



**Thursday, September 21, 2017
Board Meeting**

**2100 Evergreen Park Dr SW, Olympia, WA 98502
11:00 A.M.**

1. Call to Order/Roll Call (11:00a)

2. Adoption of Minutes (11:00-11:05)

A. Adoption of the July 18-20, 2017, Minutes

3. Public Comment (11:05-11:15)

4. Executive Director's Report (11:15-11:20)

A. August/September 2017

5. Administrative Committee Report (11:20-11:30)

A. 3-Year Policy Reviews - Technical Revisions

B. 3-Year Policy Reviews - Substantive Revisions

6. Audit Committee Report (11:30-11:40)

A. State Auditor's Office - Fiscal Year 2016 Accountability Audit - Exit Conference

7. Private Markets Committee Report (11:40-11:45)

A. Private Equity Investment Recommendation - New Mountain Partners V, L.P.

B. Private Markets Committee Recommendation - Wellspring Capital Partners VI, L.P.

8. Public Markets Committee Report (11:45-11:50)

A. Permanent Funds Implementation and Transition Plan

9. Executive Session (11:50-12:05)

A. Public Markets Committee Report (continued): CTF Public Equity Program Recommendation

B. Administrative Committee Report (continued): Assistant Attorney General's Report - Litigation Update

10. Lunch (12:05-12:25)

11. CTF Asset Allocation (12:25-1:25)

A. 2017 CTF Strategic Asset Allocation Recommendation

12. Education Session (1:25-1:55)

A. CEM Results and Cost Comparison

13. Performance Reports (1:55-2:00)

- A. Commingled Trust Fund Quarterly Update
- B. Private Markets Quarterly Reports

14. 2018 Meeting Schedule (2:00-2:05)

- A. 2018 Board Meeting Schedule

15. Strategic Insight Topic Discussion (2:05-2:20)

- A. Strategic Insight Topic Discussion

16. Innovation Portfolio - Rise Fund Update (2:20-2:30)

- A. Innovation Portfolio - Rise Fund Update

17. Executive Session (2:30-4:10)

- A. Administrative Committee Report (continued): Board Self-Evaluation
- B. Administrative Committee Report (continued): Non-Voting Board Member Expiring Term Review/Evaluation
- C. Break (3:00-3:10)
- D. Rise Fund Strategy Discussion

18. Other Items (4:10-4:15)

19. Adjourn (4:15p)

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
September 21, 2017

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

Members Present: Treasurer Duane Davidson
 Tracy Guerin
 Arlista Holman
 Judy Kuschel, Chair
 Bill Longbrake
 Yona Makowski
 Senator Mark Mullet
 Stephen Miller
 Assistant Treasurer Shawn Myers
 David Nierenberg (Teleconference)
 Representative Timm Ormsby
 Mary Pugh
 Joel Sacks, Vice Chair

Members Absent: Greg Markley
 Richard Muhlebach
 George Zinn

Also Present: Theresa Whitmarsh, Executive Director
 Gary Bruebaker, Chief Investment Officer
 Ian Cameron, Chief Operating Officer
 Chris Phillips, Institutional Relations Director
 Allyson Tucker, Senior Investment Officer – Risk
 Management and Asset Allocation
 Fabrizio Natale, Assistant Senior Investment Officer – Private
 Equity
 Stacy Conway, Executive Assistant

 Tor Jernudd, Attorney General's Office
 Mike Heale, CEM Benchmarking
 Paul Hewson, Rise Fund
 Bill McGlashan, TPG Growth

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

1. CALL TO ORDER

Chair Kuschel called the meeting to order at 11:14 a.m. and took roll call.

2. ADOPTION OF THE JULY 18-20, 2017, MEETING MINUTES

Ms. Holman moved to adopt the July 18-20, 2017, minutes.
Mr. Sacks seconded, and the motion carried unanimously.

3. PUBLIC COMMENT

There was no public comment.

4. EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh reported that she, along with several other staff and Board members, attended the Council of Institutional Investors Fall Conference earlier in the month. She introduced several new employees, along with a reporter in the audience who was working on an article for Pensions and Investments.

5. ADMINISTRATIVE COMMITTEE REPORT

Chair Kuschel reported that the Administrative Committee met earlier in the day. She said Mr. Cameron provided a budget update, in which he reported that the appropriated budget closed the fiscal year with a balance of \$3.7 million (15.5 percent savings) and the non-appropriated budget closed the fiscal year with a balance of \$26 million (6.8 percent savings).

A. 3-Year Policy Reviews-Technical Revisions

Chair Kuschel said the Committee considered technical revisions to two Board policies as part of the 3-year review process: the Board Charter Policy 1.00.110 and the Charter of the Board Vice Chair Policy 1.00.170

On behalf of the Administrative Committee, Mr. Miller moved that the Board approve the proposed technical revisions to the Board Charter Policy 1.00.110 and the Charter of the Board Vice Chair Policy 1.00.170. Ms. Guerin seconded, and the motion carried unanimously.

B. 3-Year Policy Reviews-Substantive Revisions

Chair Kuschel said also as part of the 3-year review process, the Committee considered substantive revisions to two Board policies. The Administrative Committee Charter Policy 1.00.120 was revised to include in the Administrative Committee's responsibilities the process of establishing the Confidential Secretary's compensation. The Board Monitoring and Reporting Policy 2.00.240 was revised to clarify the reporting responsibilities of WSIB staff to the Board and of the Board to external parties.

On behalf of the Administrative Committee, Chair Kuschel moved that the Board approve the proposed substantive revisions to the Administrative Committee Charter Policy 1.00.120 and the Board Monitoring and Reporting Policy 2.00.240. Vice Chair Sacks seconded, and the motion carried unanimously.

Chair Kuschel stated that the Committee also set its 2018 Committee meeting dates, which are the same as those proposed for the Board, with the exception of July.

Chair Kuschel explained that the Committee went into executive session to discuss the non-voting Board member expiring term review and evaluation. During this executive session the Committee also held a succession planning discussion and received a litigation update from the Assistant Attorney General. She said each of

these items would be discussed in detail in the executive sessions later in today's meeting.

6. AUDIT COMMITTEE REPORT

A. State Auditor's Office – Fiscal Year 2016 Accountability Audit – Exit Conference

On behalf of the Audit Committee, Ms. Holman moved that the Board accept the Fiscal Year 2016 State Auditor's Office Accountability Audit Report of the Washington State Investment Board. Ms. Guerin seconded, and the motion carried unanimously.

Ms. Holman reported that the Audit Committee reviewed the results of the accountability audit of the Washington State Investment Board. She said there were no audit issues, recommendations, or findings.

Ms. Holman reported that the Committee received an update on the status of six prior audit recommendations followed up on in the last quarter, which were all verified as resolved.

Ms. Holman stated that the Committee also received the internal audit report on the WSIB's Real Estate unit. The overall results were positive, with three recommendations: 1) ensure compliance with Board policy regarding the reporting of emerging market real estate program investments; 2) enhance legal documentation retention processes; and 3) ensure monthly staff reports are submitted in accordance with internal procedures. Management agreed with the recommendations, noting that some corrective action has occurred, and full completion is anticipated by October 31, 2017.

Ms. Holman shared that the Committee was provided information on the Internal Audit performance measures and quality assurance reporting for Fiscal Year 2017, a status update on the fiscal year 2018 internal audit plan, and the quarterly investment referral report. In addition, the Committee met in Executive Session to discuss an IT security update by management and the Audit Director's compensation.

7. PRIVATE MARKETS COMMITTEE REPORT

Ms. Guerin reported that the Private Markets Committee met on September 12, 2017, to consider two private equity investment recommendations.

A. Private Equity Investment Recommendation – New Mountain Partners V, L.P.

On behalf of the Private Markets Committee, Ms. Guerin moved that the Board invest up to \$200 million, plus fees and expenses, in New Mountain Partners V, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Ms. Holman seconded, and the motion carried unanimously.

Ms. Guerin said New Mountain Partners V, L.P. is a private equity fund with a target size of \$5 billion and a hard cap of \$5.85 billion that will pursue control investments in North American middle-market companies in “defensive growth” industries, consistent with its predecessor funds. If approved, this investment would represent a new general partner relationship falling into the unidentified allocation in the Board-approved 2017 private equity annual plan. The investment is consistent with the private equity model portfolio.

Ms. Guerin explained that the recommendation is based on the fund’s large and experienced investment team, focused strategy, consistent track record, defensive positioning, proprietary sourcing, value creation focus, and other factors relevant to the recommendation.

B. Private Markets Committee Recommendation – Wellspring Capital Partners VI, L.P.

On behalf of the Private Markets Committee, Ms. Guerin moved that the Board invest up to \$200 million, plus fees and expenses, in Wellspring Capital Partners VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Sacks seconded, and the motion carried unanimously.

Ms. Guerin stated that Wellspring Capital Partners VI, L.P. is a generalist buyout fund with a target size of \$1.2 billion and a hard cap of \$1.3 billion that will pursue value-oriented, control investments in North American middle-market companies, consistent with its predecessor funds. If approved, this investment would represent a new general partner relationship falling into the unidentified allocation in the Board-approved 2017 private equity annual plan. The investment is consistent with the private equity model portfolio.

Ms. Guerin relayed that the recommendation is based on the Wellspring Capital’s cohesive and experienced investment team, focused and consistent strategy, attractive returns, portfolio fit, favorable terms, and other factors relevant to the recommendation.

8. PUBLIC MARKETS COMMITTEE REPORT

Mr. Miller reported that the Public Markets Committee met on September 12, 2017. He said the committee discussed the Permanent Funds implementation and transition plan and associated policy changes, the 2018 Public Markets Committee meeting schedule, and a manager recommendation. In addition, the Committee received an education session on China A-Shares.

A. Permanent Funds Implementation and Transition Plan

On behalf of the Public Markets Committee, Mr. Miller moved that the Board approve the proposed revisions to the Permanent Funds Policy 2.25.100 and the Permanent Funds Policy 2.25.100 Addendum A. Ms. Holman seconded, and the motion carried unanimously.

Mr. Miller explained that at its June 15, 2017 meeting, the Board approved the hiring of State Street Global Advisors to manage a global equity portfolio for the Permanent Funds. WSIB staff and State Street worked together to develop a detailed implementation and transition plan for the addition of non-U.S. equities within the total 30 percent allocation to equities for the Permanent Funds. Mr. Miller stated that details for the decisions made regarding benchmarks, the dividend yield target, funding sources, and timing were highlighted in staff's presentation to the Committee, along with considerations for the ongoing transition and risks faced during the implementation and transition. In addition, recommended policy changes associated with the implementation and transition of the addition of non-U.S. equities to the Permanent Funds were presented by staff. He said the next steps include WSIB staff working with State Street Global Advisors to negotiate amendment terms for the existing contract and investment guidelines for the Permanent Funds equity portfolio.

9. EXECUTIVE SESSION

Chair Kuschel announced that the Board 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 Board would also discuss litigation or potential litigation with legal counsel since public knowledge regarding the discussion would likely result in an adverse legal or financial consequence to the WSIB. She said the executive session was expected to last approximately 15 minutes, after which time the Board would reconvene in open session.

[The Board went into executive session at 11:32 a.m.]

A. Public Markets Committee Report (continued): CTF Public Equity Program Recommendation

B. Administrative Committee Report (continued): Assistant Attorney General's Report – Litigation Update

[Public notice was given that the executive session would be extended. No members of the public were waiting to attend.]

[The Board reconvened in open session at 12:05 p.m.]

On behalf of the Public Markets Committee, Mr. Miller moved that the Board take the action discussed in Executive Session. Senator Mullet seconded, and the motion carried unanimously.

On behalf of the Administrative Committee, Chair Kuschel moved that the Board take the action discussed in Executive Session. Ms. Guerin seconded, and the motion carried unanimously.

[The Board recessed at 12:07 p.m. and reconvened at 12:28 p.m.]

11. CTF ASSET ALLOCATION

A. 2017 CTF Strategic Asset Allocation Recommendation

Ms. Tucker explained that the recommended asset allocation to be presented is based on the dialogue that took place at the July Board meeting. She discussed the selected set of investment beliefs, mission of the fund, risk, approach, and relative performance of asset classes, as well as the additional considerations of liquidity, finite resources, and strategies and structures. Ms. Tucker reviewed the work performed by the Board over the last year in connection with the strategic asset allocation process, explaining that because the process can take up to a year and a half, it is only done every 4 years.

Ms. Tucker stated that the modeling based on the July Board meeting voting exercise resulted in an optimal portfolio of 20 percent to fixed income, 7 percent to tangible assets, 18 percent to real estate, 30 percent to public equity, and 25 percent to private equity; however, further analysis by staff resulted in two adjustments to the modeled result due to implementation concerns. She said the first adjustment was retention of the current 23 percent weight to private equity, given challenges foreseen in reaching a higher allocation. Policy provides for a 4 percent variance, which allows the portfolio to increase up to 27 percent over the 4-year timeframe. Ms. Tucker relayed that the second adjustment was an increase in public equity to 32 percent, with the 2 percent addition resulting from the retention of the current private equity allocation.

Mr. Bruebaker said staff pushed hard to find a reasonable way to get the private equity allocation up to 25 percent but believes it will take the full 4 years to get the allocation to 23 percent, due to market conditions.

Ms. Tucker reviewed the allocation changes between the current and proposed policies, together with the deviation ranges. She discussed the expected 15-year return distribution, which is effectively unchanged with the proposed allocation; however, the downside risk is reduced slightly.

Ms. Tucker explained that should the proposed asset allocation be approved, staff would come back to the Board in November with a policy change recommendation, including a 4-year implementation plan.

Ms. Guerin asked why staff recommends the 2 percent increase in public equity rather than in real estate or tangible assets. Ms. Tucker replied that both real estate and tangible assets are constrained, and public equity is the general funding source for private equity.

In response to Mr. Longbrake's inquiry about the current variance between the target allocation and actual allocation in private equity, Mr. Bruebaker explained that it would be necessary to do bigger deals and to revise the Board's concentration policy to reach the target allocation. He explained that the larger funds, many of which are long-time partners, are cutting back the WSIB's allocations, as there is too much demand for private equity. In addition, partners are using lines of credit rather than limited partner capital, which is costing the WSIB about 1 percent. Revising the model portfolio and putting more to work with bigger funds won't work in the current market environment, so staff is looking at ways to incrementally add to commitments. Mr. Bruebaker said it is staff's intent to continue to strive for deeper relationships and make incremental differences on the margin, but it won't be enough to get to the target.

Discussion ensued around the 15-year expected rate of return for individual asset classes and the trend of declining rates of return since the global financial crisis; the effect on the allocation shifts due to future market corrections and the likelihood of actual allocations shifting outside of the target ranges; the speed of changes to the public equity portfolio which could cause actual allocations outside of the target bands; and staff's attention to market trends and ability to recommend asset allocation changes to the Board should major shifting occur.

Ms. Guerin moved that the Board approve a strategic asset allocation policy that includes a 3 percent increase to the real estate allocation, a 2 percent increase to the tangible assets allocation, and a 5 percent decrease to the public equity allocation. Mr. Miller seconded, and the motion carried unanimously.

Ms. Tucker said staff has been in discussions about how to implement the allocation changes. Staff will to work to rebalance assets, which will be done in a few waves, beginning now.

12. EDUCATION SESSION

A. CEM Results and Cost Comparison

Mr. Heale shared a comparison of the WSIB cost and return performance to that of its peers. He said the WSIB's 5-year net total return of 9.5 percent was above both the U.S. public median of 8.7 percent and the peer median of 8.4 percent. The total return of 9.5 percent is comprised of a policy return of 9.3 percent, which is above both the U.S. public median and the peer median, and value add of .2 percent.

Mr. Heale shared differences in policy returns caused by differences in benchmarks and policy mix, reviewing the 5-year returns for frequently-used benchmark indices. He explained why the WSIB's 5-year policy return exceeded the U.S. public median and how the value add component is calculated.

Mr. Heale stated the WSIB had positive 5-year net value added in all stock and real estate, and he discussed the 5-year net returns in all major asset classes. He reviewed long-term net return, policy return, and net value added relative to the U.S. Public median, stating that the WSIB's performance is very strong across the board. He reported that the WSIB had positive 21-year value added and net returns in stock, fixed income, real estate, and private equity.

Mr. Heale relayed that the WSIB investment costs were \$457.8 million, 55.6 basis points, in 2016, and he discussed the benchmark cost analysis which suggests the WSIB was 12.1 basis points low cost in 2016.

Senator Mullet inquired about the exclusion of performance fees in the CEM's analysis. Mr. Heale responded that although CEM asks for the information from funds in its database, only 33 percent of these funds provide the information; thus, CEM is not comfortable enough with the data to consider these costs in its benchmark.

Mr. Bruebaker stated that the Board has previously taken the stance that carried interest and other private market performance fees are not expenses, but rather they represent a sharing of profit.

Mr. Heale discussed differences in cost performance due to implementation style, explaining differences between the WSIB's investment program versus that of peers. He said the difference in implementation style resulted in a savings of 5.6 basis points relative to that of the WSIB's peers, and the net impact of paying more/less for similar services saved 6.5 basis points, a large portion of which is attributed to real estate.

Mr. Heale summarized the components contributing to the overall cost savings of \$99.3 million in 2016, and he discussed the 5-year and 21-year cost effectiveness peer comparison, explaining the difference in risk levels between the WSIB and its peers.

Mr. Heale summarized the key takeaways of the analysis: solid 5-year returns and value added, good long-term performance, efficient implementation of the program, and the WSIB's somewhat higher risk level.

Discussion ensued around the impact on risk measurements based on the time frame considered and the results of an increased or reduced time frame; the impact of an increased allocation to private markets during periods of generally lower returns; the standardization process used by CEM to compare risk; and the constrained real estate portfolio.

13. PERFORMANCE REPORTS

A. CTF Quarterly Performance Update

Mr. Bruebaker reported that the CTF is up 4.01 percent for the 3 months ended June 30, 2017, and 13.44 percent for the year, and equity markets are up 8.75 percent since inception as of August 31, 2017. He explained that for the quarter ending June 30, 2017, the WSIB outperformed 18 of the 21 benchmarks measured, with the underperformance in the 10-year implementation value added and the 10-year TUCS. Mr. Bruebaker stated that cash, fixed income, tangible assets, real estate, and the innovation portfolio all outperformed their respective benchmarks, and although public equity and private equity underperformed, they achieved strong returns of 18.95 and 16.81 percent respectively. He opined that the WSIB's investment portfolios continue to be positioned well for the long term.

14. 2018 MEETING SCHEDULE

Ms. Kuschel presented the proposed 2018 Board meeting dates, explaining that by statute, meetings fall on the third Thursday of each month; however, no meetings are proposed for the months of January, March, May, August, and October. The meeting dates for 2018 are: February 15, April 19, June 21, July 10-12, September 20, November 15, and December 13-14.

Ms. Holman moved that the Board approve its 2018 meeting schedule as proposed. Mr. Miller seconded, and the motion carried unanimously.

15. STRATEGIC INSIGHT TOPIC DISCUSSION

Ms. Whitmarsh explained that staff would like to capture suggestions for future Board education sessions, reviewing a few that had previously been shared. Additional topics suggested included climate change in real estate (Chair Kuschel) and how natural disasters impact the WSIB's investment portfolio, including case studies and mitigations (Vice Chair Sacks).

Mr. Bruebaker relayed to the Board that there has been minimal impact to the portfolio due to the recent disasters in Mexico and Florida.

Mr. Miller suggested a discussion on the benefits of region-based advice on direct investing, using real estate as an example of on-the-ground analysis. Mr. Bruebaker explained that WSIB invests with people who are on the ground and experts in the

locales where the investments are being made and Ms. Whitmarsh described staff's process of due diligence to understand the markets in which the WSIB invests.

Additional suggested topics included investing in Africa and South America (Ms. Guerin); discussion relative to social impacts, including job creation, from private equity partners (Ms. Makowski); a discussion with someone from the investment side to discuss how technology changes the investment world (Mr. Longbrake); human genome research and investment opportunities over time (Mr. Longbrake); technology disruption from the perspective of a long-term investor as industries trend toward obsolescence (Ms. Pugh); the WSIB's competitive advantages in real estate and private equity, the sustainability of those advantages in light of the changing market conditions, and how does the WSIB evolve to maintain the advantages (Ms. Pugh); who are our peers that are doing things differently and what are we not thinking about that we should be considering (Vice Chair Sacks); and a discussion around investments in start-up companies that are creating new types of jobs for the future (Ms. Holman).

16. INNOVATION PORTFOLIO – RISE FUND UPDATE

Ms. Tucker explained that the Board officially adopted the Innovation Portfolio in 2005 to establish a platform within the CTF for investments that did not fall neatly into one of the existing asset classes, with a secondary purpose of providing a testing ground through which the WSIB could commit smaller dollar amounts. The portfolio, approved with a 0 percent target and a 5 percent maximum, is not meant to be a portfolio with pressure to invest, and for the first 10 years it was owned collectively by the Investment Division. Ms. Tucker said that last year the portfolio was assigned to the Risk Management and Asset Allocation (RMAA) unit, which provides dedicated staff to the portfolio. The unit will add an assistant senior investment officer for this purpose; however, the portfolio still isn't exclusive to the RMAA unit. Historically underutilized, the Innovation Portfolio represents an average of about 50 basis points of the CTF, and since the transfer to RMAA, two additional investments have been made.

Discussion ensued around the source of funding and return targets of Innovation Portfolio investments.

Mr. Natale relayed that earlier in the year the WSIB was presented with an opportunity to execute a highly differentiated investment within the context of the Innovation Portfolio. This opportunity rose in connection with TPG forming the Rise Fund: a partnership between TPG Growth; a founders board of global philanthropists, activists, and business leaders; and a small group of select institutional investors such as the WSIB, with the objective of making investments in business that meet the same exact financial returns and underwriting standards as any other private equity investment made by TPG Growth, but also, at the same time, can have a demonstratively positive social and environmental impact that is inherent and intentional in their core strategy. The Rise Fund invests in the U.S. and across the world, along sector themes, predominantly in healthcare, education, information and communication technologies, financial services, energy access, food and agriculture, and growth infrastructure. The WSIB committed \$200 million toward the fund's cap of \$2 billion.

Discussion ensued regarding other investment funds in the impact investing space, the challenge of matching impact investment returns with market returns, the differentiator of scale benefiting the Rise Fund, the WSIB's ability to invest in the fund due to its

strategy of meeting the triple bottom line, and the amount of capital provided by the founding partners and other institutional investors.

17. EXECUTIVE SESSION

Chair Kuschel announced that the Board 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. She said the Board would also discuss the performance of public employees. The executive session was expected to last approximately 100 minutes, after which time the Board would reconvene in open session.

[The Board recessed at 2:04 p.m. and reconvened in Executive Session at 2:20 p.m.]

A. Administrative Committee Report (continued): Board Self-Evaluation

B. Administrative Committee Report (continued): Non-Voting Board Member Expiring Term Review/Evaluation

C. Rise Fund Strategy Discussion

[The Board reconvened in open session at 3:47 p.m.]

18. Other Items

There were no other items presented.

19. Adjournment

There was no further business to come before the Board, and the meeting adjourned at 3:48 p.m.

Judy Kuschel
Board Chair

ATTEST
Theresa J. Whitmarsh
Executive Director