WASHINGTON STATE
INVESTMENT BOARD

STATE INVESTMENT BOARD
BOARD ADOPTED POLICIES

POLICY NUMBER: 2.20.100

EFFECTIVE DATE: 11/21/02

TITLE: Labor and Industries' Insurance Funds

SUPERSEDES: 4/18/02

BOARD ADOPTION: 11/21/02

APPROVED: Joseph A. Dear

PURPOSE:

This document outlines the investment policy and guidelines for the Department of Labor and Industries' (L&I) Insurance Funds managed by the State Investment Board (SIB), and supersedes any prior Board-adopted policies.

These guidelines allow for sufficient flexibility in the management process to capture investment opportunities, while providing parameters that ensure prudence and care in the execution of the investment program.

POLICY:

Standard of Care

Under RCW 43.33A.030, trusteeship of the L&I Insurance Funds 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 listed below.

Strategic 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, a maximum return at a prudent level of risk.

Investment Approach

For the Accident and Pension Reserve Funds (Funds 608 and 610), the fixed income portfolio dollar durations are to be targeted to those of the liabilities, plus or minus 20 percent.

For the Medical Aid Fund (Fund 609), the asset duration target will be based on the need to remain responsive to changes in the rate of medical inflation, while earning a rate of return sufficient to fund expected liability payments.

For the Supplemental Pension Fund (Fund 881), the asset duration target will be based on the need to earn the highest rate of return consistent with maintaining a sufficient degree of liquidity.

Performance Objectives

Performance of the investment portfolios shall be judged relative to the Strategic Objectives and the Investment Approach. As such, the main objectives are the most important and must be met:

1. Are the funds solvent?
2. Are premium rates stable?
3. Are there enough assets available to fund the expected liabilities?

With these three criteria met, the duration structures of the funds are measured relative to their liability driven duration targets:

4. Funds 608 and 610: within plus or minus 20 percent
   Funds 609 and 881: within the current stated range of their specific targets

With these criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each fund. The return for each fund's portfolio should not be significantly different from that of its CMI, especially over the long-term, with a volatility similar to the index.

Portfolio Constraints

A. All assets under management by the SIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of statutes RCW 43.33A.110 and RCW 43.33A.140, which state in part that the SIB is to "...establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums, and, subject to this purpose, to maximize return at a prudent level of risk."

B. No corporate fixed income issue's cost shall exceed three percent of the fund's market value at the time of purchase, nor shall its market value exceed six percent of the fund's market value at any time (RCW 43.33A.140).

Asset Allocation

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

Market conditions, funding status, and liability assumptions are dynamic, not static; therefore, SIB staff will meet quarterly with L&I to review the investment portfolio, the status of funding levels, and the liability durations.

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 and the consideration of transaction costs; , therefore, they need not occur immediately.

Asset Class Structure

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

Equity

The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the Wilshire 5000. The benchmark and structure for non-U.S. equities will be the MSCI EAFE index, (Morgan Stanley Capital Indexes Europe, Australia, Far East index). Both portfolios will be 100 percent passively managed in commingled index funds.

Fixed Income

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

Permissible Investments

1. *U.S. Treasuries and Government Agencies.*

2. *Credit Bonds.*

3. *Mortgage-Backed Securities* rated BBB or higher by Standard & Poor's and Baa3 or higher by Moody's Investor's Service (Moody's).

4. *Asset-Backed Securities* rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's.

5. *Commercial Mortgage-Backed Securities* rated BBB or higher by Standard & Poor's and Baa3 or higher by Moody's.

6. *Investment Grade Non-U.S. Dollar Bonds.*

7. *U.S. Equities.*

8. *Non-U.S. Equities.*

9. *Derivative Products* used for hedging or establishing a long position. Use of derivatives for speculation is prohibited.

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 as a percentage of L&I's Total Portfolio:

Fixed Income (including cash)	85%
Public Equity	15%
	100%

Asset Allocation Ranges:

Fixed Income (including cash)	82 - 88%
Public Equity	12 – 18%
	100%

Targets Allocations for Public Equity Sectors:

Domestic Equities	80 – 90%
International Equities	10 – 20%
	100%

Target Allocations for Fixed Income Sectors:

U.S. Treasuries and Government Agencies	5 – 25%
Credit Bonds	20 – 70%
Asset-Backed Securities	0 – 10%
Commercial Mortgage-Backed Securities	0 – 10%
Mortgage-Backed Securities	0 – 25%
Total Bonds	**100%**

Total holdings of below investment grade credit bonds (rated Ba1 or below by Moody's) should not exceed five percent of total fixed income holdings.

Reporting

A. A management information system is to be used for reporting internally to senior staff on the implementation of this policy. This report is prepared monthly to include, but is not limited to:

1. Current market values and allocations, by sector, compared to the policy ranges;
2. Aggregate and individual portfolio characteristics compared to guidelines; and,
3. Delinquencies and defaults.

B. An executive management report is to be provided to the Board quarterly showing market values and performance.

RESPONSIBILITIES:

State Investment Board - Responsible for approving the fund's strategic investment policy.

Public Markets Committee - Responsible for reviewing and recommending the strategic policy to the Board, and for reviewing the structure, strategy and performance of the funds.

Staff - Responsible for recommending an investment policy to the Public Markets Committee, for implementing the policy, and for reporting to the Public Markets Committee and the Board.

Original Policy Adopted 10/20/92
Revised 6/16/94
Revised 9/21/95
Revised 10/17/96
Revised 2/19/98
Revised 8/20/98
Revised 10/25/01
Revised 4/18/02
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