

POLICY NUMBER: 2.20.100**EFFECTIVE DATE:** 6/15/17**TITLE:** Labor and Industries' Insurance Funds**SUPERSEDES:** 1/16/14**BOARD ADOPTION:** 6/15/17**APPROVED:** 

PURPOSE

This document outlines the guidelines and investment policy for the Department of Labor and Industries' (L&I) Insurance Funds managed by the Washington State Investment Board (WSIB), and supersedes any prior Board-adopted policies. These guidelines allow for sufficient flexibility in the management process to capture investment opportunities, yet provide parameters that will ensure prudence and care in the execution of the investment program.

POLICY**Standard of Care**

Under Revised Code of Washington (RCW) [43.33A.030](#), trusteeship of the 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 all WSIB 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 listed below.

Investment Objectives

In accordance with RCW [43.33A.110](#), the portfolio is to be managed to limit fluctuations in the industrial insurance premiums, and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the order of the objectives shall be:

1. Maintain the solvency of the funds.
2. Maintain premium rate stability.
3. Ensure sufficient assets are available to fund the expected liability payments.
4. Subject to those above, achieve a maximum return at a prudent level of risk.

Investment Performance Objectives

The investment performance objectives are intended to provide the WSIB and L&I with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost the performance of the investment portfolios shall be judged relative to the Investment Objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each fund. The CMIs are developed and calculated by the consultant with the goal to construct a hypothetical passive portfolio with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each L&I fund. The return for each fund's portfolio should not be significantly different from that of its CMI over the long term.

Risk Constraints

- A. The L&I funds are to be managed to attempt to limit fluctuations in the industrial insurance premiums and, subject to that purpose, maximize return at a prudent level of risk.

- B. In accordance with the requirements of [RCW 43.33A.110](#). No corporate fixed income issue's or common stock holding's cost shall exceed 3 percent of the fund's market value at the time of purchase, nor shall its market value exceed 6 percent of the fund's market value at any time ([RCW 43.33A.140](#)).

Asset Allocation

	Target and Ranges		
	Fixed Income	Equity	Real Estate*
Accident Fund	80% ±6	15% ±4	5% ±2
Pension Reserve Fund	85% ±5	10% ±3	5% ±2
Medical Aid Fund	75% ±7	20% ±5	5% ±2
Supplemental Pension Fund	100%	0%	

*If Real Estate, due to timing or illiquidity is above or below its target, Fixed Income will be used to offset the balance.

Asset allocation will be reviewed every 4 years, or sooner, if there are significant changes in funding levels or the liability durations.

Market conditions, funding status, and liability assumptions are dynamic; therefore, WSIB staff will meet quarterly with L&I staff to review the investment portfolios.

The Board has delegated to the executive director the authority to rebalance the asset allocation within the procedures established by the WSIB. Assets will be rebalanced across asset classes when market values of the assets fall outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

Asset Class Structure

Asset class structure is established by the Board with guidelines for staff to move assets in order to achieve the funds' overall objectives.

Equity

The benchmark and structure for global equities will be the MSCI All Country World Investable Market Index net with USA gross (MSCI ACWI IMI net with USA gross). The equity portfolio will be 100 percent passively managed in one or more commingled index funds. The commingled fund(s) may use futures for hedging or establishing a long position.

Fixed Income

The fixed income portfolios' structure will vary widely among funds depending upon the required duration target.

Accident Fund (608): within plus or minus 20 percent of a duration target of six.

Pension Reserve Fund (610): within plus or minus 20 percent of a duration target of eight.

Medical Aid Fund (609): within plus or minus 20 percent of a duration target of five.

Supplemental Pension Fund (881): duration will remain short.

The duration targets will be reviewed every 4 years, or sooner, if there are significant changes in the funding levels or the liability durations.

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time those differences should not be material.

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.
3. Investment Grade Mortgage-Backed Securities as defined by Bloomberg Barclays Family of Fixed Income Indices.
4. Investment Grade Asset-Backed Securities as defined by Bloomberg Barclays Family of Fixed Income Indices.
5. Investment Grade Commercial Mortgage-Backed Securities as defined by Bloomberg Barclays Family of Fixed Income Indices.
6. Investment Grade Non-U.S. Dollar Bonds.

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 portfolios must be rebalanced as soon as it is practical to the target allocations.

Target Allocations for Fixed Income Sectors:	<u>Range</u>
U.S. Treasuries and Government Agencies	5 – 25%
Credit Bonds	20 – 80%
Asset-Backed Securities	0 – 10%
Commercial Mortgage-Backed Securities	0 – 10%
Mortgage-Backed Securities	0 – 25%
Total Bonds	100%

Total market value of below investment grade credit bonds (as defined by Bloomberg Barclays Family of Fixed Income Indices) shall not exceed 5 percent of the total market value of the funds. If the market value of the below investment grade credit securities exceeds 5 percent due to ratings downgrades, portfolio holdings may continue to be held, but no additional purchases of below investment grade credit securities are allowed.

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 total market value of the funds.

Real Estate

The objectives and characteristics of the real estate portfolio are as follows:

1. The real estate portfolio will seek to generate a 6 percent annual investment return over a rolling 10-year period.

2. The majority of the return will be generated by current income, and the portfolio will intentionally be constructed with a focus on yield rather than total return.
3. The focus will generally be on making smaller investments at the asset level in order to provide maximum diversification across geography and property type.
4. The portfolio will be geographically diversified as staff will evaluate potential investments based on anticipated after-tax yield. A given country's tax regime will be a key point of consideration when evaluating potential investments.
5. The WSIB's real estate staff will primarily utilize an asset-based approach to building the L&I portfolio. While not specifically disallowed, corporate ownership will be neither anticipated nor sought.
6. The portfolio may invest through a variety of ownership structures (e.g., joint ventures, separate accounts, open-end funds, co-investments) depending on opportunities available.
7. Property management and leasing for most real estate will be externally managed by third-party professional firms.

Benchmark

A total net return of 6 percent measured over a rolling 10-year period will be the benchmark for the portfolio. Due to lack of a relevant shorter-term benchmark, an annualized 6 percent return for all reporting periods will be used for comparative purposes.

Diversification

Diversification will be achieved through a combination of factors, including property type, geography, place in the capital structure, and number of properties.

No more than 15 percent of the portfolio will be invested in a single property. This guideline is meant to be long-term and may not be possible during the build-out period.

IMPLEMENTATION

The Board has elected to take a gradual implementation approach to reach the strategic asset allocation. The public equity and fixed income holdings are expected to reach their targets after a period of 2.5 years while real estate will take longer, up to 7 years or more, given the liquidity constraints of the asset class.

The following tables set forth the projected allocations during the implementation period.

Implementation Target – as of 12/31/17

	Fixed Income	Equity	Real Estate
Accident Fund	89%	11%	0%
Pension Reserve Fund	90%	10%	0%
Medical Aid Fund	84%	16%	0%
Supplemental Pension Fund	100%	0%	0%

Implementation Target – as of 12/31/18

	Fixed Income	Equity	Real Estate
Accident Fund	86%	13%	1%
Pension Reserve Fund	89%	10%	1%

Medical Aid Fund	81%	18%	1%
Supplemental Pension Fund	100%	0%	0%

Implementation Target – as of 12/31/19

	Fixed Income	Equity	Real Estate
Accident Fund	83%	15%	2%
Pension Reserve Fund	88%	10%	2%
Medical Aid Fund	78%	20%	2%
Supplemental Pension Fund	100%	0%	0%

If the real estate allocation is below its target, the amount of the under-allocation will be invested in fixed income, which is reflected in the fixed income targets shown above.

Additionally, the public equity holdings are currently invested in two index funds, one replicating the MSCI U.S. Investable Market Index (MSCI U.S. IMI) and the other replicating the MSCI All Country World ex-U.S. Investable Market Index (MSCI ACWI ex U.S. IMI). The global equity allocation will be implemented via these two funds until such time as a new global equity fund manager is selected and approved by the Public Markets Committee and the Board, anticipated to occur prior to March 31, 2018. The table below sets out the target weights in the two commingled funds until the global manager is selected:

	Target	Range
U.S. Equity	52%	47% - 57%
Non-U.S. Equity	48%	43% - 53%

Reporting

- A. A management information system is to be used for reporting internally to the Chief Investment Officer (CIO) or his/her designee on the fixed income implementation of this policy. This report is prepared monthly to include, but is not limited to, the following:
 1. Current market values and allocations, by sector, compared to the policy ranges.
 2. Aggregate and individual portfolio characteristics compared to guidelines.
 3. Delinquencies and defaults will be reported to the CIO immediately.
- B. Market values and performance will be reported quarterly by WSIB staff to the Board.

RESPONSIBILITIES

Washington State Investment Board

The Board is responsible for approving the fund's strategic asset allocation and investment policy as well as reviewing the structure, strategy, and performance of the portfolios. The Board is also responsible for approving recommendations of the Public Markets Committee regarding public equity investment managers.

Public Markets Committee

The Committee is responsible for reviewing the investment policy and recommending any revisions to the Board. The Committee is also responsible for recommending public equity investment managers for hire or termination.

Staff

Staff is responsible for recommending to the Public Markets Committee enhancements and changes to the investment policy, as well as implementing the policy, managing the assets, rebalancing the asset allocation, and reporting performance to the Board. Staff is also responsible for recommending strategic asset allocation to the Board.

For the real estate allocation, a dedicated Portfolio Manager will be appointed to oversee and make investment decisions for the L&I portfolio on behalf of the WSIB. The dedicated portfolio manager will be responsible for portfolio construction and will have discretion to make investment decisions.

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 10/20/92

Revised 6/16/94

Revised 9/21/95

Revised 10/17/96

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