APPROVED

WASHINGTON STATE INVESTMENT BOARD
Public Markets Committee Meeting Minutes
September 13, 2016

The Public Markets Committee met in open public session at 1:33 p.m. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present:	Joel Sacks, Chair Arlista Holman Stephen Miller (Teleconference) Bill Longbrake (Teleconference) David Nierenberg (Teleconference)
Members Absent:	Bob Nakahara Representative Timm Ormsby
Other Members Present:	Kelly Fox George Masten
Others Present:	Theresa Whitmarsh, Executive Director Gary Bruebaker, Chief Investment Officer Allyson Tucker, Senior Investment Officer – Risk Management and Asset Allocation Bill Kennett, Senior Investment Officer – Fixed Income Phil Paroian, Senior Investment Officer – Public Equity Chris Biggs, Investment Officer – Public Equity Stacy Conway, Administrative Assistant Tor Jernudd, Assistant Attorney General Heidi Richardson, BlackRock Olga Bitel, William Blair Simon Fennell, William Blair

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

Chair Sacks called the meeting to order and took roll call.

ADOPTION OF DECEMBER 1, 2015, MINUTES

Due to lack of a quorum, adoption of the December 1, 2015, minutes was tabled until the next Public Markets Committee meeting.

BOARD POLICY REVIEWS

3-Year Policy Review

Mr. Bruebaker reviewed the proposed revisions to the Defined Contribution Plan 3 Funds Policy 2.1.100, 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.

> **Due to lack of a quorum, the Committee was unable to take action. It was the consensus of those Committee members present to forward this item to the Board for approval.**

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

Mr. Kennett said legislation that became effective in June authorizes the State Treasurer, local governments, and institutions of higher education to invest in corporate notes; those entities must adhere to a WSIB policy. The corporate note policy has been rolled into the commercial paper policy because both commercial paper and corporate notes are credit, and managing credit requires that the two be managed together. He listed the internal staff and external parties responsible for the creation of this revised policy, and he discussed the portfolio risk constraints, issue maturity constraints, portfolio duration constraints, and issuer concentration for corporate notes. Mr. Kennett shared the constraints for the credit portfolio, including concentration and non-quantifiable requirements, in addition to the credit risk, interest rate risk, and reinvestment risk. He detailed total portfolio guidelines, which include the impermissible investments, including derivatives, loans, and non-dollar securities, and said the entities covered by this policy are responsible for obtaining financial advice if they need it.

Discussion ensued regarding the requirement to purchase in the secondary market; the role of the Board and WSIB staff in the recommendation and adoption of policy, and who is subsequently responsible for auditing the Office of the State Treasurer, local governments, and higher education institutions for compliance; and the WSIB's lack of control over implementation of the policy.

> **Due to lack of a quorum, the Committee was unable to take action. It was the consensus of those Committee members present to forward this item to the Board for approval.**

EDUCATION SESSION

The Brexit Decision

Mr. Paroian introduced Ms. Richardson, Ms. Bitel, and Mr. Fennell and said that the discussion would consist of an overview of Brexit, and its political, economic, and market implications.

Ms. Bitel explained that Brexit is the process of taking the UK out of the European Union (EU) by virtue of a popular referendum last June, resulting from a relatively narrow vote. She discussed the effect of the vote and provided perspective around the differences between the EU and the euro area. Ms. Bitel stated that the UK has been a net contributor to the EU and discussed the differences between EU countries, including civil service, government dependence, and tax codes. She said that the Brexit campaign was based on two key themes – immigration and sovereignty – and discussed the voters' concerns around these issues.

[Mr. Miller arrived by teleconference at 2:06 p.m.]

Ms. Bitel, Mr. Fennell, and Mr. Paroian discussed the process to join the EU, the geographical changes to the EU/non-EU border with the UK exit, and the potential for bordering countries to challenge the validity of the vote.

Ms. Bitel said that today there is a paradoxical situation in the UK, as the composition of parliament does not accurately represent the popular vote and there may be future legal challenges.

Ms. Bitel and Mr. Fennell discussed polling results prior to the vote as opposed to the actual results of voting, and the issues around immigration.

When asked to address the political implications of Brexit, Mr. Fennell discussed the triggering of Article 50 in the next year or two, the decisions Britain will have to make around what it will and will not accept, and the changing nature of trade relations, including the building of relationships quickly to show that the UK is open for business.

Mr. Paroian inquired about potential scenarios, and Ms. Bitel responded that it is too early to predict what will happen.

Discussion ensued around the upcoming elections in Germany and Denmark and the impact of those elections on Brexit, as well as the feasibility and associated challenges of Britain's negotiation of free trade agreements.

Ms. Richardson, Ms. Bitel, and Mr. Fennell discussed the economic implications of Brexit, including market volatility as well as devaluation of the British pound.

Discussion ensued around Brexit vote and its potential effect the future of European integration.

Mr. Fennell discussed two key elements in the Brexit debate: the role of currencies and sovereignty.

Discussion followed regarding the impact of Brexit on investments in the UK; Scotland's vote to stay in the British Commonwealth and the possibility of a second referendum in Scotland; the UK's loss of its AAA rating; the actual process, timing, and strategy of the UK removing itself from the EU; the influence of the refugee crisis on the UK's desire to close its borders; the likelihood of another parliamentary election prior to invoking Article 50; issues around the current labor leader and changes to the electoral boundaries that are not beneficial to the labor party; and Germany's current political swing and historical desire to hold the EU together.

Chair Sacks thanked the panel for the presentation and for giving the Committee meaningful insight.

[Mr. Miller left the meeting at 3:06 p.m.]

[The Committee took a recess at 3:06 p.m. and reconvened at 3:21 p.m.]

PERMANENT FUNDS IMPLEMENTATION PLAN

Mr. Biggs introduced himself and gave an overview of the proposed implementation plan for introduction of non-U.S. equities into the Permanent Funds, as approved by the Board at its June 2016 meeting. He explained that the current asset allocation is 70 percent fixed income and 30 percent passively-managed U.S. equities. Mr. Biggs discussed the two proposed options for introducing global equities into the allocation, providing a summary of the highlights and an anticipated timeline. He explained that the first option provides a modestly higher expected rate of return, a lower level of expected risk, and maintains a home country bias; however, it is more operationally challenging. In the second option, referred to as the global option, there are moderately higher expected levels of return with a commensurate increase in expected risk, the home country bias is eliminated, and it is less operationally intensive.

Mr. Biggs detailed the considerations in choosing the appropriate option, including stakeholder requirements, with an emphasis on the need to keep realized capital gains and losses to a minimum. He explained how each proposed option meets the considerations, stating that both options accomplish the objectives, with the global option slightly better and less operationally intensive.

Mr. Biggs discussed the recommended benchmark and the potential operational issues that may arise in connection with the benchmark, the timeline and steps of implementation, and the process for policy revision. He said there was no action required at this time; staff would bring formal recommendations to the Public Markets Committee and Board at a future date.

In response to Mr. Masten's inquiry about the stakeholder need to limit capital gains and losses, Mr. Biggs explained that by law the Funds must distribute all income.

Discussion ensued regarding bias on active or passive management and the competitive process of engaging new or existing managers.

RECOMMENDATION OF RETIREMENT STRATEGY FUNDS AS DEFAULT FOR DEFERRED COMPENSATION PROGRAM (DCP)

Mr. Biggs stated that new legislation requires newly hired state employees who do not opt out of the plan to contribute 3 percent of their pay into the DCP. The proposed recommendation is for investment of these contributed funds in the Retirement Strategy Funds, also referred to as target date funds, as the default option for those who do not make an election. Mr. Biggs discussed the reasons for choosing the target date funds and said the target date funds are also the existing default options for the hybrid Plan 3 retirement funds. He clarified that employees are not locked into any investment selection, and they may make a change at any time.

In response to Mr. Sacks' inquiry about the 3 percent contribution requirement, Mr. Biggs responded that it has been set by statute.

Due to a lack of quorum, the Committee was unable to take action. It was the consensus of those Committee members present to forward this item to the Board for approval.

2017 MEETING SCHEDULE

Due to lack of a quorum, adoption of the 2017 Public Markets Committee meeting schedule was tabled until the next Public Markets Committee meeting.

OTHER ITEMS

There was no further business to come before the Public Markets Committee and the meeting adjourned at 3:45 p.m.