

**POLICY NUMBER:** 2.14.300**EFFECTIVE DATE:** 4/16/15**TITLE:** Daily Valued Funds Operations**SUPERSEDES:** 04/17/14**BOARD ADOPTION:** 04/16/15**APPROVED:** **BACKGROUND**

The Washington State Investment Board (WSIB) has created commingled, daily valued funds (DVF). The DVF are offered as self-directed investment options and/or as part of the asset allocation of the Retirement Strategy Funds (RSF).

**PURPOSE**

This policy document sets forth the Board's responsibilities with respect to the operations of the daily valued funds. It articulates the structure; permitted scope of operation; delegated authorizations; and the policy ranges, tolerances, and decision criteria for the accounting of the daily activities relating to the DVF. Additional detailed, staff operating policies and procedures will be developed to supplement this policy.

**DAILY VALUED FUNDS (DVF)**

The three daily valued funds are:

- Savings Pool
- Bond Fund
- U.S. Treasury Inflation Protected Securities (TIPS) Fund

**STRUCTURE AND OPERATING ENVIRONMENT****WSIB**

The WSIB is responsible for the investment and management of the DVF, including investment policy-setting; fund structure; engaging external investment managers; portfolio rebalancing; trade processing; securities pricing of internally managed portfolios (e.g., the fixed income portfolio); fund valuation and unitization; and determination of the unit value for each fund on a daily basis. The WSIB may contract with outside parties to perform certain parts of these functions.

**Investors**

The main investors in the DVF are the participants in the deferred compensation program (DCP) and the defined contribution retirement plans. Both the DCP and the defined contribution retirement plans are managed by the Department of Retirement Systems (DRS). The DRS contracts with third-party record keepers to perform the accounting at the participant level. The Bond Fund and the U.S. TIPS Fund will also be utilized as an investment component of the RSF. The WSIB will work with the investment manager of the RSF, AllianceBernstein, to ensure proper procedures are established for investment into the Bond Fund and the U.S. TIPS Fund.

Other funds from other state agencies (investors) may invest in the DVF, as determined by WSIB's Executive Director.

### **Other Third-Party Service Providers**

External securities pricing services are used by the WSIB to assist in pricing underlying securities for the Bond Fund and the U.S. TIPS Fund.

The WSIB will use an investment accounting system or the contracted global custodian to perform various functions, to permit the DVF to be appropriately accounted, reported, valued, unitized, and priced. They serve as the book of record at the fund and portfolio level for each of the DVF.

### **POLICY**

The daily valued funds are "institutional" products offered primarily as self-directed investment options to participants in defined contribution retirement plans and DCP, but are also offered to other funds. While the DVF provide participants with the opportunity to obtain the value of their accounts and to trade and exchange investments on a daily basis, the DVF are not mutual funds governed by the Investment Company Act of 1940, and there may be trading restrictions placed on them.

This policy cannot foresee every potential situation governing the management and operations of the DVF. Discretion is granted to staff to evaluate emergency situations, determine reasonable tolerances, and make required decisions to effectively manage and operate the funds. Rather, these guidelines will apply to many situations that may occur. Certain conditions or circumstances may require special actions that may vary from this policy and its procedures.

### **Transactions**

Ownership of units in each DVF is maintained at the participating plan/fund level by the WSIB. The WSIB does not accept trade instructions at the individual member or participant level. The WSIB executes trade instructions received from the record keepers, investment managers, and/or funds for each DVF, detailing net purchases and sales by participating plan/fund.

In normal circumstances, transactions must be received in good order from the record keepers, investment managers, and/or funds by the pre-established timeline to receive that business day's unit price for the applicable DVF. Trade instructions received later than that day's cutoff will be processed on the following business day at the unit price in effect on the close of that day. If timely instructions are received, purchases and sales of DVF units occur on a same day basis. Pre-established timelines for processing participant transactions are such that all transactions received by cutoff times on Day 1, receive Day 1 closing prices, even though the transactions settle on Day 2.

The WSIB DVF will accept transactions on days that the Bond Market (following the Securities Industry and Financial Markets Association [SIFMA] holiday schedule) is open for trading, provided that all relevant parties and functions (including third-party relationships) are fully operational and the WSIB can determine a closing price for the day. On days that the Bond Market is closed or all relevant parties and functions (including third-party relationships) are not fully operational, all daily valued fund transactions are held and processed the next business day when the markets reopen, or the parties or functions are fully operational, and receive the next current unit price.

Efforts will be made to minimize errors. The following controls have been established to ensure WSIB's operating processes result in accurate unit prices: automation has been used to reduce manual data entry; unitization and unit pricing worksheets, as well as all

activity and investment trade tickets, receive supervisor review prior to release; and a business continuance plan has been prepared and tested to ensure activity will not be suspended. However, it is reasonable to assume that errors will occur despite efforts to guard against them. Upon identification of an error, WSIB staff will determine how to remedy the error, in conformity with the Error Resolution section of this policy.

### **Valuation, Unitization and Pricing**

DVF unit values are processed and recorded at the total DVF level in the global custodian's system, as well as an investment accounting verification system. Participant fund level units will be recorded in the investment accounting verification system, as well as internally by WSIB's Operation staff.

#### Savings Pool

Guaranteed Insurance Contracts (GIC) and short term cash are the securities that primarily make up the Savings Pool. The amount invested in the GIC, plus any interest accrued to date, is used in the calculation of the daily unit value for the fund. If the credit rating of the issuer of the GIC declines to an extent that the value of the GIC is affected, the WSIB will engage a third-party to establish the fair market value of the GIC.

#### Bond Fund

External pricing services are used to assist in pricing underlying securities in the Bond Fund. A secondary pricing service for tolerance and variance checks, and to serve as a back-up in the event of service interruptions with the primary pricing service, will be retained. The WSIB shall obtain prices for the underlying securities from either 1) an independent pricing service, 2) the global custodian bank, or 3) through the investment accounting system from their external pricing source. The WSIB shall agree on selection of the pricing services used, if prices are provided by the custodian bank or the accounting system. They will follow operating policies agreed upon with WSIB in the event that pricing is outside permitted tolerances and/or in the event of a failure of the primary pricing service, to meet timelines.

#### U.S. TIPS Fund

Domestic TIPS and short term cash are the securities that primarily make up the U.S. TIPS Fund. External pricing services are used to assist in pricing the underlying TIPS in the fund. A secondary pricing service for tolerance and variance checks and to serve as a back-up in the event of service interruptions with the primary pricing service will be retained. The WSIB shall obtain prices for the underlying securities from either 1) an independent pricing service, 2) the global custodian bank, or 3) through the investment accounting system from their external pricing source. The WSIB shall agree on selection of the pricing services used if prices are provided by the custodian bank or the accounting system.. They will follow operating policies agreed upon with WSIB in the event that pricing is outside permitted tolerances and/or in the event of a failure of the primary pricing service, to meet timelines.

Any interest that is accrued to date will be included in the daily unit value for the fund. The interest rate will be based on the current month's inflation factor, which will be used as soon as the rate is available.

#### Cash

The daily interest rate factor as determined by the investment manager will be received each business day by the WSIB, according to pre-established timelines. If the factor is not received timely, the prior day's factor will be used for accrual purposes, which would create an insignificant difference in interest actually earned for the month.

### Unit Price Reporting

The closing unit prices for each DVF are communicated by the WSIB to the appropriate record keepers and investment managers by the pre-established timelines, so that the record keepers and investment managers can record the transactions, values, units and allocated expenses, if applicable, to the participants' accounts. The investment managers use this information to complete their daily pricing for their portfolios, as appropriate.

Valuation and pricing errors, incorrect values/prices submitted by WSIB's external managers or third parties, and other needed adjustments will be corrected as soon as is feasible, upon their detection or receipt of notice of such error by WSIB, and whenever possible, before finalizing the closing unit price for the DVF on the date of the error.

The funds will be priced when the Bond Market is open, unless there are emergency circumstances in the financial industry, as determined by the U.S. Securities and Exchange Commission.

### **Policy and Materiality Tolerances**

#### Closing Unit Pricing Errors

Errors amounting to less than \$0.01 (one cent) per unit value for the specific fund will be considered immaterial and will be corrected in the next day's pricing. No external parties need to be notified. Errors equal to or greater than one cent (\$0.01) per unit value for the specific fund shall be considered material and shall be communicated to the record keeper and DRS at the time the error is discovered. The WSIB will discuss with the record keeper and DRS the best way to rectify the situation. Any Investment Manager invested in the DVF will be notified as soon as possible if a material error is discovered and will be informed of any change to their units of the DVF purchased or sold.

Any closing unit pricing error shall be promptly communicated to the Chief Operating Officer (COO) or designated back-up. Errors greater than the tolerance level, regardless of their source, shall also be communicated to the Executive Director and reported to the Board. Once a year, all errors below the tolerance level, regardless of their source, will be reported to the Audit Committee.

#### **Inability to Close**

If trade processing, valuing, unitization, or pricing problems occur; the final daily interest factor from external manager is delayed; errors are detected; or other problems or disruptions occur (regardless of whether the problem is attributed to the WSIB or to external parties), and it appears the closing unit prices cannot be completed by normal timelines, the WSIB will notify the record keeper or investment manager to coordinate a delayed closing. If this is acceptable to the record keeper and/or investment manager, WSIB staff will remain on duty to complete the DVF process as normal. However, if the problem is specific to the WSIB fund(s), DRS will be notified of the situation and coordinate a delayed closing with the record keeper and/or investment manager, and inform WSIB of the outcome.

If a delayed closing timeline is not acceptable to the record keeper and/or investment manager, DRS will be immediately notified. The participant transactions will be suspended in an industry-wide event that results in the suspension of trading on the NYSE and/or Bond Market. They will be processed using the next business day's closing unit price. However, if the problem is specific to the WSIB, then the prior day prices will be adjusted by the

following indexes: for the Bond Fund – Barclays Capital Intermediate Credit Index, and for the U.S TIPS Fund - Barclays Capital U.S. TIPS Index. The Asset Allocation Officer or designated back-up will provide the index(es) to the Investment Accounting and Administration unit, who will calculate the adjustment.

The COO or designated back-up shall be alerted of potential closing problems. The record keeper, investment manager, global custodian, and/or the investment accounting verification provider will also be notified of these situations.

### **Error Resolution**

Documented losses occurring as a result of failure or errors by a WSIB external entity or third-party will be reviewed by the WSIB, and a claim may be submitted if it is cost effective to do so. Anticipated reimbursement for losses should be accounted for in accordance with appropriate accounting standards applicable to the DVF. No claim against a third-party is required for losses below the materiality policy tolerances for errors. In accordance with "Policy and Materiality Tolerances," paragraph 1, the record keeper and/or investment manager shall be informed of any material valuation error. The record keeper shall determine the impact on participant accounts and communicate the impact to the WSIB and DRS.

Errors below the tolerance level will be self-corrected through the next available unit pricing and, if so determined by the WSIB, other appropriate action may be taken.

### **Expenses and Costs**

The costs of the DVF are to be borne by the participants and/or investment managers. Expenses allocated to the DVF shall reflect direct services and/or the incremental costs associated with the investment and management of the fund(s). All expenses and costs are either allocated to the Fund and calculated in the unit price established by the WSIB/record keeper, or assessed by the record keeper to applicable participant accounts to cover the costs. Costs associated with the DVF are accrued on a daily basis and reflected in the daily unit values, to the extent practical.

### **Business Readiness**

The WSIB will take reasonable action to implement and test back-up systems and business continuance plans for the management and operation of the DVF, in the event of widespread power outages, fires, natural disasters, terrorist acts, emergencies, and other events beyond the control of the WSIB. The WSIB reserves the option to temporarily suspend all transactions for any or all daily valued funds due to an uncontrollable event, including but not limited to, those events listed above, market disruptions, localized or national emergencies, or other significant events that would make such a suspension necessary.

The Executive Director (or designated executive back-up) is authorized to suspend transactions if necessary. Suspension of transactions will be by official notification to relevant parties, including the Chair and/or Vice Chair of the Board, DRS, the record keepers, external fund managers, global custodian, investment accounting verification provider, and announcements on the WSIB Web site (when feasible).

**RESPONSIBILITIES**

The Board is responsible for approving daily valued funds operations policy.

The Audit Committee is responsible for reviewing and recommending the daily valued funds operations policy to the Board. They are also responsible for monitoring any errors that impact the daily valued fund portfolios.

Staff is responsible for processing daily participant/investment manager trade transactions, unitizing and pricing portfolios daily, and striking daily unit price for portfolios. They are also responsible for implementing and maintaining the policy and reporting all errors to the Executive Director immediately, and the Audit Committee annually.

**POLICY REVIEW**

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

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Policy Adopted 3/20/03

Revised 7/20/06

Revised 9/18/08

Revised 10/31/08

Revised 12/20/12

Revised 4/17/14  
Revised 4/16/15