

## State of Wisconsin Investment Board

July 2014

# Report Highlights ■

***As of December 2013, SWIB had \$101.3 billion in assets under management.***

***The investment performance of the Core Fund and Variable Fund has frequently met or exceeded benchmarks.***

***In 2010, the Board of Trustees approved a new asset allocation plan for the Core Fund.***

***2011 Wisconsin Act 32 authorized SWIB to establish its own operating budget and to create or abolish staff positions.***

### Key Facts and Findings

*The five-year investment return for the Core Fund ranked fourth among nine other public pension plans.*

*The investment performance*

The State of Wisconsin Investment Board (SWIB) invests assets for the Wisconsin Retirement System (WRS), the State Investment Fund, and five other state insurance and trust funds. As of December 2013, assets under management by SWIB totaled \$101.3 billion, of which the WRS Core Fund and Variable Fund accounted for 92.5 percent. SWIB's nine-member Board of Trustees establishes policies to guide the investment of these assets and approves an asset allocation plan. SWIB's expenses totaled \$351.2 million in 2013, and it had 148.1 full-time equivalent (FTE) positions as of December 2013.

In completing this statutorily required evaluation of SWIB, we:

- compared investment returns to performance benchmarks established by SWIB, investment returns of other large public pension plans, and the actuarial investment return assumption;
- analyzed SWIB's 2010 Core Fund asset allocation plan, including its investment strategies and the initial results of those strategies;
- examined SWIB's approach to investing assets in Wisconsin companies and the recent changes it has made to increase its venture capital investments; and
- reviewed changes SWIB has made that have increased its operating budget, overall investment costs, and compensation.

## The Wisconsin Retirement System

The WRS provides retirement benefits to 594,600 state public employees and employees of participating local governments. The WRS is the ninth-largest public pension plan in the United States. The Department of Employee Trust Funds (ETF) is responsible for managing the operations of the WRS, and SWIB is responsible for managing WRS investments, which totaled \$93.7 billion as of December 2013. The WRS remains a well-funded public pension plan. The plan's funded status on an actuarial basis, or the ratio of assets to liabilities, has been 99.9 percent from 2011 through 2013.

Total benefit payments paid to retired participants increased from nearly

*of several new investment strategies has been mixed.*

*As of December 2013, SWIB had \$58.5 million in venture capital investments in Wisconsin companies.*

*SWIB's expenses increased from 55.7 percent from 2009 through 2013.*

*As a result of larger bonuses paid, investment staff on average received overall compensation at 114 percent of the peer group 2012 median compensation.*

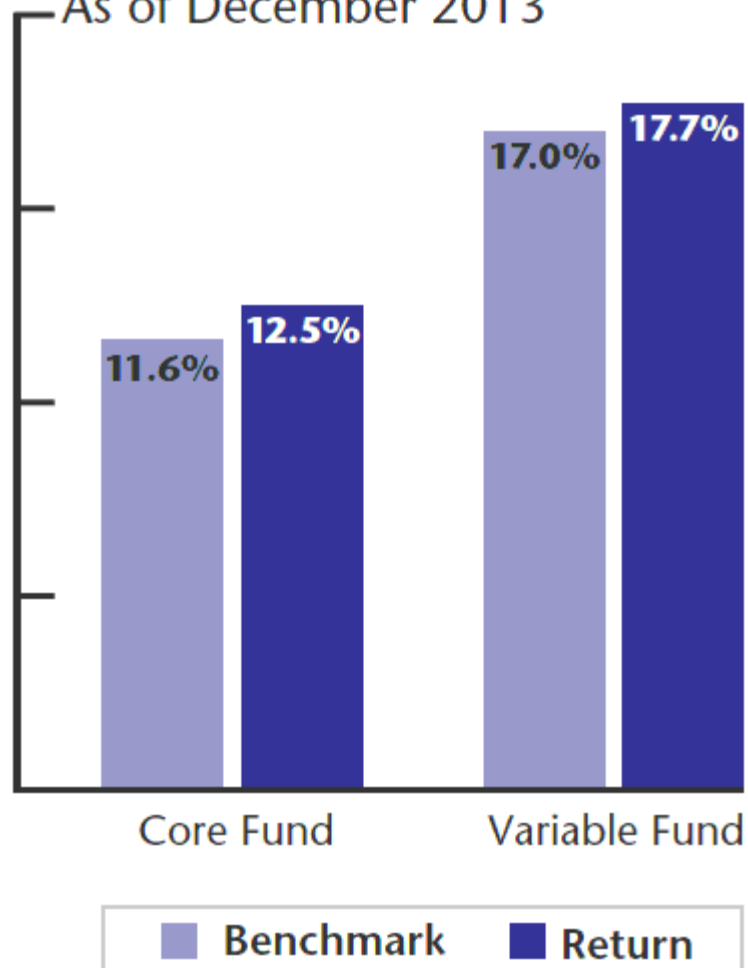
\$2.7 billion in 2003 to \$4.2 billion in 2012. Investment income represented 77.5 percent of the total funding for the WRS from 2003 through 2012. As anticipated for a mature pension plan, investment income is increasingly important in funding benefit payments for retired participants.

## Investment Performance

SWIB uses industry benchmarks to measure its success in managing investments of the WRS. As of December 2013, the five-year average annual investment return was 12.5 percent for the Core Fund and 17.7 percent for the Variable Fund. The Core Fund has met or exceeded its one-year benchmark since 2009, and the Variable Fund has met or exceeded its one-year benchmark since 2008.

### Five-Year Average Annual Investment Returns

As of December 2013



The five-year average annual investment return for the Core Fund ranked fourth compared to the investment returns earned by nine other public pension plans. However, the one- and three-year investment returns ranked seventh among the nine other public pension plans.

The WRS actuary uses the investment return assumption to develop retirement contribution rates. As of December 2013, the average annual

investment returns of the WRS since inception and over a 10-year period exceeded the investment return assumption, although the 15-year investment returns did not.

## **Core Fund Investment Strategies**

2007 Wisconsin Act 212 increased SWIB's authority to invest assets of the Core Fund. In 2010, the Board of Trustees adopted a new Core Fund asset allocation plan that was expected to be implemented over three years. The objective of the plan was to reduce volatility of Core Fund investment returns. Although SWIB has not yet fully implemented the asset allocation plan, it has begun decreasing Core Fund investments in more volatile public equity securities, increasing investments in asset classes that are expected to be less volatile, and enhancing the diversification of the Core Fund.

Because the 2010 Core Fund asset allocation plan has not yet been fully implemented, it is too soon to definitively determine whether the plan has achieved its objective. However, performance of some of its new investment strategies have been mixed, including its use of overall leverage, investments in hedge funds, and risk parity portfolios. During 2013, the leverage component resulted in estimated losses of \$65.0 million, in part, because of rising interest rates.

In recent years, SWIB has taken steps to improve its ability to monitor the asset allocation plan of the Core Fund and new investment strategies. SWIB has made organizational changes, has added additional staff, and is implementing a new information system.

## **Wisconsin Investments**

SWIB regularly makes investments in Wisconsin through the asset classes it manages. As of June 2013, it invested \$682.6 million in companies headquartered or with a significant presence in Wisconsin.

SWIB's Wisconsin private equity portfolio invests primarily in venture capital funds in Wisconsin and the midwest. Through 2013, SWIB has committed \$319.8 million to nine venture capital firms. Of that amount, \$190.7 million has been invested, including \$58.5 million, or 30.7 percent of the portfolio, in Wisconsin companies.

SWIB initiated new investments in two funds in recent years because of SWIB's assessment that they offered unique investment opportunities in Wisconsin. SWIB committed \$80.0 million to a venture capital firm and committed \$15.0 million to an equal partnership it established with the Wisconsin Alumni Research Foundation. As of December 2013, neither of these two funds made an investment in a Wisconsin company.

## **Investment Expenses**

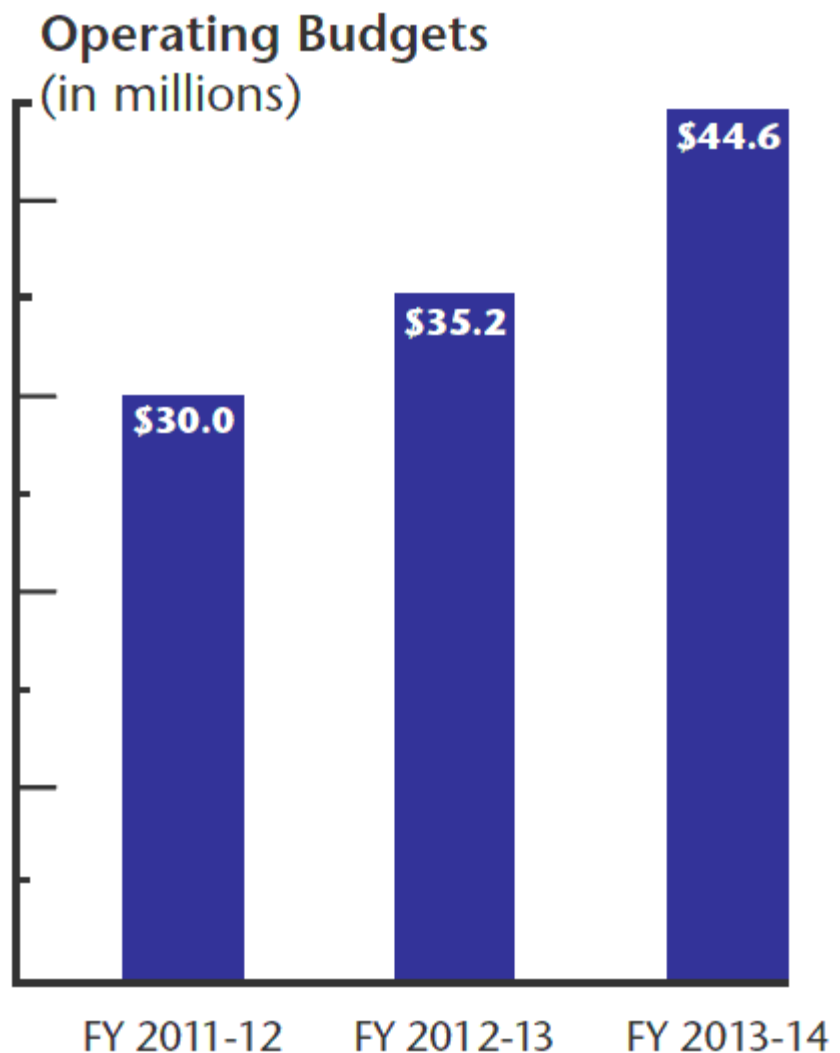
No general purpose revenue (GPR) directly supports SWIB's operations. SWIB charges certain investment expenses directly against investment earnings and operating expenses to the funds it manages. SWIB's expenses increased from \$225.5 million in 2009 to \$351.2 million in 2013, or by 55.7 percent. The increase in expenses can be attributed to several factors, including growth in investment assets, changes in internal and external

management, and the increased authority granted by 2011 Wisconsin Act 32, the 2011-13 Biennial Budget Act, for SWIB to establish its own operating budget and to create and abolish staff positions.

In July 2011, when SWIB received the authority to establish its own operating budget, the average cost of investment for each \$100 of assets managed was \$0.29. The average cost subsequently increased to \$0.36 per \$100 of assets managed as of December 2013. According to a 2012 benchmarking study, investment expenses of the Core Fund were less than peers of similar size and asset mix by \$0.05 per \$100 of assets managed.

External investment expenses increased 55.2 percent from 2009 through 2013 largely because of management fees paid to external managers SWIB hired to implement portions of the 2010 Core Fund asset allocation plan. For example, management fees paid to external hedge fund managers accounted for 56.4 percent of the 2013 increase in public market investment expenses.

Operating budgets established by the Board of Trustees under authority granted by Act 32 increased by 17.3 percent to \$35.2 million in fiscal year (FY) 2012-13 and by 26.7 percent to \$44.6 million in FY 2013-14.



Increases were primarily used to fund staff compensation because of an additional 22.85 FTE authorized positions and an increased pool of bonuses available for staff. For example, 59.5 percent of the increase in the FY 2013-14 operating budget is attributable to increased bonuses budgeted

for staff.

In SWIB's compensation plan, the Board of Trustees establishes a target for overall compensation for investment staff to approximate 100 percent of the median compensation of its peer group. However, based on 2012 compensation data, the bonuses paid to investment staff for 2013 performance resulted in overall compensation on average that was at 114 percent of the peer group median.

## Recommendations

We recommend:

- SWIB report on its progress towards full implementation of the 2010 Core Fund asset allocation plan, including any changes to the plan's target percentages for each asset class and overall leverage; report on specific investment results of overall leverage, hedge funds, and risk parity components of the 2010 Core Fund asset allocation plan; report on the status, costs, and implementation timeline for its new enterprise investment management system; and include this information in its next annual report to the Legislature by March 31, 2015 ([p. 37](#));
- SWIB report on the status of its partnership with the Wisconsin Alumni Research Foundation; report on the aggregate amount of the Wisconsin private equity portfolio invested in Wisconsin companies; and include this information in its biennial plan for making investments in Wisconsin by December 31, 2014 ([p. 46](#)); and
- the Board of Trustees clarify the target for overall compensation for investment staff established in SWIB's compensation plan; evaluate overall compensation in comparison to the established target in SWIB's compensation plan prior to approving proposed bonuses; revise, when necessary, the method for determining investment staff bonuses; and report on the status of its efforts to the Joint Legislative Audit Committee by December 31, 2014 ([p. 56](#));

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