

POLICY NUMBER: 2.10.200**EFFECTIVE DATE:** 10/4/16**TITLE:** Fixed Income Retirement Funds**SUPERSEDES:** 9/17/15**BOARD ADOPTION:** 9/17/15**APPROVED:** 

PURPOSE

This document outlines the investment policy and guidelines for the fixed income segment of the Washington State Investment Board (WSIB) retirement funds.

These guidelines allow for sufficient flexibility in the management process to capture investment opportunities, yet provide parameters that ensure prudence and care in the execution of the retirement fixed income investment program.

POLICY**Standard of Care**

Under Revised Code of Washington (RCW) 43.33A.030, trusteeship of funds under the authority of the WSIB is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives below.

Strategic Investment Objectives

The fixed income segment is to be managed to:

- A. Achieve the highest return possible consistent with the desire to:
 - (1) Control asset volatility.
 - (2) Emphasize high yield to maturity opportunities to add value through active management.
- B. Provide diversification to the WSIB's overall investment program.
- C. Provide liquidity to the WSIB's investment program.

Investment Performance Objective

The WSIB's fixed income investments are to be actively managed to meet or exceed the return of the Bloomberg Barclays Capital Universal Bond Index, with volatility similar to or less than the index.

Investment Approach

The investment approach shall be to identify enhanced yield opportunities across bond market segments and to invest where credit and reinvestment risks are understood and can be managed well within yield benefits.

The WSIB will manage the four major categories of fixed income risk:

- 1. Interest Rate Risk
- 2. Yield Curve Risk
- 3. Credit Risk
- 4. Reinvestment Risk

Interest Rate Risk is price volatility produced by changes in the overall level of interest rates.

Yield Curve Risk is price changes induced by the changing slope of the yield curve.

Credit Risk is the uncertainty surrounding the borrower's ability to repay its obligations.

Reinvestment Risk is the uncertain future yield opportunities available to invest funds which become available due to call, maturity, or coupon generated cash flow.

Strategies

Analysis of macro-economics, market and industry fundamentals, company financial statements, and security valuations are incorporated into the decision-making process. Strategies may include interest rate anticipation and sector rotation.

Permissible Fixed Income Investments

Any and all fixed income securities are permissible unless specifically prohibited, including, but not limited to, the following:

1. U.S. Treasuries and Government Agencies.
2. Credit Bonds including bank deposits.
3. Investment Grade Mortgage-Backed Securities as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices.
4. Investment Grade Asset-Backed Securities as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices.
5. Investment Grade Commercial Mortgage-Backed Securities as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices.
6. Convertible Securities.
7. Non-Dollar Bonds.
8. Washington State Housing Finance Commission (HFC) taxable municipal bonds up to a total of \$50 million with a maximum of \$10 million purchased per year.

Other fixed income segments and instruments may be added from time to time as they are developed or deemed appropriate.

Sector Allocations

Sector allocations are to be managed within the ranges presented below. These targets are long term in nature. Deviations may occur in the short term as a result of interim market conditions; however, if a range is exceeded, the portfolio must be rebalanced to the target allocations as soon as it is practical.

Target Allocations for the Fixed Income Sectors:

	<u>Range</u>
U.S. Treasuries and Government Agencies	10 – 45%
Credit Bonds	10 – 80%
Asset-Backed Securities	0 – 10%
Commercial Mortgage-Backed Securities	0 – 10%
Mortgage-Backed Securities	5 – 45%
Total Bonds	100%

Duration

The fixed income portfolio's duration is to be targeted within plus or minus 20 percent of the duration of the portfolio's performance benchmark, the Bloomberg Barclays Capital Universal Index.

Risk Constraints

- A. All assets under management by the WSIB are to be invested to maximize return at a prudent level of risk (RCW 43.33A.110 and RCW 43.33A.140).
- B. RCW 43.33A.140 prohibits a corporate fixed income issue's cost from exceeding 3 percent of the Retirement Commingled Trust Funds' (CTF) market value at the time of purchase and its market value from exceeding 6 percent of the Retirement CTF's market value at any time.
The WSIB will manage this fund with a more restrictive concentration constraint than required by the cited RCW. Exposure to any corporate issuer will not exceed 3 percent of the Retirement CTF Fixed Income Portfolio's market value.
- C. The par value of bonds from any one issuer with a below investment grade rating (as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices) shall not exceed 1 percent of the total portfolio's par value.
- D. Total market value of below investment grade credit bonds (as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices) shall not exceed 15 percent of the market value of the fixed income portfolio.
Non-rated bonds are permissible investments. Staff will assign a rating to such bonds based on the most objective measures available.
- E. Although below investment grade mortgage-backed, asset-backed, or commercial mortgage-backed securities may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held.
The total market value of below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities shall not exceed 5 percent of the market value of the fixed income portfolio.
"Investment grade" is defined by the Bloomberg Barclays Capital Global Family of Fixed Income Indices.
- F. If, in the judgment of the Senior Investment Officer for Fixed Income and the Chief Investment Officer (CIO), liquidity in the public markets is impaired, the sector ranges described in this policy will be suspended. The suspension will allow for the sale of Treasuries and reduce the likelihood of forced sales of non-Treasury securities at impaired prices. The suspension of target ranges will take effect upon written notice from the CIO to the Executive Director. If suspended, the ranges will be reinstated as soon as it is feasible once liquidity returns.

Reporting

- A. A management information system is to be used for reporting internally to the CIO or his/her designee on the implementation of this policy. This report is prepared monthly and includes, but is not limited to:
 - 1. Current market value and allocations, by sector, compared to the index and the policy ranges.
 - 2. Aggregate and individual portfolio characteristics compared to guidelines.

Delinquencies and defaults will be reported to the CIO immediately.
- B. An executive management report is to be provided to the Board quarterly showing market values and performance.

RESPONSIBILITIES

Washington State Investment Board

The Washington State Investment Board is responsible for approving the portfolios' investment policy and reviewing the structure, strategy, and performance of the portfolios.

Public Markets Committee

The Committee is responsible for reviewing the investment policy and recommending any revisions to the Board.

Staff

Staff is responsible for recommending to the Public Markets Committee enhancements and changes to the investment policy, implementing the policy, managing the assets, and reporting performance and policy compliance to the Board.

POLICY REVIEW

The Board shall review this policy at least once every three (3) years to ensure that it remains relevant and appropriate.

Original Policy Adopted 6/29/81
Revised 11/9/81
Revised 5/10/82
Revised 8/9/82
Revised 11/8/82
Revised 11/14/83
Revised 6/16/92; supersedes Policy 2.15.200
Revised 6/16/94
Revised 9/15/94
Revised 3/16/95
Revised 4/18/96
Revised 5/21/98
Revised 3/30/01 (Supersedes Policy 2.15.100, 5/21/98)
Revised 4/18/02
Revised 6/20/02
Revised 7/21/05
Revised 9/18/08
Revised 10/31/08
Revised 12/17/09
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Revised 9/17/15
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