



STATE OF WISCONSIN

Legislative Audit Bureau

NONPARTISAN • INDEPENDENT • ACCURATE

Report 21-13
September 2021

Retirement Funds Investment Activity

Calendar Year 2020

State of Wisconsin Investment Board



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State of Wisconsin Investment Board



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Legislative Audit Bureau

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Reports are submitted to the Joint Legislative Audit Committee and made available to other committees of the Legislature and to the public. The Audit Committee may arrange public hearings on the issues identified in a report and may introduce legislation in response to the audit recommendations. However, the findings, conclusions, and recommendations in the report are those of the Legislative Audit Bureau.

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Opinions Published Separately

The financial statements and our unmodified opinions on them are included in the State of Wisconsin Investment Board's *2020 Retirement Funds Annual Report*.



STATE OF WISCONSIN
Legislative Audit Bureau

Joe Chrisman
State Auditor

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September 8, 2021

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

As required by ss. 13.94 (1) (df) and 25.17 (51), Wis. Stats., we have completed a financial audit of the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable Fund) managed by the State of Wisconsin Investment Board (SWIB) as of and for the year ended December 31, 2020. SWIB invests assets of the Wisconsin Retirement System (WRS) through the Core Fund and Variable Fund, and together these funds are known as the Retirement Funds. The financial statements report the investment activity for the Retirement Funds. The financial statements and our unmodified opinions on them are included in SWIB's *2020 Retirement Funds Annual Report*, which may be found on SWIB's website.

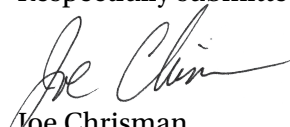
Net investment position provides a measure of overall financial condition. On the basis of generally accepted accounting principles (GAAP), the net investment position of the Core Fund increased from \$107.8 billion as of December 31, 2019, to \$120.2 billion as of December 31, 2020. The Core Fund reported net investment income of \$17.8 billion in 2019 and \$15.9 billion in 2020. The one-year investment return, net of all fees and costs, decreased from 19.4 percent in 2019 to 15.2 percent in 2020. The Core Fund investment return in 2020 is largely attributed to strong investment returns from private equity, public equity, and public fixed income investments.

The net investment position of the Variable Fund increased from \$8.7 billion as of December 31, 2019, to \$9.6 billion as of December 31, 2020. The Variable Fund reported net investment gains of \$2.0 billion in 2019 and \$1.4 billion in 2020. The one-year investment return, net of all fees and costs, decreased from 28.5 percent in 2019 to 17.5 percent in 2020. The Variable Fund investment return in 2020 is largely attributed to strong investment returns from public equity investments.

The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards*, begins on page 11. We did not identify any control or compliance concerns that were required to be reported under these standards.

We appreciate the courtesy and cooperation extended to us by SWIB staff in completing this audit.

Respectfully submitted,


Joe Chrisman
State Auditor

JC/CS/ss

Introduction

SWIB invests the assets of the Wisconsin Retirement System through the Core Fund and the Variable Fund, which together are known as the Retirement Funds.

SWIB invests the assets of the Wisconsin Retirement System (WRS) through the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable Fund). The Core Fund is a diversified fund that typically is invested for the long term in several types of investments and provides less volatile investment returns. The Variable Fund is a public equities securities fund, or stock fund, that provides returns that are typically more volatile than the Core Fund. Together these funds are known as the Retirement Funds. SWIB reports the investment activity of the Retirement Funds in the financial statements that are included in its *2020 Retirement Funds Annual Report*, which may be found on SWIB's website. These financial statements are prepared by SWIB using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB).

Total Investment Assets

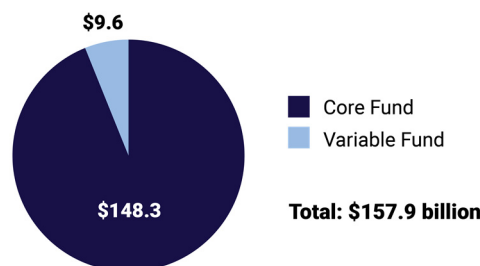
The Core Fund accounted for 93.9 percent of the total investment assets of the Retirement Funds as of December 31, 2020.

On a GAAP basis, total investment assets of the Retirement Funds were \$157.9 billion as of December 31, 2020, compared to \$137.4 billion as of December 31, 2019. As of December 31, 2020, the Core Fund accounted for \$148.3 billion (93.9 percent) of the total investment assets of the Retirement Funds and the Variable Fund accounted for \$9.6 billion (6.1 percent), as shown in Figure 1.

Figure 1

Total Investment Assets Retirement Funds

As of December 31, 2020
(in billions)



The Core Fund investment assets include cash balances and receivables related to investment sales, as well as investments. The Core Fund investments include a distinct mix of investment types, including public equities, fixed income instruments, derivative instruments, real estate, and private equities. The Variable Fund is a public equities securities fund that provides returns that are typically more volatile than the Core Fund. The Variable Fund investment assets include cash balances and receivables, in addition to investments comprised mostly of public equities and preferred securities.

Net Investment Income

Given the onset of the global pandemic early in 2020, most asset classes in both the Core Fund and the Variable Fund had negative net returns for the first quarter of 2020. However, consistent with the overall economic recovery, results improved during the remainder of the year.

The Core Fund and the Variable Fund reported net investment gains in 2020 of \$15.9 billion and \$1.4 billion, respectively.

On a GAAP basis, the Core Fund reported net investment income of \$15.9 billion in 2020, compared to \$17.8 billion in 2019. The one-year investment return, net of all fees and costs, for the Core Fund was 15.2 percent, a decline from 2019 returns of 19.4 percent. One-year investment returns exceeded the Core Fund benchmark of 14.2 percent in 2020. On a GAAP basis, the Variable Fund reported net investment income of \$1.4 billion in 2020, compared to \$2.0 billion in 2019. The one-year investment return, net of all fees and costs, for the Variable Fund was 17.5 percent in 2020, a decline from 2019 returns of 28.5 percent. One-year investment returns lagged the Variable Fund benchmark of 17.9 percent in 2020.

SWIB reported the 20-year investment return for the Core Fund was 6.9 percent.

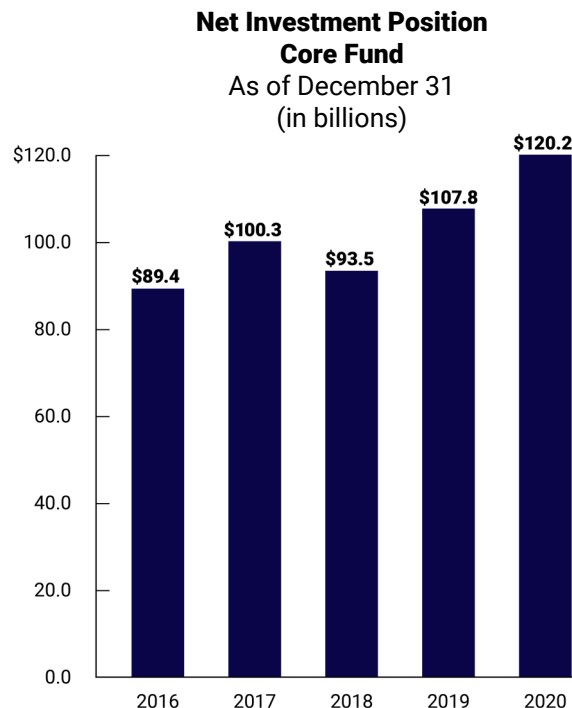
SWIB has a fiduciary responsibility to prudently invest the assets of the Retirement Funds in a diversified manner to meet WRS funding needs, while minimizing the risk of large losses. SWIB's investment strategy is to meet the long-term expected rate-of-return assumption, which has been 7.0 percent since December 2018. As of December 31, 2020, SWIB's 20-year return for the Core Fund, net of external manager fees, was 6.9 percent. SWIB reported that one-year, five-year, and ten-year investments returns for the Core Fund, as of December 31, 2020, exceeded the long-term expected rate-of-return assumption.

Net Investment Position

The net investment position of the Core Fund increased from \$107.8 billion as of December 31, 2019, to \$120.2 billion as of December 31, 2020.

Net investment position, which is the investment assets less investment liabilities, is a measure of overall financial condition. On a GAAP basis, the net investment position of the Core Fund increased from \$107.8 billion as of December 31, 2019, to \$120.2 billion as of December 31, 2020, or by 11.5 percent, as shown in Figure 2. The increase is largely attributed to strong overall investment returns from private equity, public equity, and public fixed income investments. For the year ended December 31, 2020, SWIB reported private equity investments, such as limited partnerships, had a return of 19.1 percent, compared to a benchmark of 11.6 percent. From December 31, 2016, through December 31, 2020, the net investment position of the Core Fund increased by \$30.8 billion, or by 34.4 percent.

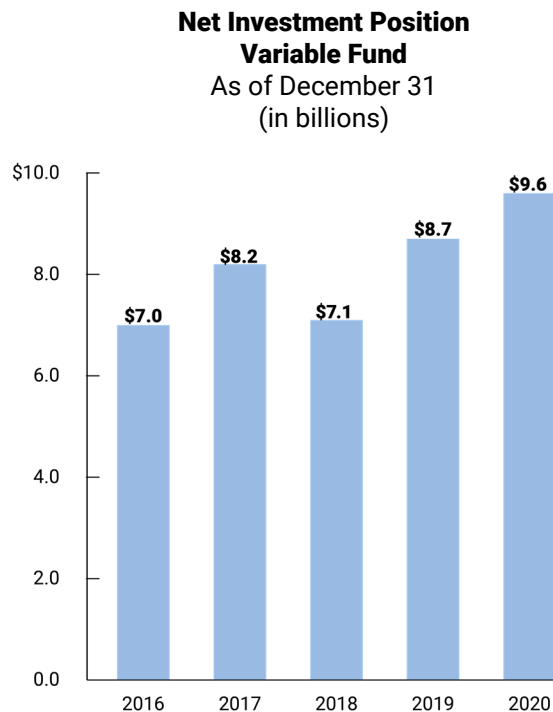
Figure 2



The net investment position of the Variable Fund increased from \$8.7 billion as of December 31, 2019, to \$9.6 billion as of December 31, 2020.

As shown in Figure 3, the net investment position of the Variable Fund increased from \$8.7 billion as of December 31, 2019, to \$9.6 billion as of December 31, 2020, or by 10.3 percent. The increase is primarily attributed to strong overall investment returns from public equity investments. From December 31, 2016, through December 31, 2020, the net investment position of the Variable Fund increased by \$2.6 billion, or by 36.4 percent.

Figure 3



Internal and External Management

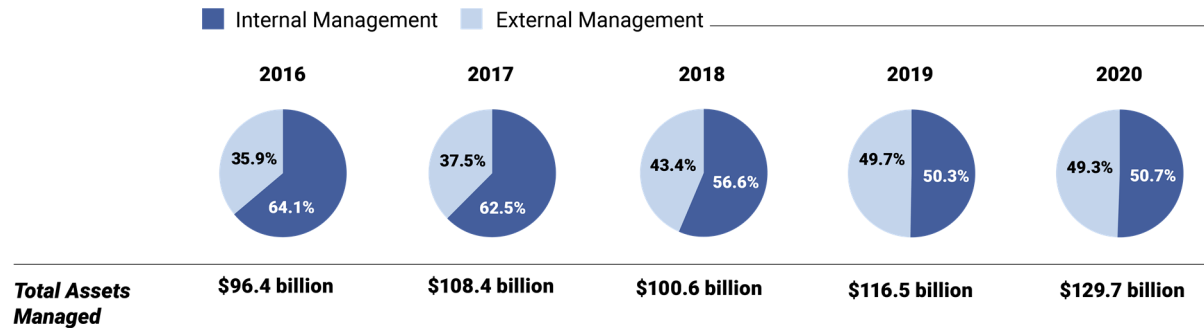
SWIB's investment strategy for the assets of the Retirement Funds employs a mix of internal and external management of assets. In report 20-23, we described SWIB's goal to increase the percentage of assets managed internally because external management is more expensive. However, the percentage of assets managed internally has decreased.

As of December 31, 2020, 50.7 percent of the assets of the Retirement Funds were managed internally by SWIB.

Total assets managed, which are the total investment assets less related investment liabilities, are reported by SWIB in required quarterly reports to the Legislature under s. 25.17 (13m), Wis. Stats. As shown in Figure 4, as total assets managed have increased the percentage of assets managed internally by SWIB has decreased from 64.1 percent as of December 31, 2016, to 50.7 percent as of December 31, 2020.

Figure 4

Internal and External Management¹
Retirement Funds' Total Assets Managed
 As of December 31



¹ Total assets managed, which are the total investment assets less related investment liabilities, are reported by SWIB in required quarterly reports to the Legislature under s. 25.17 (13m), Wis. Stats.

As noted in report 20-23, SWIB staff attributed increases in external management of investments to a shifting of funds to external managers for executing more complex active strategies that require investment skills not available within SWIB. SWIB also noted that it continues to seek to improve its information technology infrastructure and to continue to recruit investment staff with expertise to manage a portion of the assets managed by external managers. Retirement Funds external management fees reported on the financial statements were \$432.4 million in 2020.

Audit Results

We provided unmodified opinions on the financial statements of the Core Fund and the Variable Fund investment activity as of and for the year ended December 31, 2020.

As required by Wisconsin Statutes, we have completed an audit of the financial statements and related notes, of the Core Fund and the Variable Fund, as of and for the year ended December 31, 2020. The financial statements include information on the investment activity of the Core Fund and the Variable Fund, including important disclosures, such as those related to deposit and investment risk, and fair value measurements as of December 31, 2020. To complete our audit of the financial statements, we reviewed SWIB's internal controls over financial reporting, tested financial transactions, and reviewed the financial statements, notes, and required supplementary information that were prepared by SWIB management. We provided unmodified opinions on the financial statements and related notes as of and for the year ended December 31, 2020.

SWIB took steps to address the deficiency we reported in our 2019 audit of the financial statements of the Retirement Funds.

We also issued our Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards*, and begins on page 11. We did not identify any control or compliance concerns that were required to be reported under these standards. For our 2019 audit (report 20-9), we reported a significant deficiency in internal control in the Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters. This deficiency related to errors in the reporting of unfunded commitments in the notes that accompany the financial statements. Based on our recommendation, SWIB took steps in 2020 to address this deficiency.

■ ■ ■ ■

Auditor's Report

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees, and
Mr. Edwin Denson, Executive Director/Chief Investment Officer
State of Wisconsin Investment Board

We have audited the financial statements and the related notes of the Core Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund (Retirement Funds) managed by the State of Wisconsin Investment Board (SWIB) as of and for the year ended December 31, 2020, and have issued our report thereon dated September 2, 2021. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, which is issued by the Comptroller General of the United States. The financial statements and related auditor's opinions have been included in SWIB's *2020 Retirement Funds Annual Report*.

Internal Control over Financial Reporting

Management of SWIB is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered SWIB's internal control as a basis for designing audit procedures that are appropriate in the circumstance for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWIB's internal control. Accordingly, we do not express an opinion on the effectiveness of SWIB's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent misstatements, or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the financial statements of the Retirement Funds will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

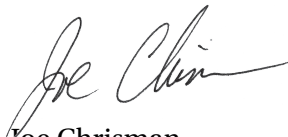
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Retirement Funds are free from material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering SWIB's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of SWIB's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

September 2, 2021