

**WASHINGTON STATE INVESTMENT BOARD  
Public Markets Committee Meeting Minutes  
September 14, 2010**

The Public Markets Committee met in open public session at 1:00 p.m. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Mike Ragan, Chair  
George Masten  
Robert Nakahara (via teleconference)  
David Nierenberg (via teleconference)  
Judi Owens  
Judy Schurke

Other Board Members Present: Bill Longbrake

Others Present: Theresa Whitmarsh, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Diana Will, Senior Investment Officer – Asset Allocation  
Philip Paroian, Senior Investment Officer – Public Equity  
Bill Kennett, Senior Investment Officer – Fixed Income  
Kristi Bromley, Administrative Assistant – Investments  
  
Steve Dietrich, Assistant Attorney General  
Marcie Frost, Department of Retirement Systems  
Ray Decker, AllianceBernstein  
Richard Davies, AllianceBernstein

[Names of other individuals attending the meeting are not included in the minutes but are listed in the permanent record.]

The meeting convened with Chair Ragan identifying members present.

**REVIEW AND APPROVAL OF MINUTES – MAY 4, 2010**

**Ms. Owens moved to adopt the May 4, 2010, Public Markets Committee minutes. Ms. Schurke seconded, and the motion carried unanimously.**

**EDUCATION SESSION – IMPLICATIONS OF PLAN DESIGN ON PARTICIPANT BEHAVIOR**

Mr. Bruebaker noted that WSIB staff has been working closely with DRS on a comprehensive review of options, which would be presented later in the meeting. The AllianceBernstein educational session is very timely and lays a good framework for the upcoming discussion on the analysis of investment options in the defined contribution programs.

Mr. Davies, AllianceBernstein, introduced himself and noted that the field of behavioral economics is very relevant for those running 401(k) and 457 plans. Much of the research conducted by behavioral economists relates directly to the defined contribution world and the results are applicable to the decisions pertaining to plan design. The themes of the presentation were around the impact on participant behavior resulting from investment menu construction and implementation approach, the problem of choice overload, and the central role of the default investment option in improving outcomes.

Information shows that participants have poor asset allocation, resulting in portfolios that are too risk adverse, too concentrated, and insufficiently diversified. In plan design, fewer investment options are better than more options in terms of helping participants make better asset allocation decisions.

Although most defined contribution participants are not skilled investors, the traditional structure of defined contribution plans is for the minority of participants that are more involved and vocal in their expectations for a large amount of flexibility and choice. Historically, the silent majority, while most in need of help, has not gotten the required attention. While the past response has focused on better educating participants, the industry is now moving more to communicating and informing participants what has been done on their behalf to develop plans that will assist them in meeting their financial objectives. Studies have shown the majority of employees do not change their behavior following participant education. If plan sponsors understand how people make decision, plans can be designed in a way that leads to socially acceptable outcomes while still providing freedom of choice.

Major behavioral challenges facing plan participants are loss aversion, choice overload, naïve diversification, status quo bias, and procrastination and inertia. It is important to determine how to use understanding of likely behavior to improve plan success. Mr. Davies expanded on these challenges, noting that investors feel pain of loss more than they feel the pleasure of gain; excessive choice makes participants more conservative in their asset allocation; participant investment choice is driven by available options; how the options are presented impacts portfolio construction; and once invested, the majority of participants rarely change their options.

Mr. Davies provided examples of how to put theory into practice and design a plan that uses these challenges to the best interest of participants in terms of how investment options and the enrollment process are structured. Factors discussed included the approximate number of options necessary to build an effective portfolio and how to help participants make good investment decisions through “one-step investing” or “build and monitor” options. Mr. Davies concluded his presentation by reviewing five key factors for increasing plan success: limit

options—less really is more; influence asset allocation through mix of options offered; guide participant selection through enrollment design; automate if possible—let inertia work for investors; and advocate an appropriate default option which is designed to meet the needs of the majority of participants.

Discussion ensued regarding the appropriate number of investment options and plan design.

[The Committee recessed at 2:05 p.m. and reconvened at 2:15 p.m.]

**ANALYSIS OF THE INVESTMENT OPTIONS IN THE DEFINED CONTRIBUTION PROGRAMS**

Ms. Will introduced herself and Ms. Whitmarsh introduced Marcie Frost, Deputy Director of the Department of Retirement Systems. Ms. Will noted that the WSIB has already identified many of the points addressed in the AllianceBernstein presentation regarding plan design. The WSIB defined contribution policies state the goal of providing an adequate number of investment options that are broad enough to offer a comprehensive set of options, yet limited in number to make the programs simple to understand and offer participants the ease of creating a diverse portfolio. The policies also note the WSIB's fiduciary duty to ensure that each defined contribution plan offers a balance of options to provide an asset allocation suitable for a range of participants, from those early in their career to those in retirement. The investment options must also cover a broad range of funds from low risk/low return to high risk/high return. The policies also address the need for the investment options to provide the best choices for a broad group of participants and cannot be all things to everyone.

Ms. Will noted that the goal of the study on the investment options in the defined contribution programs was to identify the optimal lineup of investment options in order to best serve the majority of plan members into the future. The two programs in the study were the Deferred Compensation Program (DCP)/Judicial Retirement Account (JRA) and the Plan 3 retirement systems: Public Employees' Retirement System; Teachers' Retirement System; and School Employees' Retirement System. Staff's recommended lineup of options for the defined contribution plans include one-step investing for participants who want managed funds and build and monitor options for participants who want to actively manage their portfolios.

Ms. Will reviewed a graph depicting the current and proposed options and noted that the recommended options are more consistent between the Plan 3s and DCP/JRA programs. The one-step investment options include the target date funds and socially responsible balance fund, as well as the legislatively mandated Total Allocation Portfolio for the Plan 3s. The build and monitor options include three core funds (money market for Plan 3s and savings pool for DCP/JRA; bond fund; and global equity broad market) and three strategic funds (U.S large capitalization equity; U.S. equity small capitalization value; and emerging market equity).

Ms. Will noted that only 19 percent of the defined contribution assets are in options that are being changed. The recommended changes will affect between 10 and 20 percent of Plan 3 participants and a greater majority of DCP/JRA participants.

Ms. Frost noted that Mr. Hill had asked her to speak on his behalf. She noted the collaborative nature of the study between DRS and WSIB. The study resulted from a request by the Employees' Retirement Benefits Board for WSIB staff to determine if the investment options were meeting participants' needs. As part of the effort, DRS developed plan goals and the recommended investment options are consistent with those goals. DRS is prepared to implement the investment option changes if the WSIB approves the new investment option lineup.

Ms. Will noted, if the Public Markets Committee and Board approve of the investment option changes, the next steps for the WSIB would be a review of the investment mandate of each option and a review of the investment managers. This review would come back to the Public Markets Committee and Board for approval. DRS would then communicate with stakeholders and work with the record keepers on implementing the changes.

Discussion ensued on possible implementation strategies and the importance of member education and communication.

**Ms. Owens moved that the Public Markets Committee recommend the Board approve staff's recommended menu of investment options for participants in the defined contribution programs. Mr. Masten seconded, and the motion carried unanimously.**

#### **DISCUSSION OF TIMING WITH RESPECT TO UPCOMING TRANSITIONS**

Chair Ragan announced the Committee would go into executive session to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. The executive session was expected to last about 5 minutes, at which time the Committee would reconvene in open session.

[The Committee went into executive session at 2:37 p.m. and reconvened in open session at 2:45 p.m.]

#### **2011 MEETING SCHEDULE**

Mr. Bruebaker noted that a Committee member had a conflict with the proposed April 2011 meeting dates. The results of the global equity manager search were planned for the April meeting. Staff reviewed the search timeline and determined that the results could be presented at the March 2011 meeting. Depending on the number of finalist firms presented to the Public Markets Committee, two days may be needed for the meeting.

**Mr. Masten moved that the Public Markets Committee adopt its 2011 meeting dates, holding a meeting March 1 and 2 rather than April 5 and 6. Ms. Owens seconded, and the motion carried unanimously.**

#### **OTHER ITEMS**

There was no further business to come before the Public Markets Committee and the meeting adjourned at 2:52 p.m.