

**WASHINGTON STATE INVESTMENT BOARD (WSIB)
PERMANENT FUNDS EQUITY MANAGEMENT
SEARCH DOCUMENT**

Search Objective:

The WSIB is seeking a firm to manage a dividend-oriented, tax-managed, global equity portfolio on behalf of the higher education and public instruction non-retirement permanent funds. In evaluating potential managers, consideration will be given to minimization of realized gains and losses, consistent dividend yield generation, portfolio turnover, and predicted tracking error relative to the chosen benchmark.

Currently, the equity portfolio is U.S. only. It is benchmarked to the Russell 3000 Index with a tracking error target of 70 basis points and a maximum tracking error of 100 basis points. The guidelines currently call for a portfolio dividend yield between 3.25 and 3.50 percent, with no individual stock having a dividend yield over 15 percent. WSIB staff anticipate the global portfolio would be managed in a manner similar to the current U.S. only portfolio.

In accordance with WSIB investment policy, the permanent funds' investments are to be managed to preserve the funds' capital consistent with the desire to emphasize high current yield to maturity opportunities and to achieve the highest return possible at a prudent level of risk. Because all investment income must be distributed to stakeholders by law, it is the stakeholders' aim to keep realized capital gains and losses for the aggregate total portfolio as close to zero as possible.

The WSIB is open to discussing the appropriate benchmark and tracking error for the global equity strategy given the goals and principles of the permanent funds. The WSIB has a preference for an ACWI benchmark that includes emerging markets but is open to negotiating with the selected manager what will be most practical and most appropriate for this mandate. WSIB will consider both standard as well as High Dividend Yield Indexes as potential benchmarks. The chosen manager will transition the current U.S.-only equity portfolio to a global equity portfolio over time, potentially 3 to 5 years. The exact timing will depend on several factors, including choice of funding source (contributions, maturities of fixed income investments, or sales from the current U.S.-only portfolio) and the stakeholders' desire to minimize realized capital gains and losses.

It is the desire of the WSIB to find a global equity manager in which the WSIB has high conviction, with strong capabilities for running dividend-oriented strategies while managing realized capital gains and losses.

Potential candidates should review the minimum and desirable qualifications set forth. If an interested candidate meets the minimum qualifications, they may participate in this search process by following the steps below by October 31, 2016.

1. All candidates wishing to be considered in the search are requested to contact Kyle Fekete of Callan Associates Inc, at 415-291-4133 or Fekete@callan.com to indicate interest and to obtain the necessary supplemental RFI to be completed and returned to Callan by October 31, 2016.
2. If a potential candidate's relevant product(s) are currently in Callan's database, the candidate must ensure that all current and historical information is accurate for both the relevant

product and organization. Information should be submitted in the manner the consultant requires and should be stated in the manner the offering firm desires it to be seen and evaluated.

3. If a potential candidate's relevant product(s) or organizational information is not yet in Callan's database, please contact Kyle Fekete of Callan Associates Inc., at 415.291.4133 or fekete@callan.com to obtain the necessary questionnaire for the submission of information into the consultant's database. Information should be submitted in the manner the consultant requires and should be stated in the manner the offering firm desires it to be seen and evaluated.
4. If candidate is submitting a customized product or solution, the supplemental RFI will service as the basis for evaluation (along with any other requested information) in lieu of a standard questionnaire submission.
5. In addition, candidates will need to ensure that the eVestment database is up to date with complete data as of September 30, 2016, and updated each quarter subsequently.
 - eVestment Alliance, LLC database, contact Paul Loudon, at 678.569.1465, paul@evestment.com.

Complete Supplemental RFI and current and historical data must be in the databases or returned to Callan no later than October 31, 2016, with quarterly data updated throughout the search.

Background

The WSIB is one of the largest institutional investors in the United States. The WSIB manages several pools of assets in addition to the state's pension funds, including five funds that help support the physical maintenance budgets of six higher education institutions and K-12 schools (the "permanent funds" or "perm funds"). It is for these permanent funds that the WSIB is seeking a firm to manage a dividend-oriented, tax-managed, global equity portfolio.

The current permanent funds' equity portfolio (approximately \$300 million) is U.S.-only and consists of a single passive dividend-oriented, tax-managed portfolio benchmarked to the Russell 3000 Index. In June 2016, the WSIB Board approved the addition of non-U.S. Equity to the permanent funds target allocation. The WSIB intends to transition the permanent funds' current U.S.-only equity portfolio to a global equity portfolio.

The permanent funds have several characteristics that make them very different from the pension assets WSIB manages:

- 100 percent of investment income (including both dividends and realized capital gains/losses) is distributed to beneficiaries by law.
- Legal separation of corpus versus income.
- Growth of corpus occurs when Department of Natural Resources (DNR) transfers income from timber sales to the funds or, in the case of the Common School Fund, money is received from other sources in addition to funds from DNR.
- DNR contribution rates vary by beneficiary, creating divergent outcomes over the long term.

The permanent funds' strategic objectives include:

- Safety of principal
- Current income
- Long-term stability of purchasing power
- Preservation of the public's trust

Anticipated Investment Guidelines

WSIB staff anticipate that the global equity portfolio will be managed in a manner similar to the current U.S. only equity portfolio. Investment guidelines will be developed to meet the unique needs of the permanent funds, which include consistent dividend yield and minimized realized gains and losses.

- **Benchmark:** The WSIB has a preference for an ACWI benchmark that includes emerging markets but is open to negotiating with the selected manager what will be most practical and most appropriate for this mandate. WSIB will consider both standard as well as High Dividend Yield Indexes as potential benchmarks.
- **Predicted Tracking Error:** Dependent on selected benchmark and negotiation with the selected manager. The WSIB anticipates maintaining tracking error close to the current range (70 to 100 basis points) but is willing to negotiate. Significantly higher tracking errors are not viewed as a good fit for this mandate.
- **Predicted Dividend Yield:** Approximately 3.50 percent to 4.00 percent; consistency of dividend yield is of primary importance.
- **Realized gains and losses:** By law, all investment income, including both dividends and realized capital gains and losses, must be distributed to the stakeholders. Therefore, any realized gains without offsetting realized losses create an unintended distribution to the stakeholders, one that they would strongly prefer to avoid in favor of reliability and consistency of distributions while growing the assets to achieve intergenerational equity. Ideally, realized gains and realized losses within the portfolio should be balanced so as to keep the aggregate total portfolio from incurring any forced distributions; at all times realized gains and losses MUST be kept as close to zero as possible.

Managers will be evaluated based on whether they can offer a mandate that accomplishes these objectives; whether the product is labeled “passive” or “active” is not a criterion. Regardless of whether a product is labeled passive or active, consistency of dividend income, low volatility, and the ability to keep realized gains and losses near zero are more important for this mandate than the ability to actively add value relative to the chosen benchmark.

It is anticipated that the selected manager will be utilized in the management of the non-retirement permanent funds. The WSIB does not anticipate using the chosen manager in the Retirement Commingled Trust Fund), but, upon mutual agreement, the chosen manager may be considered for use in other investment programs in the future including both defined benefit or defined contribution plans, and/or both qualified retirement programs and non-qualified programs. However, the ability to serve other programs is not a requirement of the search.

Further information on the WSIB and its investments can be found on this website:
<http://www.sib.wa.gov/>

Further information on the Public Equity program of WSIB can be found here:

http://www.sib.wa.gov/financial/pdfs/pue_opp.pdf

Selection Criteria/Minimum Qualifications

As of September 30, 2016, candidate firms must satisfy the minimum requirements as outlined below in order to be considered for selection to this mandate:

- A. Must currently provide a global equity product.
- B. Must be able to offer a separate account.
- C. Must be willing and able to offer daily liquidity (no lock-ups of any kind will be considered).
- D. Must be willing to act as a fiduciary when performing these services and certify in writing to that fact.
- E. Must be a U.S. Securities and Exchange Commission (SEC)-registered investment advisor, an advisor exempt from registration (Form ADV, Parts 1 and 2, or disclosure of the exemption must be submitted), or registered with the appropriate foreign regulatory body.
- F. Must be GIPS Compliant for the subject investment product being offered. Firms that are not currently GIPS compliant may submit a written commitment that, should they win the mandate, they will become GIPS compliant within twelve months of contract signature.
- G. Key professionals and/or the organization must not have, nor could they potentially have, a material conflict with the WSIB or its consultants.
- H. Must be willing to provide WSIB staff transparency into all material aspects of the investment process.
- I. Must have adequate fiduciary insurance coverage. At a minimum, each Candidate must provide proof of Errors and Omissions/Professional Liability Insurance.
- J. Must conduct an annual SSAE16 audit or have in place an appropriate operational control structure that will be evaluated by WSIB and judged to be a reasonable alternative.

Desirable Qualifications

As of September 30, 2016, the following characteristics are desirable:

- A. Have a total of \$500 million in dividend-oriented equity product(s) that effectively minimizes realized gains and losses.
- B. Have at least three to five (3-5) years of performance history (GIPS Compliant) for the subject investment product or similar investment product.
- C. Have experience with minimizing realized gains and losses in a portfolio.
- D. Have the ability to assist in the transition of the portfolio from U.S. equity only to global.
- E. Have demonstrated experience with large public funds such as the WSIB.

Undesirable Qualifications

As of September 30, 2016, the following characteristics are undesirable:

- A. A history (especially a recent year) of significant client or investment professional turnover.
- B. Organizational instability, including, but not limited to, any financial distress.
- C. Any evidence of legal or regulatory issues.

Contract

The terms, conditions, and approach to the contract shall be based on the sample contract that will be provided during due diligence to finalist candidates.

Candidates for this mandate will be expected to perform duties under a contract with the care, skill, prudence, and diligence under the circumstances then prevailing that an ordinary prudent investor, acting in like capacity and familiar with such matters, would use in the performance of similar services, all in accordance with the applicable federal and state laws as well as WSIB policies, guidelines, and procedures. The candidates shall not: (a) deal with WSIB assets in candidate's own interests or for its own account, or the account of its principals or affiliates; (b) act in any transaction involving WSIB assets on behalf of a party, or represent a party, whose interests are known to candidate to be adverse to the interest of the WSIB; (c) take any action or render any services when candidate's independence of judgment on behalf of the WSIB is or could reasonably be affected; or (d) receive any consideration for its own account, or for the account of any of its principals or affiliates, from any third party that candidate knows or should know is being offered or given with the intention to influence the advice or services required or rendered under an Agreement with the WSIB.

Search Modification

The WSIB reserves the right to change the schedule or modify any part of the search by issuance of an addendum which will be posted to the WSIB website. Candidates are advised to check the site regularly prior to the due dates.

Description of Evaluation Process

Any and all information that is gathered from any source, including, but not limited to, electronic submittals; consultant candidate material and subsequently requested written materials; site visits; in-person, telephone, and/or video interviews; oral presentations; and any other relevant material will be utilized in selecting the successful candidate(s).

Material will be evaluated by WSIB staff, and, eventually, the WSIB Board of Trustees. During the evaluation process, WSIB reserves the right to request additional information or clarification from candidates. At the discretion of the WSIB, either telephonic/video, in-person, or on-site interviews may be requested of candidates. The candidate(s) selected shall be required to make a presentation to the WSIB Public Markets Committee.

Further, the WSIB reserves the right, at its sole discretion, to reject, without penalty, any and all candidates. The final selection, if any, will be the candidate, which in the opinion of the WSIB, best meets the requirements and is in the best interest of the WSIB, the state of Washington, and the fund stakeholders.

Through the selection process, the WSIB reserves, at its sole discretion, the right to select the candidate(s) that is the best fit in awarding the contract. WSIB reserves the right: (i) not to select any

candidate; (ii) to select any particular product for further consideration; (iii) to accept a candidate other than the lowest cost provider; (iv) to remove a candidate from consideration at any time for criteria that is judged not in the best interest of the WSIB; or (v) to reject any and all candidates if such action is considered by WSIB in its sole discretion to be in the best interests of WSIB.

All material submitted in response to this competitive procurement shall become the property of the WSIB. Such material is subject to public disclosure requests pursuant to Washington's Public Records Act, found in Chapter 42.56 Revised Code of Washington, as well as pursuant to rules promulgated by the WSIB, in Chapter 287-02 Washington Administrative Code and cases decided by Washington courts. The WSIB's public records policy may be viewed at:

http://www.sib.wa.gov/information/pdfs/policies/2_00_250.pdf

Eligibility to Compete

Any firm(s) that, either as a parent company, subsidiary, or affiliate, is currently performing consulting services for the WSIB may **not** compete in this procurement. The firm(s), or any subsidiary, affiliate, or parent company thereof, selected as a result of this procurement may **not** compete, during the term of the resulting contract and any extensions thereto, in any subsequent WSIB procurement, the main purpose of which is to hire a firm or firms for consulting purposes.

WSIB BOARD CONTACT

The Search Coordinator is the sole point of contact for this procurement. Throughout the duration of this search, all communications are to be directed, in writing, to the contact listed below.

WASHINGTON STATE INVESTMENT BOARD
2100 EVERGREEN PARK SW, P.O. BOX 40916
OLYMPIA, WA 98504-0916
ATTN.: RUTH QI, SEARCH COORDINATOR
TELEPHONE: (360) 956-4749
FAX: (360) 956-4775
E-MAIL: rqi@sib.wa.gov

Contact by candidate's staff or by anyone on behalf of the candidate with WSIB staff, Board members, or consultant regarding this search after issuance of this search document and not previously authorized by the Search Coordinator, will disqualify the candidate. However, contact with the consultant is expressly authorized to coordinate the delivery of data into the database and to facilitate review and discussion with the consultant as they gather information.