CLIENT CASE STUDY

Russell Investments

Outsourcing helps hospital manage credit downgrade risk, address conflicts of interest

THE ORGANIZATION

A full service, non-profit healthcare facility serving its community for over 80 years. The management team oversees multiple asset pools, including long-term investments, insurance, and foundation assets totaling over $360 million.

Challenges: credit rating concerns and conflicts of interest

One of the hospital's top financial priorities was to maintain their credit rating with Moody's. Managing portfolio liquidity, days of cash on hand, and establishing a level of parity with peers' portfolios were critical in this effort. The hospital's actual asset allocation had become significantly overweighted to hedge funds and real assets relative to their investment policy. The allocations to these asset classes were 2 to 3 times those of comparable health systems with similar credit ratings.

While the committee understood the benefits of hedge funds and real assets in their portfolio, the high target allocation and even higher actual allocation did not match their specific investment objectives given their focus on liquidity and their desired credit rating. Further, they wanted to align their asset allocation with the investment objectives of the multiple asset pools they managed.

The hospital had been working with the same investment consultant for years, and had implemented many of the consultant's recommendations on good faith. When a new CFO was appointed, portfolios were examined with increased scrutiny and several questions were raised regarding the consultant's recommendations.

In addition, one of the investment committee members had an existing business relationship with the consultant, which was deemed to be a conflict of interest that needed to be addressed. All of these concerns fueled the CFO's desire to seek a new type of investment advisory solution that could strengthen the hospital's investment discipline and minimize conflicts of interests.

Multiple objectives to manage

GOAL	STRATEGY
Manage credit rating downgrade risk	Improve liquidity and align asset allocation with industry peers
Align investment program with organizational objectives	Manage asset allocation of separate asset pools in line with their respective investment objectives
Fulfill fiduciary duty	Minimize conflict of interests within investment decision making structure

Search for a co-fiduciary

The CFO and investment committee conducted a thorough review of the existing consulting relationship and issued an RFP (request for proposal) to explore approaches available from other providers. The investment committee decided to pursue an investment outsourcing approach, given their limited resources and desire to partner with a firm that would take greater accountability for investment decisions and their outcomes.

The committee eventually selected Russell Investments due to our reputation in the investment management industry and experience in investment outsourcing. They were attracted to our global resources and ability to quickly implement an investment solution customized to meet the hospital's very specific needs.

Implementing an investment outsourcing solution

Portfolio analysis

Russell Investments' first step in working with the investment committee was to understand the existing investment portfolio as a whole and the role of each individual strategy and product. As shown in **Exhibit 1**, the existing allocation was compared with the hospital's investment policy as well as peer allocations associated with Moody's Aa and A rating allocations.

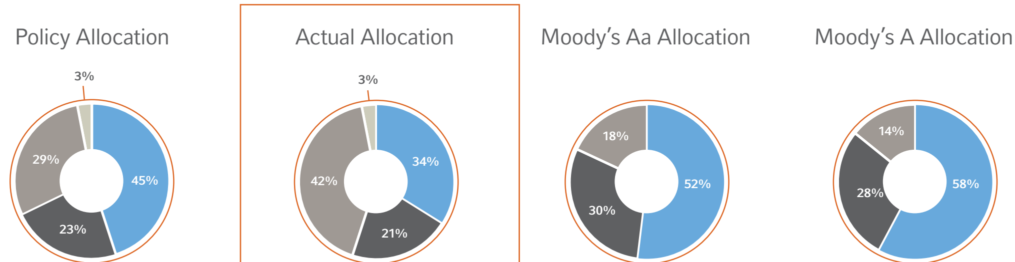
Russell Investments as a co-fiduciary

The hospital streamlined management of its investment portfolios, asset managers and vendor relationships by delegating much of this oversight to Russell Investments.

As a co-fiduciary, Russell Investments manages many of the day-to-day details of the investment program within a carefully structured system of controls that helps minimize potential conflicts of interest.

EXHIBIT 1

- Fixed Income & Cash
- Equities
- Hedge Funds & Alts
- Others



	Policy Allocation	Actual Allocation	Moody's Aa Allocation	Moody's A Allocation
30 day liquidity	85%-90%	70%-75%	89.5%	91.5%
20 year annualized return assumption*	6.2%	6.5%	6.0%	5.8%
Standard deviation of 20 year return assumptions*	7.8%	8.9%	7.7%	7.3%
Likelihood of positive cumulative returns over 5 year period	91.6%	83.9%	91.5%	93.1%

*Russell Investments' strategic planning capital markets assumptions. Please note that this analysis is based on Russell Investments' published capital market assumptions (20 year forecast horizon) as of 12/31/2013. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. There is no guarantee that the stated results will occur.

Moody's data provided by Moody's Investors Service, December 2010; Russell Investments calculations.

An initial analysis of the portfolio showed that:

- The fixed income allocation was significantly underweight in relation to both the policy as well as peer allocations.
- In contrast, the allocation to alternatives (real assets and hedge funds) significantly exceeded targets established by both policy and credit-rating peers.
- Given the illiquid nature of the hedge fund and real assets strategies, only 70-75% of the portfolio had better than 30 day liquidity while both investment policy and Moody's suggested something closer to 90%.
- The underweight to fixed income and the overweight to alternatives materially increased the volatility of the portfolio (by 14%) and decreased the likelihood of positive cumulative returns going forward (by 8.4%), relative to the policy allocation.

Our Investment Recommendations

To better match the asset allocation of industry peers and also meet the unique objectives of each asset pool, Russell Investments recommended:

› Shifting a substantial portion of the assets to fixed income and cash strategies, including short- and intermediate duration fixed income assets. Including short duration fixed income not only provided the benefits of cash (such as liquidity and low volatility) but also the opportunity for a higher yield versus cash.

› Reducing the hedge fund and real assets allocations to reduce volatility and increase portfolio liquidity.

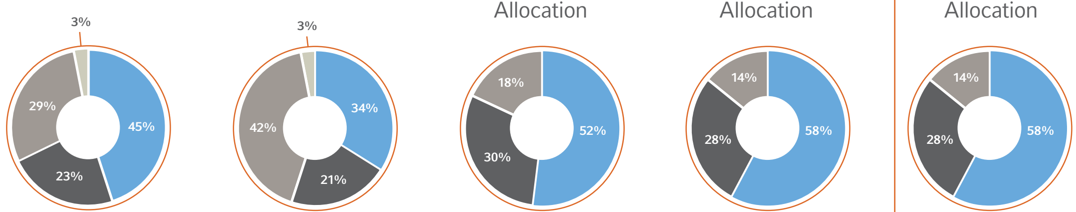
› Adjusting the equities portfolio to remove a significant home country bias embedded in the portfolio.

› Creating a more balanced approach across developed markets including a slightly higher allocation to non-US equity and emerging markets.

As a result of these changes, the liquidity of the portfolio improved from the 70-75% range to more than 91% of the portfolio having better than 30 day liquidity. In addition the volatility of the portfolio decreased by 20% and the likelihood of positive cumulative returns over a five year period increased by 8.3%, as shown in **Exhibit 2** below.

EXHIBIT 2

Fixed Income & Cash
Equities
Hedge Funds & Alts
Others



	Policy Allocation	Actual Allocation	Moody's Aa Allocation	Moody's A Allocation	Recommended Allocation
30 day liquidity	85%-90%	70%-75%	89.5%	91.5%	91.1%
20 year annualized return assumption*	6.2%	6.5%	6.0%	5.8%	5.9%
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Likelihood of positive cumulative returns over 5 year period	91.6%	83.9%	91.5%	93.1%	91.5%

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This recommended overall asset allocation brought the hospital's aggregate assets more in line with peers. Russell Investments also worked to align the asset allocation for each individual asset pool with its unique objectives as shown in **Exhibit 3** below:

EXHIBIT 3

OVERALL ASSET ALLOCATION	LONG-TERM ASSETS	INSURANCE ASSETS	FOUNDATION ASSETS
Goals	Longer-term focus (at least 3-5 years) with short-term volatility more acceptable	Maintaining liquidity and minimizing volatility Cashflows from claim payments and inflow contributions required a shorter time horizon	Balance capital preservation, liquidity and returns
Cash	0%	0%	0%
Short Duration Fixed Income	23%	40%	33%
Aggregate Fixed Income	23%	40%	33%
Domestic Equity	23%	14%	23%
International Equity	11%	6%	11%
Hedge Funds and other Alternatives	20%	0%	0%

RESULTS

By partnering with Russell Investments, the hospital:

- Decreased their credit rating downgrade risk by shifting their asset allocation to be in line with industry peers
- Minimized conflicts of interests in their investment decision making process
- Improved their 30-day liquidity profile by as much as 21%, and reduced portfolio volatility by 20%
- Increased the likelihood of positive cumulative returns over a five year period by 8.3%
- Aligned the asset allocation for each asset pool with its individual objectives

In addition, by delegating much of the day-to-day investment oversight and decision making to Russell Investments, the investment committee has been able to free up time and resources to focus on strategic decisions that give the hospital a better chance of meeting its goals.

ABOUT RUSSELL INVESTMENTS

Russell Investments has helped hospitals and health system clients navigate challenges and meet goals since 1983. We work with each of our clients to fully understand their asset pools and unique investment needs. The comprehensive investment outsourcing solutions we design for our clients are tailored to meet each organization's specific goals and incorporate our award-winning advice, investment strategy, and implementation.

FOR MORE INFORMATION:

Call Russell Investments at **866-739-7979** or visit **russellinvestments.com/healthcare**

Important information

This case study is for that of an individual Russell Investments client, and is provided to illustrate Russell Investments' capability and experience with this service. Individual actions and results will vary.

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Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates with minority stakes held by funds managed by Reverence Capital Partners and Russell Investments' management.

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