

**WASHINGTON STATE INVESTMENT BOARD
Public Markets Committee Meeting Minutes
February 1, 2011**

The Public Markets Committee met in open public session at 1:03 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
David Nierenberg
Judi Owens

Members Absent: Judy Schurke

Other Board Members Present: Mark Childs
Bill Longbrake
Treasurer McIntire

Others Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Diana Will, Senior Investment Officer – Asset Allocation
Kristi Bromley, Administrative Assistant – Investments

Steve Dietrich, Assistant Attorney General
Michael Thomas, Russell Investments
Greg Gilbert, Russell Investments
Brian Causey, Russell Investments
Michael O. Martel, State Street Global Advisors
Scott F. Powers, State Street Global Advisors
Neil J. Tremblay, State Street Global Advisors

[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 – JANUARY 4, 2011

Mr. Masten moved to adopt the January 4, 2011, Public Markets Committee minutes. Ms. Owens seconded, and the motion carried unanimously.

CASH OVERLAY PROGRAM INVESTMENT MANAGEMENT INTERVIEWS

Ms. Will introduced herself and presented staff's recommendation that State Street Global Advisors be hired for the cash overlay program mandate.

[Ms. Whitmarsh was in attendance at 1:05 p.m.]

Ms. Will provided a review of the cash overlay program, which has been in place since July 2006. The program has three primary goals. First, the program is structured to add a small incremental return to the Commingled Trust Fund by eliminating cash drag across the total portfolio. Second, the program helps keep the portfolio closer to the long-term asset allocation targets approved by the Board. Third, it allows staff to keep a large cash balance on hand, which helps reduce some of the short-term liquidity risk and transaction costs associated with funding benefit payments and capital calls. The program accomplishes its goals through purchasing futures or other derivatives in amounts proportional to the cash equivalents in the asset class(es) that are underweight the Board's approved long-term asset allocation targets. The cash overlay manager is not allowed to short futures to bring overweight asset class(es) back to target and is not allowed to add leverage to the total portfolio. The individual external managers' portfolios are not touched, and the cash overlay program is invisible to the active managers.

Ms. Will reviewed the search process, which began in November 2010. The Request for Proposal received three responses; the search team conducted on site due diligence on the top two firms: State Street Global Advisors (SSgA) and Russell Investments (Russell). Ms. Will reviewed the highly data intensive nature of the program. As such, the evaluation team's review focused on each firm's infrastructure, including staff turnover and the number of accounts each portfolio manager. The team also focused on the futures basket construction as it is important that the overlay manager replicate the index well. An important focus was on the international equity basket and the need for emerging markets exposure, which must be obtained without the use of futures since for many emerging markets futures do not exist or are highly illiquid. The evaluation team determined that SSgA fulfilled the key needs the best. She noted that the Committee would hear presentations from both Russell, the incumbent cash overlay manager, and SSgA.

Discussion ensued regarding the data intensity; need for thorough understanding of the WSIB accounts; cost and staff time associated with a manager transition; experience of the firms working with our custodian agent; past foreign exchange issue with State Street Global Markets, a separate subsidiary of SSgA's parent company; fees; and performance.

Russell Investments

Mr. Thomas introduced himself and Messrs Causey and Gilbert. Mr. Thomas reviewed the history of the relationship, noting what Russell said they would do during their presentation to the Public Markets Committee in April 2006 and what they have delivered; the benefit of Russell and the WSIB being located close geographically, the knowledge Russell has of the WSIB's portfolios, and Russell's demonstrated track record of doing the right thing.

Mr. Causey reiterated the importance of the knowledge Russell has of the WSIB's portfolios and that the WSIB knows what to expect from Russell. Since inception, two different portfolio managers and the same portfolio analyst have worked on the WSIB's accounts. Mr. Gilbert provided examples of how doing the right thing are an important part of Russell's culture.

Mr. Thomas reviewed some of the possible concerns the WSIB may have with Russell, including client to portfolio manager ratio, turnover, and experience with international exposure. He noted that not every client carries the same workload and that Russell is now staffed to support two portfolio managers on every relationship. In addition, productivity gains have resulted in a significant drop in the amount of time portfolio managers spend on systems development, allowing them to focus more of their time on client portfolios. Mr. Gilbert stressed the importance of maintaining consistency of program managers and analysts in overlay programs given the in-depth knowledge the manager has of the client's portfolio. Mr. Gilbert reviewed the causes of Russell's recent increased turnover, noting that some turnover can be healthy, and reviewed what Russell has done to address turnover. Mr. Causey reviewed Russell's international and emerging market experience, noting that Russell manages plenty of emerging markets exposure but only where it benefits the client.

Mr. Thomas concluded by stating that Russell manages \$63 billion in derivatives exposure for some of the largest state pension funds in the country and that no one cares more about Washington's state pension fund than Russell.

Treasurer McIntire noted his appreciation for Russell's comment about caring about Washington's pension fund.

State Street Global Advisors

Mr. Tremblay introduced himself and Messrs Powers and Martel. Mr. Powers provided an organizational overview, stating that SSgA is one of the major components of State Street Corporation. SSgA is a separate business unit from State Street Corporation, although they do make use of common platforms when it makes sense to do so but the business operations are autonomous. Mr. Powers presents a strategic plan to the State Street corporate board and, upon approval of the plan, he executes the plan and reports to the board periodically. Mr. Powers noted that SSgA is a global company with 28 offices across the world with approximately a third of their assets under management from clients outside the U.S. While SSgA has breadth and depth globally, they have one common operating platform that provides consistency with one common infrastructure methodology. He reviewed the overall financial strength of the firm, post financial crises.

Mr. Powers reviewed SSgA's governance structure and stated that the executive management group sets the tone for the organization and creates clarity around goals and objectives. The management group is pushing decision-making rights down into and across the organization, to those closest to the markets and clients, particularly related to investment decisions. Since Mr. Powers started at SSgA, he has established the Operations and Compliance Committee, Fiduciary Committee, and Product Committee; these are in addition to the Investments Committee, which was already in existence. The Operations and Compliance Committee ensures proper separation of duties and the proper degree of checks and balances. Management is striving to keep teams together as they are experts at what they do. SSgA's culture is to first and foremost do a good job on behalf of their clients.

Discussion ensued regarding the separation of business units under State Street Corporation, with State Street Global Markets being separate from SSgA. Further discussion ensued regarding corporate culture and SSgA's performance and compensation systems.

Mr. Martel provided an overview of SSgA's Multi Asst Class Solutions group, a global team focused on design and implementation of client tailored, and custom multi asset class solutions. Mr. Martel noted that one of the keys of their work in the area of cash overlay is to understand client objectives and to focus on total portfolio solutions. Minimizing tracking error is another important component of success in this area. Two portfolio managers are assigned to each account and the WSIB's portfolio would be managed out of Boston. Mr. Martel reviewed tools available to SSgA in implementing exposure management options for clients. He reviewed ways to structure a program for Washington that would address our portfolio and asset allocation needs.

In response to a request from Mr. Longbrake, Mr. Martel reviewed strategies for emerging markets that would meet the WSIB's needs.

[Treasurer McIntire was no longer in attendance at 2:51 p.m.]

Mr. Martel reviewed an implementation flowchart showing the process used for exposure management. He reviewed SSgA's risk controls, proprietary exposure management system, and enterprise wide global exposure management system.

In response to a question from Mr. Nierenberg, discussion ensued regarding stress testing and scenario analysis. In response to a question from Mr. Masten, discussion ensued regarding performance and the value provided by a cash overlay program.

Following the presentations, Ms. Will reiterated staff's recommendation. Discussion ensued regarding what each firm offered in terms of the construction of the cash overlay program. Ms. Will noted that the performance of a cash overlay program depends on our asset class weightings and on current market conditions. The overlay manager does not make decisions on what asset class to invest in but rather purchases derivatives in asset classes in which we are underweight in order to minimize tracking error for the overall portfolio. Further discussion ensued regarding the number of relationships managed by the portfolio managers of each firm and organizational issues.

Ms. Owens moved that the Public Markets Committee recommend the Board hire State Street Global Advisors for the Cash Overlay Program mandate, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Ragan seconded. The motion carried, with Mr. Masten voting no.

PLAN 3 DEFAULT LEGISLATION DISCUSSION

Chair Ragan stated that the bulk of defined contribution assets of Plan 3 participants are invested in the Total Allocation Portfolio (or TAP) because it is currently the default option for those who do not self direct their investment option. As part of the Commingled Trust Fund, the TAP's asset allocation is designed for a very long-term investment horizon and it may prove too risky for those nearing retirement. Behavioral finance evidence indicates that most people rarely override the default option and many never rebalance their portfolios to reduce volatility over time to achieve their post-retirement income goals.

Following a discussion about ways to rectify this situation at the December 16 Board meeting, an *Ad Hoc* Committee formed by Chair McElligott agreed to recommend that the WSIB and DRS jointly support legislation to change the default Plan 3 investment option from the TAP to the Retirement Strategy funds. The Retirement Strategy funds are designed and periodically rebalanced to adjust to an individual's retirement time horizon. Senator Lisa Brown offered to sponsor legislation to make that change and the Code Reviser's Office was asked to draft companion proposals for the Senate and the House which are now moving through the legislative process. Any participant who wants to invest their defined contribution money into the TAP would still have the option to do so. Changing the automatic default option from the TAP to the Retirement Strategy funds would only apply to new Plan 3 members and would not have any impact on existing participants.

Mr. Ragan moved that the Public Markets Committee recommend the Board approve support for the draft legislation, which would establish the Retirement Strategy Funds as the default option for new members entering the Plan 3 retirement systems. Ms. Owens seconded. The motion carried with Mr. Masten voting no.

OTHER ITEMS

There was no further business to come before the Public Markets Committee and the meeting adjourned at 3:30 p.m.