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| Agency: 126 – State Investment Board |
| Decision Package Code/Title: 97 - Merit System Increments |
| Budget Period: 2015-2017 |
| Budget Level: M2 - Inflation and Other Rate Changes |

Recommendation Summary Text:

The Washington State Investment Board (WSIB) requests funding to cover merit increments for classified staff only (WSIB has less than 100 FTEs).

Fiscal Detail

Operating Expenditures

| | FY 2016 | FY 2017 | Total |
|---|--------------|--------------|--------------|
| 031-1 State Investment Board Expense Acct-State | 1,400 | 5,396 | 6,796 |
| Total Cost | 1,400 | 5,396 | 6,796 |

Revenue

| Fund | Source | FY 2016 | FY 2017 | Total |
|--------------------------|-------------------------|--------------|--------------|--------------|
| 031 Invest Bd Expens | 0499 Other Revenue | 51 | 195 | 246 |
| 031 Invest Bd Expens | 0623 Investment Admin T | 1,349 | 5,201 | 6,550 |
| 608 Accident | 0623 Investment Admin T | (76) | (292) | (368) |
| 609 Medical Aid | 0623 Investment Admin T | (71) | (275) | (346) |
| 788 Adv College Tuit Pay | 0623 Investment Admin T | (37) | (143) | (180) |
| 833 Dev Dis Endow Trust | 0623 Investment Admin T | 0 | (1) | (1) |
| Total Revenue | | 1,216 | 4,685 | 5,901 |

Package Description:

To request merit increments for classified staff only. As an agency with less than 100 FTEs, the WSIB does not have the vacancy rate capacity to absorb merit system increments for classified staff. Per Office of Financial Management (OFM) budget instructions, the WSIB respectfully requests full funding of merit system increments for classified staff. As instructed, this request does not exceed the 2.5 percent of annual salaries.

For additional information in this proposal please contact:

Celina Verme, Finance and Administrative Services Director at (360) 956-4740

Narrative Justification and Impact Statement

What specific performance outcomes does the agency expect?

This request comes in response to merit system rules and state compensation provisions. Funding of this request will allow the agency to cover the required merit increments for the current classified staff.

Performance Measure Detail

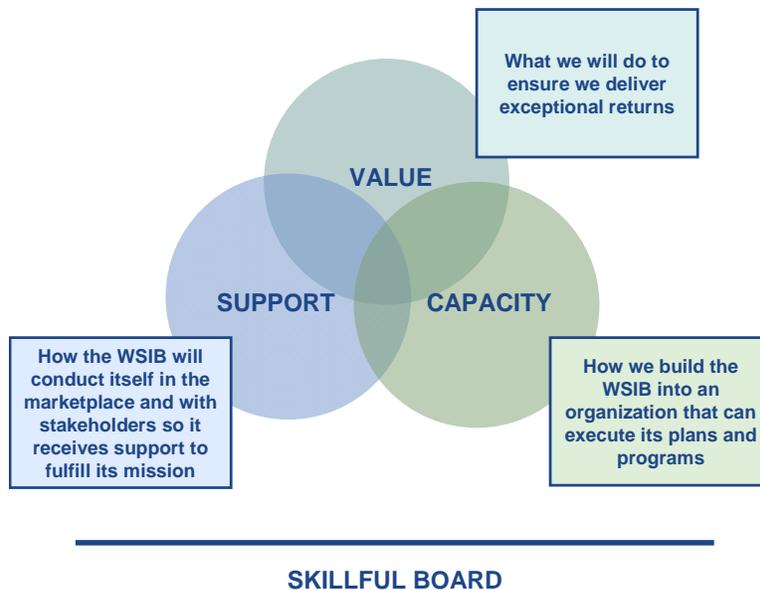
Activity: A001 Investment Activities

| | | Incremental Changes | |
|------------------|--|---------------------|---------|
| Outcome Measures | | FY 2016 | FY 2017 |
| 000279 | Retirement Funds: The variance from the median rate of return in comparison to a nationally recognized public pension fund benchmark (TUCS Public Fund > \$1 Billion Median) | 0.00% | 0.00% |
| 000329 | Permanent Funds: The variance from the average rate of return in comparison to a nationally recognized bond fund benchmark (Barclay Capital Aggregate) | 0.00% | 0.00% |
| 000385 | Retirement Funds Value Added Benchmark: Measure the variance from the median rate of return in comparison to an implementation value added benchmark. | 0.00% | 0.00% |

Is this decision package essential to implement a strategy identified in the agency's strategic plan?

The WSIB builds its strategic plan around three core principles that interact with one another, as seen in the diagram below.

Table 1 – WSIB's Strategic Framework



This package addresses the capacity core principle and its strategic initiative to develop a cohesive budget proposal to provide WSIB with adequate resources, to maintain high performance in order to meet or exceed the financial objectives of those we serve.

Does this decision package provide essential support to one or more of the Governor's Results Washington priorities?

Yes. This proposal supports the Governor's Results Washington priority of "Efficient, Effective & Accountable Government."

What are the other important connections or impacts related to this proposal?

By merit systems rules and state compensation provisions, classified employees are entitled to receive merit increments.

What alternatives were explored by the agency, and why was this alternative chosen?

There are no alternatives. By merit system rules and state compensation provisions, classified employees will receive their merit increments, whether they are funded or not. The agency does not have the capacity to absorb these costs.

What are the consequences of adopting or not adopting this package?

This decision package cover non-discretionary costs based on merit system rules and compensation provisions for classified employees. The WSIB does not have the financial capacity to absorb the additional costs.

What is the relationship, if any, to the state's capital budget?

None.

What changes would be required to existing statutes, rules, or contracts, in order to implement the change?

None.

Expenditure and revenue calculations and assumptions

All expenses of the WSIB are funded from the earnings of the funds managed by the WSIB. No general fund monies are involved.

Revenue calculations and assumptions are made using May 31, 2014 market values. Revenue will not equal the expenditures because the WSIB only has the authority from OFM to transfer revenue funds that are in allotted status.

The merit increments were completed using two separate Salary Projection System (SPS) reports for classified employees only. One report was run with merit increments and the other report was run without. The variance between the two reports is the merit increments. As instructed in OFM budget instructions, this request does not exceed 2.5 percent of annual salaries.

Table 2 – Calculations and Assumptions

| M2-97 Merit System Increments | | | |
|--------------------------------------|------------------|--------------------|--------------|
| Source: Salary Projection System | | | |
| Sub Object | With Increments | Without Increments | Variance |
| Fiscal Year 2016 | | | |
| AA - Salaries | 1,471,800 | 1,470,600 | 1,200 |
| BA - OASI | 91,248 | 91,176 | 72 |
| BB - Retirement | 135,556 | 135,444 | 112 |
| BC - Medical | 9,288 | 9,288 | 0 |
| BD - Health | 206,544 | 206,544 | 0 |
| BH - Medicare | 21,340 | 21,324 | 16 |
| Total | 1,935,776 | 1,934,376 | 1,400 |
| Fiscal Year 2017 | | | |
| AA - Salaries | 1,475,219 | 1,470,600 | 4,619 |
| BA - OASI | 91,463 | 91,176 | 287 |
| BB - Retirement | 135,864 | 135,444 | 420 |
| BC - Medical | 9,288 | 9,288 | 0 |
| BD - Health | 206,544 | 206,544 | 0 |
| BH - Medicare | 21,394 | 21,324 | 70 |
| Total | 1,939,772 | 1,934,376 | 5,396 |
| 2017 - 2019 Biennium | | | |
| AA - Salaries | 2,947,019 | 2,941,200 | 5,819 |
| BA - OASI | 182,711 | 182,352 | 359 |
| BB - Retirement | 271,420 | 270,888 | 532 |
| BC - Medical | 18,576 | 18,576 | 0 |
| BD - Health | 413,088 | 413,088 | 0 |
| BH - Medicare | 42,734 | 42,648 | 86 |
| Total | 3,875,548 | 3,868,752 | 6,796 |

Which costs and functions are one-time? Which are ongoing? What are the budget impacts in future biennia?

These are ongoing costs and will continue in future biennia.

Object Detail

| | FY 2016 | FY 2017 | Total |
|-----------------------|----------------|----------------|--------------|
| A) Salaries And Wages | 1,200 | 4,619 | 5,819 |
| B) Employee Benefits | 200 | 777 | 977 |
| Total Objects | 1,400 | 5,396 | 6,796 |

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| Agency: 126 – State Investment Board |
| Decision Package Code/Title: N0 – Investment Officer Compensation |
| Budget Period: 2015-2017 |
| Budget Level: PL – Performance Level |

Recommendation Summary Text:

The Washington State Investment Board (WSIB) believes that a competitive compensation structure is essential to recruit and retain highly skilled investment officers. Therefore, the WSIB is requesting a budget allocation to incrementally narrow the investment officer compensation gap to an average of 9 percent below the 2012 peer average by FY 2017, in compliance with RCW 43.33A.100.

Fiscal Detail

Operating Expenditures

| | FY 2016 | FY 2017 | Total |
|---|----------------|------------------|------------------|
| 031-1 State Investment Board Expense Acct-State | 688,000 | 1,376,000 | 2,064,000 |
| Total Cost | 688,000 | 1,376,000 | 2,064,000 |

Revenue

| Fund | Source | FY 2016 | FY 2017 | Total |
|--------------------------|-------------------------|----------------|------------------|------------------|
| 031 Invest Bd Expens | 0499 Other Revenue | 24,879 | 49,758 | 74,637 |
| 031 Invest Bd Expens | 0623 Investment Admin T | 663,121 | 1,326,242 | 1,989,363 |
| 608 Accident | 0623 Investment Admin T | (37,182) | (74,363) | (111,545) |
| 609 Medical Aid | 0623 Investment Admin T | (35,037) | (70,073) | (105,110) |
| 788 Adv College Tuit Pay | 0623 Investment Admin T | (18,215) | (36,430) | (54,645) |
| 833 Dev Dis Endow Trust | 0623 Investment Admin T | (80) | (161) | (241) |
| Total Revenue | | 597,486 | 1,194,973 | 1,792,459 |

Package Description:

In 2008, the Legislature amended RCW 43.33A.100 and granted the WSIB authority to develop a performance management and compensation program in order to address recruitment and retention problems and to reward performance. This statute also authorizes the WSIB to set the compensation levels and incentive compensation for investment officers based upon a biennial salary survey conducted by a consultant with review and comment by the Joint Legislative Audit and Review Committee. This statute requires compensation levels for investment officers be limited to the average of total compensation provided by state or other public funds of similar size.

Based on a compensation analysis for 2012 total cash compensation conducted by McLagan Partners as required by statute, the WSIB's investment officer compensation levels are not competitive and are significantly below average levels versus other public funds. Overall, the WSIB's total cash compensation levels are 27 percent below the peer average for other public funds. The Board approved new salary ranges on April 17, 2014. The top end of the new approved ranges are equal to the average compensation of the WSIB peers, based on 2012 total cash compensation.

The WSIB is requesting funding to cover investment officers salary increases to be granted in July 2015 and July 2016. The salary increases will incrementally bring investment officers' compensation gap down to an average of 9 percent of the 2012 peer average by FY 2017, with an estimated cost of \$2,064,000.

For additional information in this proposal please contact:

Celina Verme, Finance and Administrative Services Director at (360) 956-4740

Narrative Justification and Impact Statement

What specific performance outcomes does the agency expect?

The investment world is a fast-paced environment requiring specific professional and technical skills. The WSIB must employ a staff of a size and quality appropriate to the complexity, size, type, and magnitude of the investment funds. In order to retain existing staff and attract qualified new staff, we must provide compensation that is fair and equitable to peer professionals.

Funding of this request will allow the WSIB to continue meeting its goal of maximizing returns for the benefit of the more than 700,000 retired and active state employees, the Labor and Industries Industrial Insurance trust funds, the Guaranteed Education Tuition fund (GET), the Developmental Disabilities Endowment fund, and other colleges and universities permanent funds for whom we invest.

Performance Measure Detail

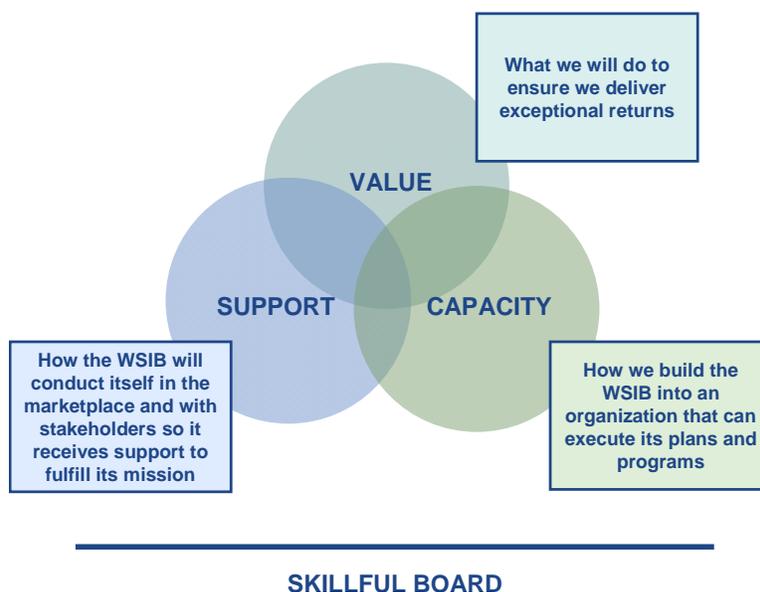
Activity: A001 Investment Activities

| | | Incremental Changes | |
|------------------|--|---------------------|---------|
| Outcome Measures | | FY 2016 | FY 2017 |
| 000279 | Retirement Funds: The variance from the median rate of return in comparison to a nationally recognized public pension fund benchmark (TUCS Public Fund > \$1 Billion Median) | 0.00% | 0.00% |
| 000329 | Permanent Funds: The variance from the average rate of return in comparison to a nationally recognized bond fund benchmark (Barclay Capital Aggregate) | 0.00% | 0.00% |
| 000385 | Retirement Funds Value Added Benchmark: Measure the variance from the median rate of return in comparison to an implementation value added benchmark. | 0.00% | 0.00% |

Is this decision package essential to implement a strategy identified in the agency's strategic plan?

The WSIB builds its strategic plan around three core principles that interact with one another, as seen in the diagram below.

Table 1 – WSIB’s Strategic Framework



This package addresses the capacity core principle and its strategic initiative to develop a cohesive budget proposal to provide the WSIB with adequate resources, including compensation, to maintain high performance in order to meet or exceed the financial objectives of those we serve.

Does this decision package provide essential support to one or more of the Governor's Results Washington priorities?

Yes. This proposal supports the Governor's Results Washington priority of "Efficient, Effective & Accountable Government."

What are the other important connections or impacts related to this proposal?

Funding of this request will increase the WSIB's competitiveness in recruiting and retaining skilled staff, allowing it to continue meeting its goal of maximizing returns for the benefit of the more than 700,000 retired and active state employees, the Labor and Industries Industrial Insurance trust funds, the Guaranteed Education Tuition fund (GET), the Developmental Disabilities Endowment fund, and other colleges and universities permanent funds for whom we invest.

What alternatives were explored by the agency, and why was this alternative chosen?

There are no other alternatives available within current resources. The alternative of using outside consultants and managers in lieu of internal staff would result in a significant cost increase. The WSIB needs to ensure that it can recruit and retain highly skilled investment professionals specializing in the assigned asset classes and who are also proficiently skilled in management of resources and programs. The agency does not have the capacity to absorb these costs.

What are the consequences of adopting or not adopting this package?

Without the requested funding, the WSIB will have no capacity to provide compensation increases that are important to retain skilled and knowledgeable incumbents who are experienced in managing, evaluating and investing in large institutional and trust portfolios. Additionally, compensation has been a key factor in the WSIB's inability to fill investment officer vacancies in a timely manner. Over the past several years, the average time to fill vacancies is almost one year, with several key positions vacant for almost two years. Extended vacancies increase the WSIB's reliance on high cost outside consultants.

What is the relationship, if any, to the state's capital budget?

None.

What changes would be required to existing statutes, rules, or contracts, in order to implement the change?

None.

Expenditure and revenue calculations and assumptions

All expenses of the WSIB are funded from the earnings of the funds managed by the WSIB. No general fund monies are involved.

Revenue calculations and assumptions are made using May 31, 2014 market values. Revenue will not equal the expenditures because the WSIB only has the authority from OFM to transfer revenue funds that are in allotted status.

Cost assumptions used in this request assume a 15 percent increase over a two year period for investment officer positions as detailed in the table below.

Table 2 – Calculations and Assumptions

| | 07/1/2015 Monthly Increase | FY 2016 | 07/1/2016 Monthly Increase | FY 2017 | Total |
|-----------------|----------------------------------|---------|----------------------------------|-----------|-----------|
| Salaries | 49,068 | 589,000 | 49,068 | 1,178,000 | 1,767,000 |
| Benefits | 8,000 | 99,000 | 8,000 | 198,000 | 297,000 |
| Total | 57,068 | 688,000 | 57,068 | 1,376,000 | 2,064,000 |

Which costs and functions are one-time? Which are ongoing? What are the budget impacts in future biennia?

These are ongoing costs and will continue in future biennia. A bow-wave step will be necessary to carry forward funding for the 2017-2019 biennium.

Object Detail

| | FY 2016 | FY 2017 | Total |
|-----------------------|---------|-----------|-----------|
| A) Salaries And Wages | 589,000 | 1,178,000 | 1,767,000 |
| B) Employee Benefits | 99,000 | 198,000 | 297,000 |
| Total Objects | 688,000 | 1,376,000 | 2,064,000 |

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| Agency: 126 – State Investment Board |
| Decision Package Code/Title: N1 – Public Equity Investment Strategies |
| Budget Period: 2015-2017 |
| Budget Level: PL – Performance Level |

Recommendation Summary Text:

This budget request will enable the Washington State Investment Board (WSIB) - Public Equity Unit to continue to improve and institutionalize manager monitoring and to pursue new strategies. The WSIB's objective is to effectively construct and oversee investment portfolios for state retirement systems and other public funds. This request favorably positions the WSIB to attain the high level of return objective set by the Legislature.

Fiscal Detail

Operating Expenditures

| | FY 2016 | FY 2017 | Total |
|---|----------------|----------------|----------------|
| 031-1 State Investment Board Expense Acct-State | 408,000 | 315,000 | 723,000 |
| Total Cost | 408,000 | 315,000 | 723,000 |

Staffing

| | FY 2016 | FY 2017 | Annual Average |
|------|----------------|----------------|-----------------------|
| FTEs | 1.0 | 1.0 | 1.0 |

Revenue

| Fund | Source | FY 2016 | FY 2017 | Total |
|--------------------------|-------------------------|----------------|----------------|----------------|
| 031 Invest Bd Expens | 0499 Other Revenue | 14,754 | 11,391 | 26,145 |
| 031 Invest Bd Expens | 0623 Investment Admin T | 393,246 | 303,609 | 696,855 |
| 608 Accident | 0623 Investment Admin T | (22,050) | (17,024) | (39,074) |
| 609 Medical Aid | 0623 Investment Admin T | (20,778) | (16,041) | (36,819) |
| 788 Adv College Tuit Pay | 0623 Investment Admin T | (10,802) | (8,340) | (19,142) |
| 833 Dev Dis Endow Trust | 0623 Investment Admin T | (48) | (37) | (85) |
| Total Revenue | | 354,322 | 273,558 | 627,880 |

Package Description:

The WSIB's Public Equity Unit oversees all aspects of this asset class which include program structure, policy development, implementation, external investment manager selection and program monitoring. The market value of the portfolio as of June 30, 2014 was \$41 billion. Currently the program has only 4 staff managing 57 accounts, 36 mandates and 16 managers.

Funding of this proposal will enable the WSIB to continue to improve the program, keep pace with a rapidly changing market and risk environment, and continue researching new ideas to increase return without compromising our fiduciary duty or our rigor of thoroughly researching investment strategies and potential investment partners, consistent with our fiduciary duty.

Budget implications for this request includes 1 assistant senior investment officer (with associated costs), as well as additional funding for professional recruiting services and travel.

Table 1 – WSIB Global Equities Compared to the MSCI ACWI IMI (with US gross) Index

| | | | |
|-----------------------------------|-----------------------|---|---------------------------|
| WSIB | U.S. 49.68% | Other Developed Countries 39.62% | Emerging 10.70% |
| MSCI ACWI IMI w/U.S. Gross | U.S. 49.01% | Other Developed Countries 40.36% | Emerging 10.63% |

For additional information in this proposal please contact:

Celina Verme, Finance and Administrative Services Director at (360) 956-4740

Narrative Justification and Impact Statement

What specific performance outcomes does the agency expect?

Funding of this request favorably positions the WSIB to attain the high level of return objective set by the Legislature, while at the same time controlling for risk. In order to consistently deliver the expected risk-adjusted returns, the WSIB must build the capacity to manage global funds, and move towards model portfolio, with balanced partner selection and diversification by strategy, sector and geography. Moving into new markets and investment vehicles requires 1) experienced investment and operations staff to describe and understand the risks inherent to these vehicles; 2) an expanded view of asset allocation that encompasses new techniques and tools for analysis, and 3) increased oversight of external investment partners and vendors to ensure adherence to more complex investment policies and guidelines. The specific desired result is performance over the long-term that meets or exceeds the benchmarks set for each fund, as described below. The undesired result we wish to avoid is not meeting the benchmarks, which is an unacceptable outcome for the WSIB since investment income is a critical funding source for each fund listed below.

Performance Measure Detail

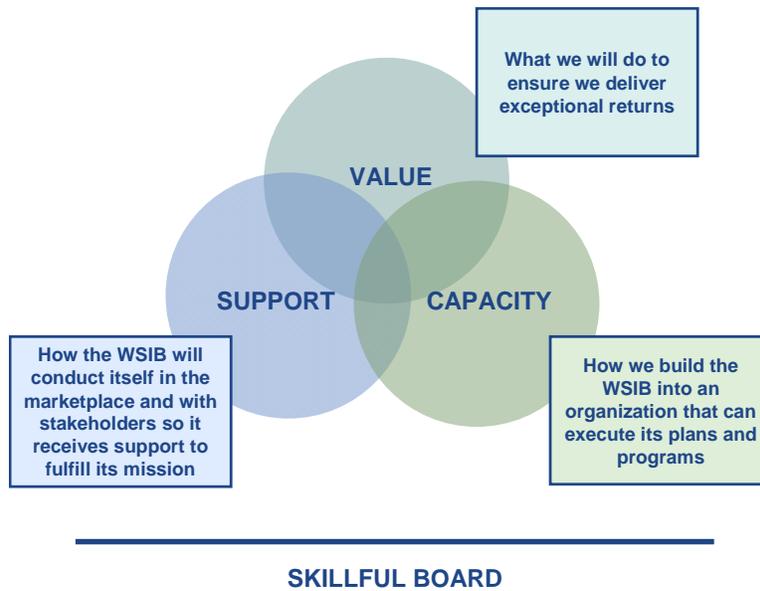
Activity: A001 Investment Activities

| | | Incremental Changes | |
|--------|--|---------------------|---------|
| | Outcome Measures | FY 2016 | FY 2017 |
| 000279 | Retirement Funds: The variance from the median rate of return in comparison to a nationally recognized public pension fund benchmark (TUCS Public Fund > \$1 Billion Median) | 0.00% | 0.00% |
| 000329 | Permanent Funds: The variance from the average rate of return in comparison to a nationally recognized bond fund benchmark (Barclay Capital Aggregate) | 0.00% | 0.00% |
| 000385 | Retirement Funds Value Added Benchmark: Measure the variance from the median rate of return in comparison to an implementation value added benchmark. | 0.00% | 0.00% |

Is this decision package essential to implement a strategy identified in the agency's strategic plan?

The WSIB builds its strategic plan around three core principles that interact with one another, as seen in the diagram below.

Table 2 – WSIB's Strategic Framework



This package addresses both the value and the capacity core principles and its strategic initiatives to sustain excellent investment performance in order to meet or exceed the financial objectives of those we serve.

Does this decision package provide essential support to one or more of the Governor's Results Washington priorities?

Yes. This proposal supports the Governor's Results Washington priority of "Efficient, Effective & Accountable Government."

What are the other important connections or impacts related to this proposal?

In addition to providing investment management services for the retirement system, the WSIB also manages the Labor and Industries Industrial Insurance trust funds, the Guaranteed Education Tuition Funds (GET), and numerous permanent and other funds. Each of these stakeholders has a keen interest in the success of the WSIB's investment management services. Senior investment staff routinely meets with the stakeholders to develop appropriate asset allocations for each fund. The major fund beneficiary groups have representatives serving on the WSIB Board, so were integral to the development of the strategic plan and the approval of this budget request. In short, the WSIB has sought extensive stakeholder input for its proposal and considers this decision package a direct outgrowth of the needs identified in discussions with its Board and stakeholders.

What alternatives were explored by the agency, and why was this alternative chosen?

The alternatives to increased staff are:

- Limit the due diligence on the managers employed by the WSIB to a minimum standard instead of industry best practices. We believe it is questionable whether this is consistent with our legislated fiduciary duty, and at a minimum, exposes the fund to unquantifiable future underperformance from managers that are not as carefully selected or monitored.
- Limit the number of managers employed (i.e. fewer relationships for the limited staff to monitor). This will significantly increase organizational risk (there will be more money invested with any investment manager, if something goes wrong) and will significantly increase risk and volatility (less diversification amongst managers). Again, the exact effect is very hard to quantify, but very real.
- Outsource due diligence. We believe this approach would both decrease the quality of oversight, and could potentially cost the fund more in fees to whomever we would pay to conduct this oversight.

What are the consequences of adopting or not adopting this package?

Not adopting this request will limit the WSIB's capability to effectively manage the portfolio, will increase the risk of managers underperforming because of lower monitoring and analysis standards, risk that the investment returns will under perform due to inability to keep pace with changes in the investment environment, will pose legal risks that the WSIB is not fulfilling its fiduciary duties, and risk of not achieving the level of return objective set by the Legislature.

What is the relationship, if any, to the state's capital budget?

None.

What changes would be required to existing statutes, rules, or contracts, in order to implement the change?

None.

Expenditure and revenue calculations and assumptions

All expenses of the WSIB are funded from the earnings of the funds managed by the WSIB. No general fund monies are involved.

Revenue calculations and assumptions are made using May 31, 2014 market values. Revenue will not equal the expenditures because the WSIB only has the authority from OFM to transfer revenue funds that are in allotted status.

Cost assumptions used in this request are detailed in the tables below.

Table 3 - Calculations and Assumptions

| Request Summary | 2015-2017 | | |
|---|------------------|------------------|------------------|
| | FY 2016 | FY 2017 | Total |
| FTEs | 1.0 | 1.0 | 1.0 |
| A - Salaries | \$210,000 | \$210,000 | \$420,000 |
| BA - OASI @ .0620 | 13,000 | 13,000 | 26,000 |
| BB - Retirement @ .0921 | 19,000 | 19,000 | 38,000 |
| BC - Medical @ \$30 per staff month | - | - | - |
| BD - Health @ \$782 per staff month | 9,000 | 9,000 | 18,000 |
| BH - Medicare @ .0145 | 3,000 | 3,000 | 6,000 |
| B - Benefits | \$44,000 | \$44,000 | \$88,000 |
| CK - Recruiting Services @ \$58,000 per Inv Off FTE - One time only | 58,000 | - | 58,000 |
| C - Personal Services Contracts | \$58,000 | \$0 | \$58,000 |
| EA - Supplies @ \$2,000 per FTE | 2,000 | 2,000 | 4,000 |
| EB - Communications @ \$3,000 (Inv Off) or \$1,000 (other) per FTE | 3,000 | 3,000 | 6,000 |
| ED - Lease Cost @ \$1,000 per staff month | 12,000 | 12,000 | 24,000 |
| EG - Training & Conferences @ \$3,000 (Inv Off) or \$1,000 (other) per FTE | 3,000 | 3,000 | 6,000 |
| EJ - Subscriptions @ \$1,000 (Inv Off) or \$150 (other) per FTE | 1,000 | 1,000 | 2,000 |
| EN - Personnel Service Contract @ .007 of salaries | 1,000 | 1,000 | 2,000 |
| ER - Purchased Services | - | - | - |
| E - Goods and Services | \$22,000 | \$22,000 | \$44,000 |
| G* - Travel @ \$5,000 (Inv Off Non-international) or \$2,000 (other) per FTE | - | - | - |
| G* - Other Travel Expenses @ \$22,000 per FTE - One time only Interview Travel = \$7,000 and Moving Expenses = \$15,000 | 22,000 | - | 22,000 |
| G* - Travel @ \$36,000 per FTE (International Travel) International Travel = \$36,000. Based on actual travel expenses as of 3/31/12 with projected annualized costs (\$27,000/9*12) | 36,000 | 36,000 | 72,000 |
| G - Travel | \$58,000 | \$36,000 | \$94,000 |
| J* - Landscape Equipment @ \$11,000 per FTE Standard cost in the 1st year is \$11,000 Cost in 2nd year and beyond is \$2,000 (20% of 1st year costs) | 11,000 | 2,000 | 13,000 |
| J* - IT Equipment @ \$5,000 per FTE Standard cost in the 1st year is \$5,000 Cost in 2nd year and beyond is \$1,000 (20% of 1st year costs) | 5,000 | 1,000 | 6,000 |
| J - Equipment | \$16,000 | \$3,000 | \$19,000 |
| Total | \$408,000 | \$315,000 | \$723,000 |

Table 4 – FTE Detail

| FTE Detail | | | | |
|-------------------------------------|---------------|----------------|----------------|-----------------------|
| Job Classification | Salary | FY 2016 | FY 2017 | Annual Average |
| Assistant Senior Investment Officer | \$210,000 | 1.0 | 1.0 | 1.0 |
| | | - | - | - |
| Total | | 1.0 | 1.0 | 1.0 |

Which costs and functions are one-time? Which are ongoing? What are the budget impacts in future biennia?

These are ongoing costs with the exception of one-time hiring costs (recruiting, interviewing, moving, and equipment) and will continue in future biennia. A bow-wave step will be necessary to carry-forward funding for the 2017-2019 biennium.

Object Detail

| Object Detail | FY 2016 | FY 2017 | Total |
|-----------------------------------|----------------|----------------|----------------|
| A) Salaries And Wages | 210,000 | 210,000 | 420,000 |
| B) Employee Benefits | 44,000 | 44,000 | 88,000 |
| C) Professional Service Contracts | 58,000 | 0 | 58,000 |
| E) Goods And Services | 22,000 | 22,000 | 44,000 |
| G) Travel | 58,000 | 36,000 | 94,000 |
| J) Capital Outlays | 16,000 | 3,000 | 19,000 |
| Total Objects | 408,000 | 315,000 | 723,000 |

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| Agency: 126 – State Investment Board |
| Decision Package Code/Title: N2 – Investment Compliance Staff |
| Budget Period: 2015-2017 |
| Budget Level: PL – Performance Level |

Recommendation Summary Text:

The Washington State Investment Board (WSIB) is requesting funding to hire an investment officer to allow the Risk and Compliance unit to build an operational back-office review monitoring program to examine WSIB’s real estate partners’ risk management, internal controls, and governance oversight processes. This new position will enhance the current investment due diligence process to provide assurance that the partners’ control structures are in place and operating effectively, within a reasonable period of time upon investing, and periodically thereafter.

Fiscal Detail

Operating Expenditures

| | FY 2016 | FY 2017 | Total |
|---|----------------|----------------|----------------|
| 031-1 State Investment Board Expense Acct-State | 275,000 | 240,000 | 515,000 |
| Total Cost | 275,000 | 240,000 | 515,000 |

Staffing

| | FY 2016 | FY 2017 | Annual Average |
|------|----------------|----------------|-----------------------|
| FTEs | 1.0 | 1.0 | 1.0 |

Revenue

| Fund | Source | FY 2016 | FY 2017 | Total |
|--------------------------|-------------------------|----------------|----------------|----------------|
| 031 Invest Bd Expens | 0499 Other Revenue | 9,944 | 8,679 | 18,623 |
| 031 Invest Bd Expens | 0623 Investment Admin T | 265,056 | 231,321 | 496,377 |
| 608 Accident | 0623 Investment Admin T | (14,862) | (12,970) | (27,832) |
| 609 Medical Aid | 0623 Investment Admin T | (14,004) | (12,222) | (26,226) |
| 788 Adv College Tuit Pay | 0623 Investment Admin T | (7,281) | (6,354) | (13,635) |
| 833 Dev Dis Endow Trust | 0623 Investment Admin T | (32) | (28) | (60) |
| Total Revenue | | 238,821 | 208,426 | 447,247 |

Package Description:

At the WSIB, protecting our reputation in the market place is a high priority. We have zero tolerance for reputational risk. To that end, we expect impeccable integrity from all members of the Board and staff. This expectation extends to the managers investing our portfolio, and the partners they invest with. Given the expansion of the Board’s global real estate portfolio in both size and complexity, it is critical that our partners adopt and implement strong internal control policies and procedures to best manage their key risks.

WSIB continues to expand the use of intermediaries as the standard structure for real estate investing. This creates an additional layer between the Real Estate Operating Companies (REOCs) and the WSIB.

- An intermediary is a limited liability company established by an investment manager through which the WSIB invests in real estate operating companies. Thus, they are not REOCs, but they own REOCs on our behalf. Intermediaries oversee investments, together with WSIB staff; providing additional oversight resources to monitor the funds invested. With the future real estate vision, and staff having limited resources, this structure gives them needed additional oversight.
- A REOC is a private company with a primary business of owning and operating real property. The company is generally focused on a specific property type and geography. They are often “vertically integrated,” meaning they can do everything from development, to leasing, to property management, to maintenance.

Funding of this proposal will enable the WSIB’s Risk and Compliance unit to build an operational back-office review monitoring program to examine WSIB’s real estate partners’ risk management, internal controls, and governance oversight processes. The new operational due diligence review program will monitor and ensure the following institutional level controls and processes are in place at the real estate investment partners offices.

Table 1 – WSIB’s Institutional Level Controls and Processes

| Financial Controls | |
|---------------------------------------|--------------------------------------|
| ● Separation of Financial Duties | ● Valuation Procedures |
| ● Budgets | ● Procurement Procedures |
| ● Cash Receipts/Accounts Receivable | ● Financial Reporting |
| Internal Governance | |
| ● Risk Management/Insurance | ● Human Resources |
| ● Policies/Procedures | ● Confidential Information |
| ● Ethics | ● IT System Security |
| ● Audits | ● Disaster Preparedness |
| Investment Management Process | |
| ● Investment Approval Process | ● File Review/Organization |
| ● Due Diligence Process and Reporting | ● Verification of Supporting Reports |

Budget implications for this request includes 1 investment officer (with associated costs), as well as additional funding for travel.

For additional information in this proposal please contact:

Celina Verme, Finance and Administrative Services Director at (360) 956-4740

Narrative Justification and Impact Statement

What specific performance outcomes does the agency expect?

Funding of this request will allow the WSIB to work with consultants and intermediaries to establish an internal control and governance structure for WSIB intermediaries to adopt and implement within their organizations and the REOCs they oversee. Enhance the current review process to include ongoing monitoring framework for the WSIB to have assurance the control structures are in place and operating effectively, within a reasonable period of time upon investing, and periodically thereafter.

Outcome Measures:

- Better alignment and understanding between the WSIB and the intermediaries regarding expectations for effective risk management, internal controls, and governance processes.
- Establishment of a list of standard risk management, internal controls, and governance practices that can be used going forward with new intermediaries and REOCs while working with outside consultants and intermediaries.
- Incorporate monitoring plan regarding risk, controls, and governance at the real estate investment managers.

Performance Measure Detail

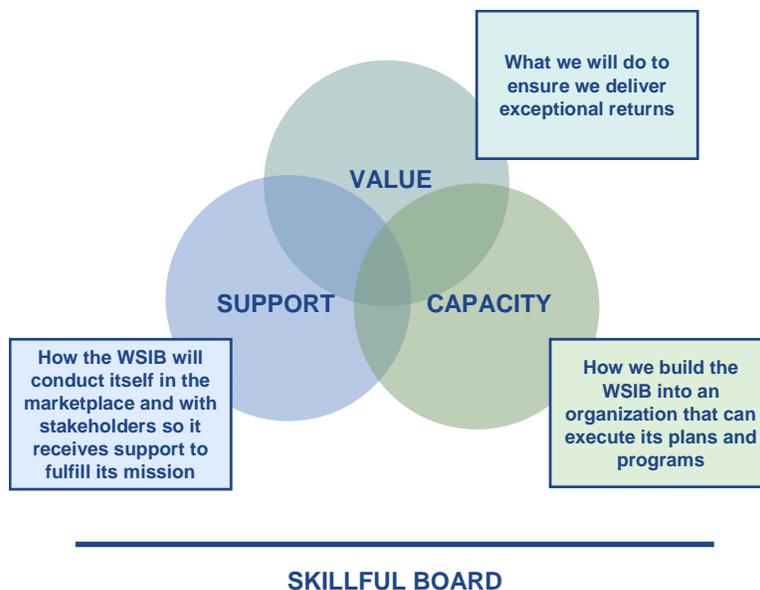
Activity: A001 Investment Activities

| | | Incremental Changes | |
|------------------|--|---------------------|---------|
| Outcome Measures | | FY 2016 | FY 2017 |
| 000279 | Retirement Funds: The variance from the median rate of return in comparison to a nationally recognized public pension fund benchmark (TUCS Public Fund > \$1 Billion Median) | 0.00% | 0.00% |
| 000329 | Permanent Funds: The variance from the average rate of return in comparison to a nationally recognized bond fund benchmark (Barclay Capital Aggregate) | 0.00% | 0.00% |
| 000385 | Retirement Funds Value Added Benchmark: Measure the variance from the median rate of return in comparison to an implementation value added benchmark. | 0.00% | 0.00% |

Is this decision package essential to implement a strategy identified in the agency's strategic plan?

The WSIB builds its strategic plan around three core principles that interact with one another, as seen in the diagram below.

Table 2 – WSIB’s Strategic Framework



This package addresses the capacity core principle and its strategic initiatives to enhance risk management and control in order to meet or exceed the financial objectives of those we serve.

Does this decision package provide essential support to one or more of the Governor’s Results Washington priorities?

Yes. This proposal supports the Governor's Results Washington priority of "Efficient, Effective & Accountable Government."

What are the other important connections or impacts related to this proposal?

Funding of this request will position the agency to achieve its goal to meet or exceed the financial objectives of the beneficiaries.

What alternatives were explored by the agency, and why was this alternative chosen?

The only alternative would be to outsource. While this option may be efficient, it would also be very expensive and will not serve the best interests of the beneficiaries:

What are the consequences of adopting or not adopting this package?

Adopting this request, will allow the WSIB to enhance risk management and internal control processes.

What is the relationship, if any, to the state's capital budget?

None.

What changes would be required to existing statutes, rules, or contracts, in order to implement the change?

None.

Expenditure and revenue calculations and assumptions

All expenses of the WSIB are funded from the earnings of the funds managed by the WSIB. No general fund monies are involved.

Revenue calculations and assumptions are made using May 31, 2014 market values. Revenue will not equal the expenditures because the WSIB only has the authority from OFM to transfer revenue funds that are in allotted status.

Cost assumptions used in this request are detailed in the tables below.

Table 3 - Calculations and Assumptions

| Request Summary | 2015-2017 | | |
|--|------------------|------------------|------------------|
| | FY 2016 | FY 2017 | Total |
| FTEs | 1.0 | 1.0 | 1.0 |
| A - Salaries | \$146,000 | \$146,000 | \$292,000 |
| BA - OASI @ .0620 | 9,000 | 9,000 | 18,000 |
| BB - Retirement @ .0921 | 13,000 | 13,000 | 26,000 |
| BC - Medical @ \$30 per staff month | - | - | - |
| BD - Health @ \$782 per staff month | 9,000 | 9,000 | 18,000 |
| BH - Medicare @ .0145 | 2,000 | 2,000 | 4,000 |
| B - Benefits | \$33,000 | \$33,000 | \$66,000 |
| CK - Recruiting Services @ \$58,000 per Inv Off FTE - One time only | - | - | - |
| C - Personal Services Contracts | \$0 | \$0 | \$0 |
| EA - Supplies @ \$2,000 per FTE | 2,000 | 2,000 | 4,000 |
| EB - Communications @ \$3,000 (Inv Off) or \$1,000 (other) per FTE | 3,000 | 3,000 | 6,000 |
| ED - Lease Cost @ \$1,000 per staff month | 12,000 | 12,000 | 24,000 |
| EG - Training & Conferences @ \$3,000 (Inv Off) or \$1,000 (other) per FTE | 3,000 | 3,000 | 6,000 |
| EJ - Subscriptions @ \$1,000 (Inv Off) or \$150 (other) per FTE | 1,000 | 1,000 | 2,000 |
| EN - Personnel Service Contract @ .007 of salaries | 1,000 | 1,000 | 2,000 |
| ER - Purchased Services | - | - | - |
| E - Goods and Services | \$22,000 | \$22,000 | \$44,000 |
| G*- Travel @ \$5,000 (Inv Off Non-international) or \$2,000 (other) per FTE | - | - | - |
| G*- Other Travel Expenses @ \$22,000 per FTE - One time only Interview Travel = \$7,000 and Moving Expenses = \$15,000 | 22,000 | - | 22,000 |
| G*- Travel @ \$36,000 per FTE (International Travel) International Travel = \$36,000. Based on actual travel expenses as of 3/31/12 with projected annualized costs (\$27,000/9*12) | 36,000 | 36,000 | 72,000 |
| G - Travel | \$58,000 | \$36,000 | \$94,000 |
| J* - Landscape Equipment @ \$11,000 per FTE Standard cost in the 1st year is \$11,000 Cost in 2nd year and beyond is \$2,000 (20% of 1st year costs) | 11,000 | 2,000 | 13,000 |
| J* - IT Equipment @ \$5,000 per FTE Standard cost in the 1st year is \$5,000 Cost in 2nd year and beyond is \$1,000 (20% of 1st year costs) | 5,000 | 1,000 | 6,000 |
| J - Equipment | \$16,000 | \$3,000 | \$19,000 |
| Total | \$275,000 | \$240,000 | \$515,000 |

Table 4 – FTE Detail

| FTE Detail | | | | |
|---|---------------|----------------|----------------|-----------------------|
| Job Classification | Salary | FY 2016 | FY 2017 | Annual Average |
| Investment Officer - Internal Control Investment Specialist | \$146,000 | 1.0 | 1.0 | 1.0 |
| | | - | - | - |
| Total | | 1.0 | 1.0 | 1.0 |

Which costs and functions are one-time? Which are ongoing? What are the budget impacts in future biennia?

These are ongoing costs with the exception of one-time hiring costs (interviewing, moving, and equipment) and will continue in future biennia. A bow-wave step will be necessary to carry-forward funding for the 2017-2019 biennium.

Object Detail

| Object Detail | FY 2016 | FY 2017 | Total |
|-----------------------|----------------|----------------|----------------|
| A) Salaries And Wages | 146,000 | 146,000 | 292,000 |
| B) Employee Benefits | 33,000 | 33,000 | 66,000 |
| E) Goods And Services | 22,000 | 22,000 | 44,000 |
| G) Travel | 58,000 | 36,000 | 94,000 |
| J) Capital Outlays | 16,000 | 3,000 | 19,000 |
| Total Objects | 275,000 | 240,000 | 515,000 |