



Washington State Investment Board

Strategic Plan 2007-2013



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Executive Director
June 1, 2006

Strategic Framework



WSIB Mission

Invest with integrity, prudence, and skill to meet or exceed the financial objectives of those we serve.

Introduction

The purpose of the WSIB is to invest the funds entrusted to us in order to meet or exceed the financial objectives of those we serve. We aspire to be the best public institutional investor in the world. This means our strategy, execution, performance, and reputation must be excellent. To succeed we have identified five key drivers to our success:

Five Key Drivers

1. A skillful Board with the knowledge and capacity to make prudent investment policy decisions, oversee staff and investment managers, and faithfully carry out its fiduciary duty.
2. A disciplined, long-term investment perspective that adheres to a structured, forward looking analysis and decision making process.
3. Operational excellence to support continuously improving investment analysis and management, risk management, accounting and oversight, communications, and Board support.
4. A work environment that attracts, develops, and retains high quality people who are committed to serving our beneficiaries with integrity, prudence, and skill.
5. Impeccable integrity at all levels.



Critical Success Factors

The five key drivers are the foundation for ensuring success in each of the essential activities of the board.

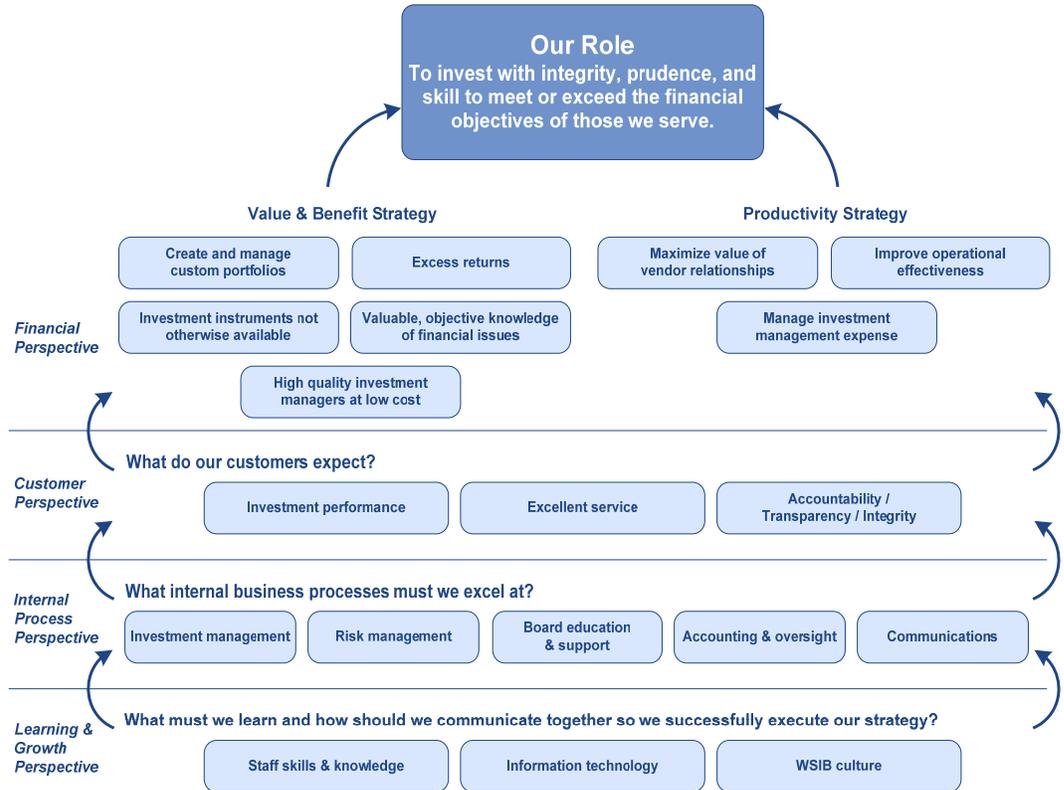
- ❖ Strategic asset allocation: research indicates that asset allocation is the greatest contributor to investment returns.
- ❖ Identify, evaluate and implement investment ideas: Investment ideas abound. The difference between good and great institutional investors is their ability to find and implement the best ideas.
- ❖ Select great managers: like most public pension funds, the WSIB relies on outside money managers to invest a significant portion of its funds. Gaining access to the best managers in every asset class is critical to our success.
- ❖ Construct and manage portfolios: the financial objectives of our customers vary and portfolios must be constructed with a view toward their particular income and risk goals.





Executing on the Mission - Balanced Scorecard:

The Board adopted a new framework for developing strategy when it started using the Balanced Scorecard in 2003. The scorecard displays how the various functions of the Board contribute to its mission to invest well and highlight how current projects improve the WSIB's capacity to accomplish that mission. This in turn helps move strategy into action. The scorecard provides focus and coordination for performance improvement projects. Each of the projects has quantifiable, short-term objectives that connect the mission with specific actions that can be managed.



Value and Benefit

Goals

Have a total investment portfolio that is diversified in accordance with the principles of prudence, as well as satisfying the investment objectives of the various funds. The WSIB has responsibility for 36 funds, which are categorized in five fund types: retirement (defined benefit and defined contribution), deferred compensation, insurance, permanent and other trusts. Each fund type has unique objectives that call for a portfolio construction appropriate for the objective.

1. Retirement funds:

- ❖ Defined Benefit CTF (PERS 1, PERS 2/3, SERS 2/3, TRS 1, TRS 2/3, LEOFF 1, LEOFF 2, WSP 1, WSP 2, Judicial, Volunteer Firefighters): Maximize return at a prudent level of risk.
- ❖ Defined Contribution (TRS 3, SERS 3, PERS 3, Judicial): Provide participants with a broad spectrum of well-managed, self-directed investment options.





WSIB Investment Principles

The Board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk.

(RCW 43.33A.110)

The Board shall consider investments not in isolation, but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund.

(RCW 43.33A.140)

The Board shall diversify the investments of the particular fund unless, because of special circumstances, the board reasonably determines that the purposes of that fund are better served without diversifying.

(RCW 43.33A.140)

2. **Deferred Compensation Program:** Provide participants with a broad spectrum of well-managed, self-directed investment options.
3. **Insurance funds** (Accident, Medical Aid, Pension Reserve and Supplemental Pension): Achieve highest return possible consistent with the need to: (1) maintain the solvency of the funds; (2) maintain premium rate stability; and (3) ensure sufficient assets are available to fund the expected liability payments. It is of paramount importance to coordinate the level of risk taken on by investments with the level of risk arising from insurance operations.
4. **Permanent funds** (Agricultural, Common School, Normal School, Scientific, State University and Millersylvania Park): Achieve the highest return possible consistent with the desire to emphasize high current income and to add value through active management.
5. **Other Trust funds** (Game and Special Wildlife, State Employees Insurance Reserve, Radiation Perpetual, Reclamation Revolving, Emergency Reserve Fund, Developmental Disabilities Endowment): Achieve the highest return possible consistent with the need to meet any liabilities.
 - ❖ **Other Trust Funds--Guaranteed Education Program (GET) Program:** Achieve highest return possible at a prudent level of risk to meet or exceed the rate of college tuition inflation over the long-term.

Objectives

To achieve fund performance that is appropriate for each of the various components of the overall fund, given the unique objectives of each component, which is comparable to other large public institutional investors.

1. **Retirement funds:**
 - ❖ **Defined Benefit CTF:** To exceed the returns of a policy benchmark, which is a composite of appropriate market indices weighted according to our asset allocation target. (WSIB Policy 2.10.050)
 - ❖ **Defined Contribution:** To offer members a comprehensive range of investment options, which effectively meet the investment needs of these large and diverse constituencies, as determined in cooperation with the Employee Retirement Benefits Board. (WSIB Policy 2.11.100)
2. **Deferred Compensation Program:** To offer participants well-managed institutional investment options at low cost to meet the investment needs of this large and diverse constituency, as determined in cooperation with the Employee Retirement Benefits Board. (WSIB Policy 2.13.100)
3. **Insurance funds:** To meet the reserve and duration targets as set forth by the Department of Labor and Industries. (WSIB Policy 2.20.100)
4. **Permanent funds:** To emphasize stability of income to support operations of each irreducible trust. To actively manage the funds to exceed the return of the Lehman Aggregate Index. The objective of the Common School Fund is to maximize growth of assets while maintaining a targeted level of income to the fund. (WSIB Policy 2.25.100)
5. **Other Trust funds:** To emphasize stability of income to support operations or liabilities of each respective fund. To actively manage the funds to exceed the return of each funds' respective benchmark. (WSIB Policies 2.35.100, 2.35.200, 2.35.200, 2.35.400)
 - ❖ **GET Program:** To generate a 4.5 percent real rate of return (CPI + 4.5 percent).



Statutory Authority

RCW 43.33A.010:

"The State Investment Board shall exercise all the powers and perform all duties prescribed by law with respect to the investment of public trust and retirement funds."

RCW 43.84.150:

"...the State Investment Board shall have full power to invest, reinvest, manage, contract, or sell or exchange investments acquired."

RCW 41.50.080:

Investment of Retirement Systems Funds.

RCW 51.44.100:

Investment of Industrial Insurance Funds.

RCW 43.84.031:

Investment of the Permanent Funds.

RCW 43.84.170:

Investment of the Permanent Funds.

RCW 2.10.080:

Investment of Judicial Retirement System Funds.

RCW 2.14.080:

Investment of Judges' Supplemental Retirement Funds.

Strategies:

1, 2:

- ❖ Continually determine, review, alter, implement, and monitor a prudent asset allocation policy for each class of funds.
- ❖ Evaluate satisfaction with custom portfolios and adjust to meet customer need.
- ❖ Review investment options in Defined Contribution and Defined Benefit plans and implement in investments as needed.

3, 4, 5:

- ❖ Evaluate satisfaction with custom portfolios and adjust to meet customer need.

Measurements / Benchmarks

1. **Retirement funds:**

- ❖ Implementation value added
- ❖ Each option has its own benchmark, such as the Dow Jones Wilshire 5000, etc.

2. **Deferred Compensation Program:** Each option has its own benchmark, such as the Russell 3000, etc.

3. **Insurance funds:** The Comparable Market Indices duration targets

4. **Permanent funds:** Lehman Aggregate Index. Common School Fund: Lehman and Wilshire 5000, based on asset allocation

5. **Other Trust funds:** Custom benchmark based on asset allocation

Assets Under Management

Goals

Manage each asset class to meet the unique goals of the different funds. Each fund type contains various asset classes appropriate to achieve the fund's investment objectives. Each asset class has its own rate of return objectives.

1. **Public Equity:** Achieve the highest return possible consistent with the desire to control asset volatility, and diversify the overall investment program.
2. **Fixed Income:** Receive the highest return possible consistent with the unique goals and requirements of each fund type and diversify the overall investment program.
3. **Real Estate:** Produce a well diversified and profitable real estate portfolio, enhance the returns to the overall investment program, and diversify the overall investment program.
4. **Private Equity:** Enhance the returns to the overall investment program, and diversify the overall investment program.

Objectives

1. **Public Equity:**

- ❖ U.S. equity: Meet or exceed the returns of the Dow Jones Wilshire 5000 index
- ❖ International equity: Meet or exceed the returns of the MSCI ACWI Free ex-U.S. index. (All Country World Index freely traded except U.S.); the returns of the active non-U.S. managers should exceed the returns of passively managed funds, as represented by appropriate benchmarks.





Statutory Authority

RCW 28B.95.070:
Investment of Advanced College Tuition Payment Program Funds.

RCW 1.05.140(2):
Investment of Health Care Authority Insurance Funds (State Employee's Insurance Reserve).

RCW 41.24.030:
Investment of Volunteer Firefighters' Relief and Pension Funds.

RCW 41.34.060:
Investment of Defined Contribution Retirement Funds.

RCW 43.33A.190:
Investment of Defined Contribution Self-Directed Retirement Funds.

RCW 41.50.780:
Investment of Deferred Compensation Funds.

RCW 70.121.050:
Investment of Radiation Perpetual Maintenance Funds.

RCW 77.12.323:
Investment of Special Wildlife Account

RCW 43.33A.030:
Investment of Emergency Reserve Fund.

RCW 43.330.205:
Investment of Developmental Disabilities Fund.

RCW 41.05.140(4):
Investment of Basic Health Fund

- ❖ Public equity components of the Insurance Funds and the Guaranteed Education Tuition program are managed to meet or exceed the returns of the MSCI EAFE + Canada index.
2. **Fixed Income:**
 - ❖ Retirement funds: Exceed the returns of the Lehman Universal Index, with volatility similar to or less than the index.
 - ❖ Insurance funds: Meet the reserve and duration targets as set forth by the Department of Labor and Industries.
 - ❖ Permanent funds: Exceed the returns of the appropriate benchmark index, which for the majority of the funds is the Lehman Aggregate Index.
 - ❖ Other Trust funds: Effectively manage within customized policy objectives.
 3. **Real Estate:** Maximize total returns within a prudent level of risk by investing in the real estate equity and debt markets, which can be expected to deliver a superior risk-adjusted return premium of 100 to 300 basis points over the NCREIF benchmark.
 4. **Private Equity:** Achieve superior total returns compared to traditional asset classes and exceed returns in large capitalization public stocks by 500 basis points in the long run.

Strategies

1. **Public Equity:** Manage the equity portfolio with minimal tracking error.
2. **Fixed Income:** Achieve the highest risk adjusted return consistent with the desire to control asset volatility.
3. **Real Estate:** Expand global corporate and public real estate strategies, while trying to manage to the target of 12 percent of the CTF.
4. **Private Equity:** Expand investment in secondary opportunities and small/mid corporate restructuring while leveraging successful existing relationships to manage private equity exposure to 17 percent of the CTF.

Measurements / Benchmarks

1. **Retirement funds:**
 - ❖ Implementation value added
 - ❖ Each option has its own benchmark, such as the Dow Jones Wilshire 5000, etc.
2. **Deferred Compensation Program:** Each option has its own benchmark, such as the Russell 3000, etc.
3. **Insurance funds:** The Comparable Market Indices duration targets
4. **Permanent funds:** Lehman Aggregate Index. Common School Fund: Lehman and Wilshire 5000, based on asset allocation
5. **Other Trust funds:** Custom benchmark based on asset allocation

Productivity

Goals

1. Establish a centralized research function at the WSIB to assist and provide the investment staff technical, analytical and strategic research to support the management of the funds entrusted to the WSIB.





2. Examine the investment beliefs of the WSIB staff and Board and develop a statement of principles and beliefs that will serve as a fundamental guide in the investment decision-making process.
3. Establish an innovation portfolio for the CTF to allow the WSIB to capture investment opportunities that do not clearly fit into the investment philosophy and risk and return goals of the established asset classes of public and private equity, fixed income and real estate.

Objectives

1.
 - ❖ Improve the investment decision making process through more robust analysis of opportunities.
 - ❖ Increase the overall curiosity of the organization through a formal research process for surfacing and exploring new investment ideas.
 - ❖ Free Investment Officer staff from labor-intensive data preparation so they are focused instead on higher value manager research and portfolio management activities.
2. Challenge unexamined biases or historical beliefs that may not be relevant in today's investment environment and develop a common set of beliefs that can be used to benchmark our current program to those stated beliefs.
3. Proactively seek incremental return commensurate with risk across a spectrum of opportunities; increase investment flexibility across market environments; exploit market inefficiencies to provide above market return at an appropriate level of risk and enhance long term returns while diversifying and or lowering the risk to the portfolio.

Strategies

1.
 - ❖ With the hiring of a new research director, develop a research agenda to include current issues, such as commodities, currency management, fundamental indexing, real assets, and concentrated portfolio and long term trend analysis.
 - ❖ Establish research relationships with key investment and academic partners, including exploring use of fellows and interns to provide WSIB additional research capacity.
 - ❖ Procure a data repository and analytical tools with the data and tools necessary to support research.
2. Work with a consultant to lead the staff and Board through an examination of beliefs and an analysis of our investment program in light of those beliefs.
3. Develop a framework for the development, analysis and ongoing execution of innovation portfolio ideas.

Measurements / Benchmarks

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4. **Permanent funds:** Lehman Aggregate Index. Common School Fund: Lehman and Wilshire 5000, based on asset allocation
5. **Other Trust funds:** Custom benchmark based on asset allocation

Internal Processes

Goals

1. Expand the recently established Enterprise Risk Management program by adopting the Committee on Sponsoring Organizations (COSO) control framework.
2. Provide additional transparency by obtaining an independent audit of our financial statements from an audit firm specializing in investment accounting.
3. Improve our compliance program by adopting the Sarbanes Oxley (SOX) Section 404 framework, where applicable, to our financial statement controls.
4. Develop an investment product review process to plan operationally for new investment vehicles.

Objectives

1.
 - ❖ Strengthen the control and risk management framework of the WSIB by adopting industry standard practices.
 - ❖ Benchmark our control framework against best practices.
 - ❖ Enhance accountability and communication.
- 2, 3:
 - ❖ Achieve exemplary governance.
4. Ensure all operational (accounting, reporting, custody, settlement, valuation, currency, pricing, taxation, IT, legal, compliance, cost allocation, corporate governance, etc.) logistics are considered and resolved prior to the transaction of new investment vehicles.

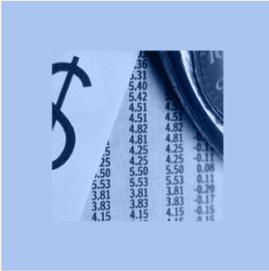
Strategies

1.
 - ❖ Conduct a gap analysis examining our control framework against COSO
 - ❖ Build a plan and budget to bring our framework into alignment with COSO.
2. Engage an investment accounting auditing firm to conduct the audit for 2005-2006 financials.
3. Conduct a gap analysis of SOX 404 controls to the WSIB controls and develop a plan for voluntary compliance, where applicable.
4. Establish a product review committee of representatives from all units impacted by a new investment to review investment proposals, raise and resolve issues, and create implementation plans prior to commencement of a transaction.

Measurements / Benchmarks

1. **Retirement funds:**
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 - ❖ Each option has its own benchmark, such as the Dow Jones Wilshire 5000, etc.





2. **Deferred Compensation Program:** Each option has its own benchmark, such as the Russell 3000, etc.
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Learning and Growth

Goals

1. Develop, inspire and support people who are passionate about investment management.
2. Create an information technology infrastructure.
3. Foster an effective culture that maximizes the value of human capital and ensures successful organizational changes.

Objectives

1.
 - ❖ Recruit the best employees for open positions through targeted recruitments that attract quality candidates.
 - ❖ Retain existing staff through compensation that is fair and equitable to peer professionals, training and development, promotional opportunities and recognition.
 - ❖ Develop supervisors and managers that can lead through training and development focused on the unique needs of an investment management organization.
2.
 - ❖ Establish strong IT project management skills and resources in the agency.
 - ❖ Build IT data management expertise within the agency.
 - ❖ Build investment systems expertise within the agency.
3. Become known as a destination employer within Washington State government and within the broader pension management world.

Strategies

1.
 - ❖ Equip our managers and supervisors to guide and support their staff by conducting management training.
 - ❖ Conduct the salary survey and adjust salaries accordingly.
 - ❖ Apply for Performance Confirmation status from the DOP and implement performance based compensation plans for classified and WMS staff.
2.
 - ❖ Deploy new FTEs provided this biennium to establish an IT project management office.
 - ❖ Obtain investment IT consulting resources to assist with specialty systems implementations.





- ❖ Train new IT staff in investment systems and investment data management through appropriate conferences and access to consulting resources.
 - ❖ Create a recognition program based on balanced scorecard goals and other achievements.
3. Apply for recognition from the Best Places to Work institute as one of the Best Small places to work in America.

Measurements / Benchmarks

1. **Retirement funds:**
 - ❖ Implementation value added
 - ❖ Each option has its own benchmark, such as the Dow Jones Wilshire 5000, etc.
2. **Deferred Compensation Program:** Each option has its own benchmark, such as the Russell 3000, etc.
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Appraisal of Internal and External Environment

This section describes and analyzes the internal and external environment in which the WSIB operates. It sketches out the strategic approach the WSIB intends to pursue in the coming years.

Background and Recent Developments

The WSIB is entering the third phase in its development. Created in 1981, the WSIB has seen its assets under management (AUM) grow from \$5.5 billion to \$69.9 billion by March 2006. The first phase involved staffing up, developing investment strategies and policies made possible by removing restrictions on investing in corporate securities by the voters, and implementing those policies. From the beginning, the Board employed innovative approaches including passive equity investments in U.S. stocks and investment in private equity (venture capital and corporate buyouts) and taking dominant positions in private equity and real estate investments.

The second phase of the Board's development occurred in the late 1980's and early 1990's when it shifted from a staff-driven to a board-driven approach to governance, policy and decision making. This shift was prompted by disappointments in the private equity portfolio and the desire of the trustees to assert greater direction of the Board's affairs. New staff was added with specialized expertise in separate asset classes and investment accounting was brought in house. Under a new executive director, the Board developed comprehensive investment policies and procedures, a code of ethics, its current organizational structure of standing committees who prepare investment decisions for Board approval, improved performance reporting, and use of external consultants for private equity, real estate, manager selection, and asset allocation. Through this work, the WSIB established a reputation for innovation, performance and cost effectiveness.

The Board entered its third phase in 2002 when it hired a new executive director with the charge to regain the Board's innovative edge, improve its communications with beneficiaries and policy makers, enhance its investment systems technology, improve





Board governance practices, increase trust between Board and staff, and improve investment performance. Since November 2002 the Board has:

- ❖ Strengthened Board governance by completely revising the Board's policies and charters.
- ❖ Refined its organizational structure to acknowledge the increasing importance of risk management, compliance, performance reporting and corporate governance.
- ❖ Upgraded investment systems and tied planning to operational goals.
- ❖ Improved staff productivity through projects to eliminate unnecessary work and streamline procedures.
- ❖ Adopted a comprehensive policy on public disclosure.
- ❖ Applied the balanced scorecard as the strategic framework for focusing the Board's planning and operations.
- ❖ Established a strong corporate governance program.
- ❖ Restructured its international equity portfolio.
- ❖ Revamped the WSIB website, improving navigation and adding detailed performance information about private equity and other investments.
- ❖ Conducted Board education sessions in fiduciary duty, ethics, investment policies and beliefs, private equity, real estate, strategic asset allocation, investing in Asia, and more.
- ❖ Completed outside reviews of fixed income staff and performance and private equity staff, program, and performance.
- ❖ Implemented a comprehensive review and adjustment of the strategic asset allocation for the \$10.5 billion insurance assets of the Department of Labor and Industries, and the \$53.6 billion CTF.
- ❖ Established an enterprise risk management framework and program that has gained statewide recognition.
- ❖ Upgraded the IT infrastructure.

Strategy and Capacity Assessment

Like most investors, the WSIB rode the boom of the 1990's to tremendous growth in AUM, including significant expansion of investment in private equity and increasing use of Board controlled investment in real estate operating companies. The exhilarating returns drove the funding status of the defined benefit retirement plans to fully funded status (with one exception) and simultaneously enabled significant contribution rate reductions that helped state agencies, school districts, and local governments cope with budget cuts necessitated by rising service demand and declining revenues.

Hindsight reveals how quickly things can change. The astonishing gains of the late 1990's rapidly disappeared into three years of negative equity returns in the U.S. and around the world. The collapse of technology, telecommunications, and media companies revealed the extent of the delusions suffered by most investors. Junk bond debt of many of these businesses turned nearly or completely worthless and the value of many portfolio companies in venture capital funds raised in 1999 and 2000 evaporated. The morning after had a double whammy: AUM fell and liabilities increased because equity values contracted sharply and liabilities jumped as interest rates fell to 30-year lows. While the funded status of the retirement plans remained comparatively healthy, contribution rates stand poised for steep increases (although this will only take them back to historical levels).



As the asset manager, the WSIB looks out to an environment in which the returns of the roaring 90's will be fondly remembered as a time when high investment returns were seemingly easy to obtain. After the equity bubble popped returns suffered. Over the past 3 years markets rebounded particularly in private equity and real estate and the WSIB's performance has been well above average. It may seem like a deliberate exercise in lowering expectations to say that the WSIB believes that it will be extremely challenging to attain the expected 8 percent rate of return for the CTF in the coming years, but that is no exaggeration. Our forecast for capital market returns over the next 10 to 20 years set forth our assumptions about asset class returns, volatility and correlations. They are not encouraging. We note that asset class returns tend to be mean reverting, that is, periods of exceptional above average returns are followed by periods of well below average returns. These periods of return regimes last from 10 to 20 years. If this problem holds in the coming years, that 8 percent return target will indeed be challenging. The WSIB's large allocation to private equity and real estate, its focus on cost, risk, portfolio construction and manager research and selection are all indication of how seriously we take the return objective we have been given.

The WSIB's fundamental beliefs about investment include a belief that developed economy equity markets are extremely efficient. This means it is exceptionally difficult to earn above market returns on a sustained basis. Accordingly, the Board's policy is to earn a market return (the average return for all equities in the U.S. for example) in exceptionally low cost commingled index funds. We believe venture capital, distressed debt, and corporate buyout markets are somewhat less efficient, meaning that investors with exceptional insight and skill can earn above market returns. This explains why the WSIB maintains a distinctively large allocation to private equity and real estate. The WSIB's ability to achieve the 8 percent rate of return assumed in the funding policies of the state require above average success in these two asset classes, and only average performance in publicly traded domestic and international equity and fixed income.

Other institutional investors also see the benefits of higher allocations to private equity and increased safety in real estate. As more capital floods into real estate and private equity, returns can be expected to decline, adding pressure to the Board to extend its commitments to its best managers, cull out weaker performers, and find the best of the emerging managers. It will be critically important to augment the WSIB's staff, research, and analytical capacity to cope with this increasing challenge.

More Challenges

If increasing competitive investment markets are not enough of a challenge, the WSIB is also coping with realities of the corporate governance scandals epitomized by Enron and WorldCom. This called for stepped up intervention in corporate governance, including exercise of the Board's proxy voting capacity and regulatory initiatives of the Securities and Exchange Commission, the Public Company Accounting and Oversight Board, other government agencies, and the investment industry's self regulatory organizations.

Technical Resources

A critical strategic objective of the WSIB is to provide the information technology resources to meet the productivity needs of staff while conforming to the statewide technology architectural standards set forth by the Department of Information Systems. Therefore, projected expenditures for the 2007-2009 biennium include provisions for replacing equipment that is reaching the end of its useful life with current-technology equipment, and for updating system software to current version levels. These upgrades will provide the WSIB with continued access to the efficient and highly reliable information processing systems and communication services needed to support the agency mission.



The WSIB contracts for outside investment management, custodial banking, and investment accounting services, which are delivered via computer connections. Several investment data subscription services are also connected to the agency's computer network. It is essential that the WSIB have state-of-the-art technology systems appropriate for complex investment management transaction and accounting requirements. Outside service providers continually update and upgrade their systems, and the WSIB must be positioned to interface to those systems to obtain the full benefit from current investment analytics and accounting information.

The WSIB has developed and continues to develop more comprehensive internal systems and data repositories using database management and office automation applications. All these internal and external resources are essential and must be readily available to staff who need them to meet the agency's complex investment management and accounting requirements.

Staffing Resources

The WSIB must employ a staff of a size and quality appropriate to the complexity, size, type, and magnitude of the investment funds. The number of staff is expected to grow, as the size of assets increase and new and innovative investment programs are added. Current staff size is 67.0 FTEs. Total assets under management are \$69.9 billion as of March 31, 2006. Current staff-to-asset ratio is approximately: 1 to \$1.0 billion.

Currently, most of the asset management is contracted out to external money managers except for fixed income management (which is performed internally by the WSIB employees). As the number of external managers and partnerships increase, an increase in internal staff required to monitor the managers and partnerships is expected to occur. Projections for the long term depend on various factors, such as change in the asset size, investment asset allocation policy, number of investment funds, and/or investment strategies. Assessment of internal versus external management of funds, active versus passive management, and other decisions can also directly impact needed resources to fund agency activities.

In recent years, the WSIB has become trustee for defined contribution retirement plans (Deferred Compensation Program, TRS 3 and SERS 3 and PERS 3) and for other participant trust programs (Guaranteed Education Tuition and Developmental Disabilities Endowment Trust Fund). The WSIB also invests and manages the assets for the participant-directed Judges Supplemental Retirement Fund. In March, 2002, the PERS 3 defined contribution hybrid retirement plan came under the trusteeship of the WSIB. These forms of retirement plans and trust programs, the concept of individual trust accounts and participant directed investments, have radically and irrevocably changed the way in which the WSIB must function as a trustee. The WSIB now creates and offers daily-valued investment vehicles to individual participants in defined contribution retirement and deferred compensation programs. Private sources of funds not previously invested, such as the Developmental Disabilities Endowment Trust Fund, add taxable accounting and investing to WSIB's current processes.

Personal Service Contracts and Legal Services

The WSIB will continue to contract with qualified independent professional consultants, advisors, money managers, and other contract services to assist in its investment management responsibilities. This process will continue to utilize the OFM statutes and regulations that govern the competitive procurement and contracting of professional personal services. The policy direction to rely on external resources will continue.

In addition to the legal services provided by the Attorney General's Office (AGO), the WSIB pays for external legal services that specialize in specific investment areas. These firms are contracted through the AGO and appointed as Special Assistant Attorneys



General. Since this is pursuant to state law, it is anticipated this trend will continue and legal services costs paid through these types of contracts will continue to increase, especially when the investment world continues to demand strong ethics and good governance.

Funding

All expenses of the WSIB are funded from the earnings of the funds managed by the WSIB. No general fund monies are involved, unless appropriated by the Legislature due to special legislative mandates. The WSIB's total proposed budget for the next biennium is .026 percent of the total assets managed (currently \$69.9 billion) equivalent to about 1.31 "basis points" per annum¹. This compares very favorably to other public pension plans of our size across the nation. Earnings on investments will more than cover the WSIB's operating costs, as well as achieve the projected investment performance benchmarks.

The whole investment arena is becoming more competitive as markets globalize, demands for better returns escalate, and new investment vehicles are employed. While the WSIB must remain aware of its status as a state agency with its attendant requirements for transparency and democratic accountability, it must also recognize that it is an investment manager operating in ruthlessly competitive global markets and accordingly adopt the tools, strategies, discipline, knowledge, and outlook of the world's best investment managers. The purpose of this plan is to enable that to happen.

¹Subject to change when 2007-2009 proposed budget is finalized.

Performance Assessment

Defined Benefit Retirement Fund	
March 31, 2006	
Qtr	6.0%
1 Year	19.3%
3 Year	18.5%
5 Year	8.7%
10 Year	9.8%

Performance Highlights

- ❖ Total assets of funds managed by the WSIB is \$69.9 billion as of March 31, 2006.
- ❖ Washington's four individual Industrial Insurance Funds all had positive one-year returns ending March 31, 2006, with the highest being 6.67 percent return on the Medical Aid Fund.
- ❖ As of March 31, 2006, the FYTD accrued earnings for Permanent funds is \$24.2 million for distribution to beneficiaries. That is up 0.8 million from 1 year ago.
- ❖ Other Trust Funds totaled approximately \$826 million as of March 31, 2006. As of March 31, 2006 they all have positive returns for the quarter, one-, three-, five- and ten-year time frames.
- ❖ Defined contribution assets are at \$7.2 billion in five separate programs: Deferred Compensation Program, Judicial Retirement Account, School Employees' Retirement System Plan 3, Teachers' Retirement System Plan 3, and Public Employees' Retirement System Plan 3.

Organizational Chart

