

POLICY NUMBER: 2.11.100**EFFECTIVE DATE:** 9/21/23**TITLE:** Defined Contribution Plan 3
Retirement Funds**SUPERSEDES:** 6/18/20**BOARD ADOPTION:** 9/21/23**REVIEWED:**

PURPOSE

This document is the investment policy for the assets of the defined contribution programs and articulates the Washington State Investment Board's (WSIB's) investment objectives and risk tolerance for the investment options in accordance with Revised Codes of Washington (RCWs) [43.33A.110](#), [43.33A.140](#), [43.33A.190](#), [41.34.060](#), and [41.34.130](#). This document also formulates the Board's policies and guidelines on the:

1. Number and type of investment options.
2. Investment style and strategy for each specific investment option.
3. Process of prudently monitoring and evaluating the performance and risk of the investment options.

Background

RCW [41.34.120](#) states that the assets of the Teachers' Retirement System Plan 3 (TRS 3), School Employees' Retirement System Plan 3 (SERS 3), and Public Employees' Retirement System Plan 3 (PERS 3) are held in trust by the WSIB for the exclusive benefit of the members and their beneficiaries. In accordance with RCW [41.34.130](#) and [43.33A.190](#), the WSIB has the sole authority over selection and management of the investment options. In accordance with RCW [41.50.088](#), the Department of Retirement Systems (DRS) makes recommendations to the WSIB on types of self-directed options, reflecting the members' preferences. In accordance with RCW [41.34.130](#), the WSIB, after consultation with the DRS on such recommendations, determines the investment options for members to choose from for self-directed investments. The DRS has responsibility for program administration; investment accounting; and participant record keeping, education, and communication.

TRS 3, SERS 3, and PERS 3 are hybrid pension plans comprised of a defined benefit and a defined contribution component. The employer contribution funds a 1 percent formula defined benefit. The employee contribution is invested in a defined contribution 401(a) program. The employee sets their contribution rate from a menu of options and directs the investment of the funds. Within the investment options, the employee may invest their contribution into the Commingled Trust Fund (CTF) through the WSIB Total Allocation Portfolio (TAP). The employee contribution funds a self-directed retirement account; therefore, the employee's proper selection of options, or asset allocation, is critical for sufficient growth of the funds and for meeting the employee's desired retirement goals.

Since TRS 3, SERS 3, and PERS 3 are similar in structure and identical in purpose and intent, the standard of care, investment objectives, investment performance objectives, risk constraints, investment structure, and investment options for each are identical. Therefore, all plans are combined into this single investment policy (Defined Contribution Plan 3 Retirement Funds).

POLICY

Standard of Care

Under RCW [41.34.120](#) and [43.33A.030](#), trusteeship of all defined contribution 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 investment decisions and seeks to meet the investment objectives listed below.

Investment Objectives

In accordance with RCW [43.33A.110](#), the program is managed to maximize return at a prudent level of risk. The WSIB has a fiduciary duty to ensure that each plan's self-directed program offers a balance of options to allow employees to build an asset allocation suitable for a range of participants from employees early in their career to those in retirement. The investment options cover a broad spectrum of funds, from low risk/low return to high risk/high return. The majority of the options offer participants the opportunity to seek long-term capital appreciation.

Based on this requirement, the order of the objectives is to:

1. Provide a diverse set of investment options to allow participants to invest their funds to maximize their future capital accumulation for retirement at their personal level of risk tolerance.
2. Provide an adequate number of options. The number of options should be broad enough to offer a comprehensive set of options, yet be limited in number to make the programs easy to understand and offer the participant the ease of creating a diversified portfolio.
3. Manage expenses to ensure participants receive the best value for their retirement dollars.
4. Ensure that each investment option maintains its investment objectives and investment strategy as described to participants.
5. Provide investment options that do not compromise the participants' confidence in the programs.

In keeping with these objectives and to offer an efficient and cost-effective investment menu, it must be understood that not every participant's unique desire or request can be met. Participants' requests for specialized funds or highly focused investment strategies are best obtained through their own personal investments. This list of options is designed to provide an appropriate and easily understood menu of investment options for a broad group of participants and cannot be all things to each individual person.

Investment Performance Objectives

Since each participant in the employee portion of the plan is responsible for the design and selection of their investment portfolio, the overall program does not have an aggregate investment performance objective. However, each investment option described below has a specific investment performance objective as depicted in its respective fund fact sheet.

Risk Constraints

1. Invest the assets to maximize return at a prudent level of risk in accordance with the requirements of RCW [43.33A.110](#) and RCW [43.33A.140](#). Within each plan, the WSIB offers investment options that are suitable for long-term retirement investments for individuals.
2. Ensure that each investment option is within its prescribed level of risk.

Asset Allocation and Investment Options

The WSIB offers the investment options listed below for each plan. The WSIB will implement the investment management of the options as deemed necessary.

Capital market conditions, management style of investment options, and investment performance are dynamic, not static. Consequently, the WSIB staff reviews the performance and management of the options with the DRS at least annually. For those options managed internally by the WSIB, the Board has delegated to the Chief Executive Officer (CEO) the authority to invest the funds pursuant to written policies and procedures.

Within the menu of options, the WSIB strives to offer an appropriate array of options including balanced and retirement strategy (target date) funds.

Asset Class	Style	Fund
Money Market	Short-term investment	Money Market Fund
Fixed Income	Active intermediate bond	Washington State Bond Fund
Balanced	Balanced equity/debt	<ul style="list-style-type: none"> • WSIB TAP • Socially Responsible Balanced Fund
Asset Allocation	Multi-asset Class	Retirement Strategy Funds
U.S. Equities	Passive large-cap index Passive small-cap value index	U.S. Large Cap Equity Index Fund U.S. Small Cap Value Equity Index Fund
Global Equity	Passive global index	Global Equity Index Fund
Emerging Markets Equity	Passive emerging markets index	Emerging Market Equity Index Fund

Money Market Fund

Objective: The money market option seeks to protect principal while generating an income return in excess of inflation.

Strategy: The fund invests in high-quality short-term securities.

Benchmark: 90-day Treasury Bill

Washington State Bond Fund

Objective: The fund seeks current income. The fund is expected to meet or exceed the return of the Bloomberg U.S. Intermediate Credit Index.

Strategy: The fund invests in investment-grade fixed income instruments.

Benchmark: Bloomberg U.S. Intermediate Credit Index

WSIB TAP

Objective: A balanced fund that seeks to achieve a maximum long-term rate of return at a prudent level of risk. The fund's long-term objective is to exceed its benchmark.

Strategy: The TAP Fund is invested in the WSIB CTF, which is comprised of the assets of multiple public employee retirement funds managed by the WSIB. It has an aggressive asset allocation that includes actively and passively managed public equity, actively managed fixed income, and actively managed private market investments in private equity, real estate, and tangible assets. The portfolio includes private securities that are not actively priced on a regular basis; therefore, the credited return is an approximation of the overall portfolio return. The fund value is calculated monthly.

Benchmark: Custom blend matched to the Retirement CTF Asset Allocation Policy approved by the Board.

Socially Responsible Balanced Fund

Objective: A balanced fund that seeks long-term capital growth through an actively managed portfolio of stocks, bonds, and money market instruments consistent with certain social criteria established by the fund. The fund's rolling 3- and 5-year returns should exceed the assigned benchmark.

Strategy: The fund seeks to invest in a portfolio of companies that have demonstrated above average and/or improving performance in a variety of social criteria. Equity investments in firms primarily involved in products or activities associated with tobacco, alcohol, defense/weapons, and gambling are prohibited.

Benchmark: Custom blend: 45 percent MSCI USA Standard (Gross) Index, 15 percent MSCI World Ex USA (Net) Index, and 40 percent Bloomberg Capital Aggregate Bond Index.

Retirement Strategy Funds

Objective: A fund managed for participants based on their projected retirement date. The strategies are made up of dynamic, professionally managed investment options that gradually shift over time as participants approach their retirement dates and move through retirement. The strategies have a target asset allocation that places assets in U.S. Large Cap Equity, U.S. Small/Mid Growth Equity, U.S. Small/Mid Value Equity, Global Ex-U.S. Equity, WSIB TAP, Global Real Estate Investment Trusts (REITs), High-Yield Bonds, Intermediate-Term Bonds, Short-Term Bonds, Inflation Protected Securities, and other such strategies that may be deemed appropriate over time. They provide a broadly diversified option for people who may not have the time or desire to build and monitor their own investment portfolio. The objective for each retirement strategy is to achieve the highest total return over time at a level of risk consistent with its asset mix.

Strategy: Retirement strategies are diversified asset allocation portfolios that place ongoing investment decisions with an experienced portfolio management team after a retirement strategy is selected with the date closest to an expected retirement date (e.g., 2035, 2040, 2045, 2050). The management team adjusts the asset mix of the retirement strategy over time to the allocation it deems appropriate. Far from a target retirement date most of the assets are invested in globally diversified equity portfolios. Closer to the retirement date, and continuing for 15 years beyond a retirement date, the management team gradually adjusts the retirement strategy to a more conservative asset mix. That means fewer stocks and more bonds and short-term investments that can help generate income and protect savings in retirement. In very general terms, the focus is on capital appreciation early in a career and capital preservation later on.

Benchmark: The benchmark for each portfolio is a customized benchmark that has the same asset allocation as each portfolio and uses index returns to represent performance of the asset classes. The benchmark returns are calculated by weighting the monthly index returns of each asset class by each portfolio's monthly target allocation for each asset class. Target allocations adjust quarterly in accordance with the customized retirement strategy's glide path.

U.S. Large Cap Equity Index Fund

Objective: Passively managed to approximate the return of the Standard & Poor's (S&P) 500 Index. Annual performance difference due to the portfolio management is expected to be within 5 basis points of the benchmark return. Passive defined contribution funds can experience additional performance differentials due to daily cash flows from members. During times when daily cash flows are large relative to the size of the fund and/or market

volatility is high, performance differentials are expected to be within 50 basis points annually, but could be higher. These expected performance differences are estimates and actual results could be different. Interim period (i.e., less than 1 year) performance differences may be higher.

Strategy: The fund invests primarily in U.S. equities, futures, and options in order to approximate the characteristics and performance of the S&P 500 Index.

Benchmark: S&P 500 Index

U.S. Small Cap Value Equity Index Fund

Objective: Passively managed to approximate the return of the Russell 2000 Value Index. Annual performance difference due to portfolio management is expected to be within 15 basis points of the benchmark. Passive defined contribution funds can experience additional performance differentials due to daily cash flows from members. During times when daily cash flows are large relative to the size of the fund and/or market volatility is high, performance differentials can increase significantly. Total performance differentials between the fund and the benchmark are expected to be within 100 basis points annually, but could be higher. These expected performance differences are estimates and actual results could be different. Interim period (i.e., less than 1 year) performance differences may be higher.

Strategy: To approximate the characteristics and performance of the Russell 2000 Value Index. Companies in this index generally have low price-to-book and price-to-earnings ratios, higher dividend yields and lower forecasted growth values than more growth-oriented securities.

Benchmark: Russell 2000 Value Index

Global Equity Index Fund

Objective: Passively managed to approximate the return of global markets as measured by a broad global equity index. Annual performance difference due to portfolio management is expected to be within 20 basis points of the benchmark. Passive defined contribution funds can experience additional performance differentials due to daily cash flows from members. During times when daily cash flows are large relative to the size of the fund and/or market volatility is high, performance differentials can increase significantly. Total performance differentials between the fund and the benchmark are expected to be within 100 basis points annually, but could be higher. These expected performance differences are estimates and actual results could be different. Interim period (i.e., less than 1 year) performance differences may be higher.

Strategy: The fund invests in global equity markets (U.S., non-U.S. and emerging) comprised of large-, mid-, and small-capitalization securities.

Benchmark: MSCI ACWI Investable Market Index (MSCI ACWI IMI).

Emerging Market Equity Index Fund

Objective: Passively managed to approximate the return of emerging markets as measured by a broad emerging markets index. Annual performance difference due to portfolio management is expected to be within 40 basis points of the benchmark. Passive defined contribution funds can experience additional performance differentials due to daily cash flows from members. During times when daily cash flows are large relative to the size of the fund and/or market volatility is high, performance differentials can increase significantly. Total performance differentials between the fund and the benchmark are expected to be within 150 basis points annually, but could be higher. These expected performance

differences are estimates and actual results could be different. Interim period (i.e., less than 1 year) performance differences may be higher.

Strategy: The fund invests in emerging markets comprised of large-, mid-, and small-capitalization securities.

Benchmark: MSCI Emerging Markets Investable Market Index (MSCI EM IMI).

Performance Review Guidelines and Reporting

Performance of the TAP Fund and the Washington State Bond Fund is reported by the WSIB staff. For the other options within each plan, the specific external investment managers measure investment performance for their option. The WSIB staff compiles and performs a quality check of the returns from the internal and external investment managers and provides quarterly performance reports to the Board and DRS for each plan. The quarterly report identifies the distribution of total participant assets among the various options for each plan and compares each option to its appropriate benchmark.

Implementation

The Board has established numerous policies and procedures for the investment staff to ensure consistent and efficient handling of the investment duties. The Board regularly reviews performance and costs of all funds under its control. On an annual basis, the Board reviews all the investment costs of the WSIB, including investment management and external service providers. Any direct costs related to the management of fund assets will be deducted from the returns of the various investment options. Additionally, under RCW [43.33A.160](#), the WSIB is allowed to deduct from the funds under its control the fund's proportional share of the WSIB's operating expenses, based on its assets under management.

RESPONSIBILITIES

Washington State Investment Board

The Board is responsible for approving the investment policy, setting the investment options, and reviewing the investment performance of the options. The Board makes manager hiring decisions and selects service providers pertaining to the investment management of the defined contribution portfolios.

Public Markets Committee

The Committee is responsible for reviewing and recommending the investment policy and investment options to the Board. The Committee provides recommendations to the Board concerning the investment management of the defined contribution portfolios.

WSIB Staff

Staff is responsible for implementing policy, managing the assets, and direct management and daily pricing/unitization of the internally managed investment options; oversight, monitoring, and evaluation of the external investment managers; and preparing and presenting the quarterly investment report to the Board. The CEO is responsible for manager and service provider terminations as delegated by the Board. Additionally, staff is responsible for recommending enhancements and changes to the investment policy and investment options to the Public Markets Committee. Staff is also responsible for providing quarterly performance reports to DRS and reviewing the performance and management of the options with DRS at least annually.

Department of Retirement Systems

DRS is responsible for recommending to the WSIB the types of investment options for member self-directed investment (RCW [41.50.088](#)).

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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