr. McVey summarized key macroeconomic themes, including the paradigm shift in fiscal policy, deregulation, domestic agendas, and currency volatility; stronger growth, but lower returns over the next five years; maturity of the cycle; and the high-conviction themes.

Discussion ensued around the potential effects on the healthcare industry should the Affordable Care Act (ACA) be repealed; burden of debt in China and its inability to further carry the world's global growth issue; the fiscal activity of the current administration; healthcare, professional, and food and beverage sector growth; limited growth in government and goods sectors; and U.S. monetary policy.

[The Board recessed at 10:45 a.m. and reconvened at 11:02 a.m.]

## **6. EXECUTIVE DIRECTOR'S REPORT**

Ms. Whitmarsh provided her report to the Board, including a reminder about the July offsite Board meeting at Alderbrook. She reported to the Board on her activities since the last Board meeting, including a Council of Institutional Investors (CII) event focusing on *The Activist Director* with Ira Millstein, and her work with Tracy Guerin on adding private assets into the deferred compensation program.

Ms. Whitmarsh shared staffing updates, introducing new staff and relaying that Ms. Sandboe, Corporate Governance Officer, would retire on July 7 after 12 years with the WSIB, adding that Ms. Sandboe started the WSIB's corporate governance program and built it to what it is today. She announced the passing of Linda Buchanan after a courageous battle with cancer.

Ms. Whitmarsh relayed updates on the ABLE and GET programs and said the WSIB is in a quiet period on two open Requests for Proposal. At Ms. Whitmarsh's request, Mr. Jernudd introduced the WSIB's newly assigned Assistant Attorney General, Mr. Nelson. Ms. Whitmarsh discussed Mr. Nelson's excellent work on contingency planning for a potential agency shutdown in the event the legislature does not pass a 2017-19 biennial budget by June 30.

## **7. PRIVATE MARKETS COMMITTEE REPORT**

Ms. Kuschel reported that the Private Markets Committee met on June 8, 2017, to consider one real estate investment recommendation and one private equity investment recommendation. In addition, the Committee considered several proposed policy revisions.

### **A. Arable Capital, LLC**

**On behalf of the Private Markets Committee, Ms. Kuschel moved that the Board invest up to \$300 million, plus fees and expenses, in Arable Capital, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Ms. Makowski seconded, and the motion carried unanimously.**

Arable Capital (Arable) is a newly-formed organization targeting investments in existing operating assets in the midstream agriculture sector. The WSIB will be the sole source of funding for Arable's first vehicle other than the manager's capital. This proposed investment falls into the unidentified section of the Board-approved 2017 tangible assets annual plan.

The recommendation is based on staff's early identification of a high potential team, the personal networks and industry experience of the Arable team, the patient capital that will provide an edge in the marketplace, an investment model that creates a long-term alignment and is consistent with tangible assets objectives, a strategy that fulfills a portfolio gap and that has been difficult to access, and other factors relevant to the recommendation.

#### **B. Tailwind Capital Partners III, L.P.**

**On behalf of the Private Markets Committee, Ms. Kuschel moved that the Board invest up to \$200 million, plus fees and expenses, in Tailwind Capital Partners III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Treasurer Davidson seconded, and the motion carried unanimously.**

The Fund is a growth-oriented, middle market private equity fund, with a target size of \$1 billion and hard cap of \$1.5 billion. Tailwind Capital Group LLC is expected primarily to make control investments in growth-oriented, North American companies at the smaller end of the middle market, focusing on the healthcare, business services, and industrial services sectors. If approved, Tailwind would be a new general partner relationship for the WSIB. The proposed investment would fall into the unidentified allocation in the Board-approved 2017 private equity annual plan and is consistent with the model portfolio.

The recommendation is based on Tailwind's experienced team, repeatable investment process, dedicated operating executives, strong performance, attractive economic terms, excellent fit with the WSIB's portfolio, and other factors relevant to the recommendation.

**C. Vestar Capital Partners VII, L.P.**

**On behalf of the Private Markets Committee, Ms. Kuschel moved that the Board invest up to \$200 million, plus fees and expenses, in Vestar Capital Partners VII, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Treasurer Davidson seconded, and the motion carried unanimously.**

The fund will be a North America-focused lower middle-market buyout and growth equity fund, focused on investing in companies operating in the industry verticals of consumer, healthcare, business services, and industrial products. The WSIB has invested in four prior Vestar funds. The proposed investment would fall into the unidentified allocation in the Board-approved 2017 private equity annual plan and is consistent with the model portfolio.

The recommendation is based on Vestar's substantial long-term track record, improving recent performance, deep and experienced senior-heavy investment team supported by in-house industry experts, strong deal flow combined with a management friendly investment approach, complementary portfolio fit, and other factors relevant to the recommendation.

Ms. Makowski inquired as to why the Private Markets Committee was recommending the Vestar Capital Partners VII, L.P. transaction for Board approval in light of the policy revision allowing staff execution authority for private markets managers with whom the WSIB has an existing relationship. Mr. Bruebaker responded that this transaction was coming before the Board for approval because the specific investment was not included in the Private Equity Annual Plan approved by the Board in December of 2016.

**D. Abraaj Private Equity Fund VI L.P.**

**On behalf of the Private Markets Committee, Ms. Kuschel moved that the Board invest up to \$250 million, plus fees and expenses, in Abraaj Private Equity Fund VI L.P., subject to continuing due diligence and final negotiation of terms and conditions. Ms. Makowski seconded, and the motion carried unanimously.**

The Fund will invest across the spectrum of emerging and frontier markets, with the exception of China and Russia; however, it has identified a specific subset of emerging and frontier markets across Africa, Asia, Latin America, the Middle East, and Turkey as its chosen markets. Abraaj primarily focuses on markets where domestic consumption is the key demand driver of the economy, principally as a result of young populations, urbanization, rising incomes and catch-up dynamics. If approved, Abraaj would be a new general partner relationship for the WSIB. The proposed investment would fall into the unidentified allocation in the Board-approved 2017 private equity annual plan and is consistent with the model portfolio.

The recommendation is based on Abraaj's solid overall investment performance, large, institutionalized team with extensive emerging and frontier markets experience and on the ground presence, opportunity to deploy capital dynamically across emerging markets according to a consistent investment and risk underwriting process applied globally, attractive fit with the WSIB's model portfolio, and other factors relevant to the recommendation.

## **8. PUBLIC MARKETS COMMITTEE REPORT**

Mr. Miller relayed that the Public Markets Committee met on June 6, 2017. The Committee received recommendations for the Global Equity manager for Permanent Funds and proposed changes to two policies.

### **A. Global Equity Manager Recommendation for Permanent Funds**

Mr. Miller explained that at its June 16, 2016, meeting the Board approved 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. He said WSIB staff reviewed the search process that led to the recommendation of State Street Global Advisors (SSGA) to manage a global equity portfolio for the Permanent Funds. If approved, WSIB staff will work with SSGA to develop a detailed implementation plan, and staff expects to present that plan, as well as any recommended Permanent Funds policy changes, to the Public Markets Committee in September.

**On behalf of the Public Markets Committee, Mr. Miller moved that the Board select State Street Global Advisors as the global equity manager for the Permanent Fund portfolios, subject to continuing due diligence and final negotiation of terms and conditions. Further, that the Board allow staff to take action to begin transitioning the portfolio to a global portfolio prior to the presentation of a recommended implementation plan at the September Board meeting if market conditions allow for it. Ms. Holman seconded, and the motion carried unanimously.**

Mr. Zinn acknowledged that one of the benefits of using SSGA is their ability to cross trades before presenting them to the open market.

### **B. Public Markets Equity – Retirement Funds Policy 2.10.100 and Savings Pool Policy 2.13.200 Proposed Revisions**

Board policies are required to be reviewed every 3 years to ensure they remain relevant and appropriate. As part of the 3-year review, technical changes and revisions were proposed for two Board policies: Retirement Funds Policy 2.10.100 and the Savings Pool Policy 2.13.200. The bulk of these changes are housekeeping in nature and made for clarity and consistency with other Board policies. One substantive change was made to the Savings Pool Policy 2.13.200, changing the diversification limit from 15 percent to 20 percent. This allows the WSIB to get more money to work with investment contract carriers without lowering our standards in terms of requirements for a company.

**On behalf of the Public Markets Committee, Mr. Miller moved that the Board approve the proposed revisions to the Public Markets Equity-Retirement Funds Policy 2.10.100 and the Savings Pool Policy 2.13.200. Ms. Makowski seconded, and the motion carried unanimously.**

**9. L&I INSURANCE FUNDS POLICY 2.20.100 PROPOSED REVISIONS**

Mr. Martinell presented the revised L&I Insurance Funds Policy 2.20.100, providing an overview of the proposed changes, including the addition of a 5 percent real estate allocation; a change to a global benchmark for public equity; the new duration targets as approved by the Board at its February 16 meeting; and a real estate return target for L&I of 6 percent, which is lower than the CTF real estate target due to a lower risk portfolio and desire for current income. He discussed the timing of the implementation of the new allocations and said the portion of the real estate allocation that is unable to be invested in real estate would be invested in fixed income. Mr. Martinell stated that the L&I real estate portfolio will have a dedicated staff member, which has been requested in the current budget request.

Ms. Whitmarsh reported that this position has been included in the House of Representatives budget but not in the Senate budget. Senator Mullet is aware of the importance of this request to the L&I stakeholders, and if this is not approved a supplemental budget request will be made next year.

**Ms. Holman moved that the Board approve the proposed revisions to the L&I Insurance Funds Policy 2.20.100. Mr. Miller seconded, and the motion carried unanimously.**

Ms. Whitmarsh stated that Board member Sacks, Director of Labor and Industries, could not attend today's Board meeting; however, she has discussed this with him, and he is in support of the proposed policy.

**10. AUDIT COMMITTEE REPORT**

**A. Calendar Year 2016 Conflict of Interest Policy Compliance Review**

The Committee received the annual report of compliance with the Board's Conflict of Interest Policy, prepared by an independent CPA firm. The review covered required reporting by the Board and employees, travel expenses paid for by an outside source, personal investments, and policy certifications and training. The report contained exceptions in all areas. Management indicated staff is working with two current Board members regarding the submission of the Statement of Financial Affairs and that the other issues noted are being addressed.

**On behalf of the Audit Committee, Ms. Holman moved that the Board accept the Calendar Year 2016 Conflict of Interest Policy Compliance Review Report. Ms. Makowski seconded, and the motion carried unanimously.**

**B. Audit Committee Charter Policy 1.00.130 and Investment Referral Process Policy 2.05.800 Proposed Revisions**

Changes were made to the Audit Committee Charter Policy to reflect the Governor's Executive Order 16-06, requiring agencies to create or update a risk management policy to clarify responsibilities. Language has been added to the Investment Referral Process Policy to enhance the Summary Log and what is being presented to the Committee.

**On behalf of the Audit Committee, Ms. Holman moved that the Board adopt the proposed revisions to the Audit Committee Charter Policy 1.00.130 and Investment Referral Process Policy 2.05.800. Treasurer Davidson seconded, and the motion carried unanimously.**

**C. Fiscal Year 2018 Internal Audit Plan**

The Committee reviewed the 2018 Internal Audit Plan and the audit selections that were made using a rigorous risk assessment process.

**On behalf of the Audit Committee, Ms. Holman moved that the Board adopt the Fiscal Year 2018 Internal Audit Plan. Ms. Makowski seconded, and the motion carried unanimously.**

Ms. Holman said the Committee received two internal audit reports: one on the payroll function and transactions and the other on cash receipting and accounts receivable. The overall results were positive; however, there were four recommendations from the payroll audit that would serve to enhance internal controls and ensure compliance with state rules and regulations. Management agreed with the recommendations and staff has implemented corrective action, with Internal Audit having verified the action taken for three of the four recommendations. In addition, there were five recommendations from the cash receipting and accounts receivable audit to strengthen internal controls and safeguard assets. Management agreed with the recommendations and identified corrective action to be taken, and Internal Audit will review the corrective action taken to address the recommendations and will provide a report at the next quarter's Audit Committee meeting.

Ms. Holman said the Committee also received an update on the status of prior audit recommendations and was provided information on the status of the fiscal year 2017 internal audit plan, and engagement terms for the Fiscal Year 2017 Independent Financial Statement Audits.

**11. PERFORMANCE REPORTS**

**A. CTF Quarterly Performance Update**

Mr. Bruebaker stated that was a good quarter and year for investment returns on an absolute basis. The CTF was up 4.04 percent for the 3 months ended March 31, 2017, and up 10.72 percent for the year. The equity markets were up 3.64 percent

since the quarter end. The since inception investment return for the CTF was 8.68 percent as of May 31, 2017.

During the quarter the portfolio struggled against the Passive Benchmark, the TUCS Public Fund greater than \$1 billion benchmark, and the TUCS Public & Corporate Fund greater than \$1 billion benchmark. The portfolio outperformed the primary benchmark of the Implementation Value added for the quarter and all four benchmarks in the 10-year time period.

Our investment portfolios continue to be positioned well for the long term. Cash, Fixed Income, Public Equity, Tangible Assets, and Private Equity all outperformed their respective benchmarks for the quarter, while Real Estate and the Innovation Portfolio underperformed their respective benchmarks for the quarter. Public equities were up 7.02 percent for the quarter, while private equity was up 3.22 percent. Any time this is the case, we will not look good compared to our peers. Compared to other public funds, our long-term investment performance continues to be top decile.

## **12. ADMINISTRATIVE COMMITTEE REPORT**

Chair Fox reported that the Administrative Committee met earlier this morning. The Committee received a budget update indicating the appropriated budget has a projected balance of \$3 million (12.4 percent savings), and the non-appropriated budget has a projected balance of \$34.9 million (9 percent savings).

### **A. Executive Director Salary Policy 2.01.110**

Chair Fox said the Administrative Committee also considered a new policy and the Committee is recommending adopting of the Executive Director Salary Policy 2.01.110.

**On behalf of the Administrative Committee, Mr. Miller moved that the Board adopt the Executive Director Compensation Policy 2.01.110 as proposed. Ms. Holman seconded, and the motion carried unanimously.**

Chair Fox stated that the Committee went into executive session to discuss performance of public employees. Information will be shared with the Board during the scheduled executive session later in today's meeting.

[The Board recessed at 11:45 a.m. and reconvened at 12:25 p.m.]

## **EXECUTIVE SESSION**

Chair Fox announced that the Board would now go into executive session to discuss the performance of public employees. The executive session is expected to last about 20 minutes, after which time the Board would reconvene in open session.

**A. Executive Assistant Appointment Salary (The Executive Assistant is the Confidential Secretary serving the Executive Director and the Board.)**

**B. Executive Director Performance Evaluation and Compensation**

[The Board went into executive session at 12:25 p.m.]

Public notice was given that the executive session would be extended for an additional 30 minutes. No members of the public were waiting to attend.

Public notice was given that the executive session would be extended for an additional 10 minutes. No members of the public were waiting to attend.

[The Board reconvened in open session at 1:36 p.m.]

**Mr. Miller moved that the Board approve the compensation level for the Executive Assistant at \$78,500. Ms. Makowski seconded, and the motion carried unanimously.**

**13. Other Items**

There were no other items presented.

**14. Adjournment**

There was no further business to come before the Board, and the meeting adjourned at 1:37 p.m.

**Judy Kuschel  
Board Chair**

**ATTEST  
Theresa J. Whitmarsh  
Executive Director**