Washington State Investment Board

BOARD ADOPTED POLICY

POLICY NUMBER: 2.20.100	**EFFECTIVE DATE:** 6/17/21
TITLE: Labor and Industries' Insurance Funds	**SUPERSEDES:** 12/17/20
BOARD ADOPTION: 6/17/21	**APPROVED:**

PURPOSE

This document is the 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. The policy allows for sufficient flexibility in the management process to capture investment opportunities, while providing 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.

Strategic 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 evaluated 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.

Risk Constraints

1. 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 (RCW 43.33A.110).

2. 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).
3. Total market value of below investment grade credit bonds (as defined by Bloomberg Barclays U.S. Global Family of Fixed Income Indices) shall not exceed 5 percent of the total market value of the funds.
4. Below investment grade mortgage-backed, asset-backed, or commercial mortgage-backed securities may not be purchased. If investment grade mortgage-backed, asset-backed, or commercial mortgage-backed securities are downgraded to below investment grade, the securities may continue to be held, but their total market value shall not exceed 5 percent of the total market value of the funds.
5. If, in the judgment of the Fixed Income Senior Investment Officers and the Chief Investment Officer (CIO), liquidity in the public markets is impaired, the fixed income sector ranges and duration limits 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 feasible upon return of liquidity.
6. No more than 15 percent of the long-term target allocation for real estate will be invested in the equity position for a single property at the time of acquisition.

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%	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. Rebalancings will be based on market opportunities, cash flows, and the consideration of transaction costs and, therefore, 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 25 percent of a duration target of seven.

Pension Reserve Fund (610): within plus or minus 25 percent of a duration target of ten.

Medical Aid Fund (609): within plus or minus 25 percent of a duration target of six.

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.

The fixed income portfolios will be managed within the duration target guidelines.

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

Fixed Income Sector Allocations
Fixed income 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 to the target allocations as soon as practical.

Target Allocations for Fixed Income Sectors:	Range
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%

Market Changes and Portfolio Rebalancing
There are three instances when normal policy constraints can place unintended burdens on the portfolios through no action of the fixed income portfolio manager: changes in market interest rates, portfolio rebalancing, and rating downgrades. It is not the intent of this policy to force sales or purchases of fixed income securities that harm the portfolio or are not in the best interest of stakeholders. If any of the following cases occur, the CIO must be notified in writing.

1. If the fixed income portfolio falls outside of guidelines for sector allocations, duration, or limits on below investment grade credits, or any combination of the three, due to changes in the market interest rates and not actions by the portfolio managers, the portfolio can remain outside the guidelines until it can be rectified without harming the portfolio.
2. If the fixed income portfolio falls outside of guidelines for sector allocations, duration, or limits on below investment grade credits, or any combination of the three, due to total portfolio rebalancing, the portfolio can remain outside the guidelines until it can be rectified without harming the portfolio.
3. Credit rating downgrades by applicable rating agencies that cause the constraint regarding the limit on total below investment grade holdings to be violated do not require securities to be sold. However, additional below investment grade securities may not be purchased where the constraint has been violated.

Real Estate
The Executive Director has delegated the authority to make portfolio construction and investment decisions for the L&I real estate portfolio to the dedicated L&I real estate portfolio manager, consistent with policies and directives adopted by the Board.

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, and co-investments) depending on opportunities available.
7. Property management and leasing for most real estate will be externally managed by third-party professional firms.

Real Estate Benchmark
A total net return of 6 percent measured over a rolling 10-year period will be the benchmark for the real estate 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.

Real Estate 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 long-term target allocation for real estate will be invested in the equity position for a single property at the time of acquisition. 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 target for real estate given the liquidity constraints of the asset class. When the real estate allocation is below its target, the amount of the under allocation will be invested in fixed income.

The following tables set forth the projected allocations during the implementation period. For asset allocation monitoring purposes, the initial calendar year-end implementation targets become effective upon Board adoption, and subsequent year-end implementation targets become effective at the beginning of the specified calendar year.

Implementation Target – Calendar Year-End 2021

	Fixed Income	Equity	Real Estate
Accident Fund	84.50%	15.00%	0.50%
Pension Reserve Fund	89.50%	10.00%	0.50%
Medical Aid Fund	79.50%	20.00%	0.50%
Supplemental Pension Fund	100.00%	0.00%	0.00%

Implementation Target – Calendar Year-End 2022

	Fixed Income	Equity	Real Estate
Accident Fund	83.75%	15.00%	1.25%
Pension Reserve Fund	88.75%	10.00%	1.25%
Medical Aid Fund	78.75%	20.00%	1.25%
Supplemental Pension Fund	100.00%	0.00%	0.00%

Implementation Target – Calendar Year-End 2023

	Fixed Income	Equity	Real Estate
Accident Fund	83.00%	15.00%	2.00%
Pension Reserve Fund	88.00%	10.00%	2.00%
Medical Aid Fund	78.00%	20.00%	2.00%
Supplemental Pension Fund	100.00%	0.00%	0.00%

Implementation Target – Calendar Year-End 2024

	Fixed Income	Equity	Real Estate
Accident Fund	82.00%	15.00%	3.00%
Pension Reserve Fund	87.00%	10.00%	3.00%
Medical Aid Fund	77.00%	20.00%	3.00%
Supplemental Pension Fund	100.00%	0.00%	0.00%

Implementation Target – Calendar Year-End 2025

	Fixed Income	Equity	Real Estate
Accident Fund	81.00%	15.00%	4.00%
Pension Reserve Fund	86.00%	10.00%	4.00%
Medical Aid Fund	76.00%	20.00%	4.00%
Supplemental Pension Fund	100.00%	0.00%	0.00%

Reporting

WSIB staff will report performance of the funds quarterly to the Board and L&I. Performance is measured by the custodian bank, and the CMIs are developed and calculated by the L&I consultant.

WSIB staff will report internally to the CIO or designee on the fixed income implementation of this policy. This report will be prepared monthly and will include, but not be 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.

Delinquencies and defaults will be reported to the CIO immediately.

Responsibilities

Washington State Investment Board

The Board is responsible for approving the investment policy and setting the investment objectives, risk standards, and asset allocation of the portfolios as well as reviewing the structure, strategy, and performance of the portfolios. The Board is also responsible for the approval of recommendations made by the Public Markets Committee regarding public market components of the portfolios, including public equity investment managers, and by the Private Markets Committee regarding the private market components of the portfolios.

Public Markets Committee

The Public Markets Committee is responsible for reviewing the structure and strategy of the public market components of the portfolios and recommending any revisions to the Board. The Public Markets Committee is also responsible for recommending public equity investment managers for hire or termination.

Private Markets Committee

The Private Markets Committee is responsible for reviewing the structure and strategy of the private market components of the portfolios and recommending any revisions to the Board.

Staff
Staff is responsible for recommending strategic asset allocation to the Board and enhancements and changes to the asset class related components of the investment policy to the Public Markets and Private Markets Committees, as appropriate. Staff is also responsible for implementing the policy, managing the assets, rebalancing the asset allocation, and reporting performance to the Board and L&I.

POLICY REVIEW

The Board shall review this policy at least once every four (4) years to ensure it remains relevant and appropriate.

Original Policy Adopted 10/20/92
Revised 6/16/94
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