

## State of Wisconsin Investment Board

November 2020

# Report Highlights ■

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**Assets managed by SWIB totaled \$128.8 billion as of December 2019.**

**Both WRS funds exceeded the one-year and five-year benchmarks as of December 2019.**

**The Core Fund's five-year investment return ranked fifth among ten large public pension plans that we reviewed.**

**In 2019, SWIB's annual expenses totaled \$480.3 million, which was an increase of 48.3 percent since 2015.**

**SWIB had 235.0 authorized FTE positions as of December 2019, of which 36.6 percent were investment management staff.**

**SWIB awarded \$13.9 million in bonuses to 172 staff for 2019 performance.**

The State of Wisconsin Investment Board (SWIB) invests assets for the Wisconsin Retirement System (WRS), the State Investment Fund (SIF), and four other funds. Assets managed by SWIB totaled \$128.8 billion as of December 2019. The WRS Core Fund and Variable Fund accounted for 90.5 percent of assets managed. The WRS is intended to provide retirement benefits for more than 648,000 current and former state and local government employee participants. The Department of Employee Trust Funds (ETF) is responsible for managing WRS operations that interact with employers and participants, including collecting contributions and paying benefits, and SWIB is responsible for managing WRS investments.

We have completed an evaluation of SWIB, as required under s. 25.17 (51m), Wis. Stats. In completing this evaluation, we:

- analyzed investment returns by comparing them to market-based benchmarks established by SWIB, the long-term expected rate-of-return assumption, and investment returns of other large public pension plans;
- assessed expenses, including expenses for management fees SWIB pays to external investment managers, carried interest costs, and internal operating expenses;
- examined staffing levels and trends in staffing, including the use of contracted staff;

- analyzed staff compensation, including salaries and bonuses; and
- reviewed specific aspects of hiring practices.

## **Investment Performance**

The Board of Trustees establishes market-based benchmarks with the guidance of a consultant to evaluate SWIB investment performance. As of December 2019, the investment return for the five-year period was 7.8 percent for the Core Fund and 9.8 percent for the Variable Fund. Both funds exceeded their one-year and five-year benchmarks as of December 2019.

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**Wisconsin Retirement System**  
**One-Year and Five-Year Investment Performance**  
**Relative to Benchmarks** | As of December 31, 2019

	Investment Benchmark	Investment Return
<b>Core Fund</b>		
One-Year	19.2%	19.9%
Five-Year	7.5	7.8
<b>Variable Fund</b>		
One-Year	28.3	28.6
Five-Year	9.7	9.8

We also analyzed trends in Core Fund 20- and 30-year investment returns relative to the long-term expected rate-of-return assumption (return assumption) approved by the ETF Board. The Core Fund's 20-year investment return has not met the return assumption since 2015. However, the Core Fund's 30-year investment return was 8.3 percent and remained above the return assumption as of December 2019.

The ETF Board approved a decrease in the return assumption from 7.2 percent to 7.0 percent beginning with the December 31, 2018 valuation. Based on investment returns from passive management in the Core Fund, SWIB anticipates investment returns of 6.2 percent over the next five to seven years. Therefore, to achieve returns of 7.0 percent, SWIB employs active strategies with Core Fund investments in investment classes such as public equity, private equity and debt, and real estate securities, as well as complex multi-asset and hedge fund strategies.

The Core Fund's five-year investment return ranked fifth among ten large public pension plans that we reviewed. Plan returns are affected by differences in plan structure, such as asset allocation, return assumptions, investment styles, funding levels, and risk tolerance levels.

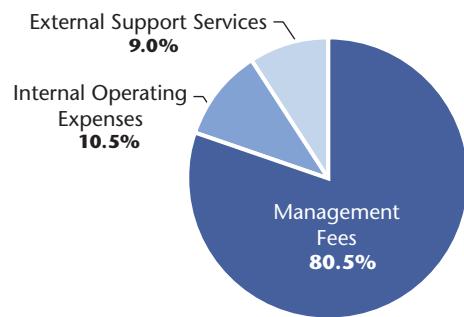
## Investment and Operating Expenses

2011 Wisconsin Act 32, the 2011-13 Biennial Budget Act, granted SWIB the authority to establish its own operating budget and to create staff positions outside of the legislative budget process. SWIB's annual expenses totaled \$480.3 million in 2019, an increase of 48.3 percent since 2015. Management fees for assets managed by external managers were 80.5 percent of SWIB expenses in 2019.

In addition to expenses included in SWIB's total cost of management plan, some external private equity and real estate investments incur performance fees in the form of carried interest. Carried interest costs for SWIB were \$217.4 million in 2019.

The percentage of assets managed externally increased to 46.5 percent in 2019. In part, this increase occurred as SWIB sought expertise to manage more complex active strategies. SWIB has indicated that it has a goal to increase the percentage of assets managed internally. In September 2020, SWIB estimated that for each \$1 billion in WRS assets transitioned from external to internal management,

### SWIB 2019 Expenses<sup>1</sup>



<sup>1</sup> Excludes certain management fees, also known as "carried interest." Because carried interest fees are charged directly to investment returns, they are not reported with other SWIB expenses.

### Key Facts and Findings

*The investment return for the five-year period as of December 2019 was 7.8 percent for the Core Fund and 9.8 percent for the Variable Fund.*

*The Core Fund's 30-year investment return was 8.3 percent and remained above the return assumption as of December 2019.*

*To achieve returns of 7.0 percent, SWIB uses external managers to employ active strategies with Core Fund investments.*

*From December 2017 to December 2019, the percentage of SWIB assets managed externally increased from 36.0 percent to 46.5 percent.*

*In July 2020, SWIB placed itself between levels one and two (out of six) on its data management maturity assessment.*

*Overall compensation provided to SWIB investment management staff for 2019 performance was at 66.0 percent of its comparison group median, which decreased from 99.0 percent of the median in 2016.*

the WRS will save \$3 million in management fees. To do so, SWIB is improving its IT infrastructure and indicates plans to recruit investment staff with expertise to manage a portion of the assets currently managed by external managers.

When comparing SWIB costs to its cost benchmark, SWIB had savings of approximately \$0.10 per \$100 of assets managed in 2013, but the level of savings has been trending downward since that year and was approximately \$0.05 per \$100 of assets managed in 2018, the most recent year for which data were available.

The Board of Trustees authorized an additional 47.0 full-time equivalent (FTE) positions during 2018 and 2019. The increase in positions generally related to the conversion of contracted positions to FTE positions and efforts to address understaffing identified by SWIB's consultant. As a result, SWIB had 235.0 authorized FTE positions as of December 2019, which included 86.0 FTE positions for investment management staff, or 36.6 percent. In addition to authorized FTE positions, SWIB had 25 contracted staff positions as of August 2020.

In July 2020, SWIB placed itself between levels one and two (out of six) on its data management maturity assessment model. Insufficient data management can lead to the use of inaccurate data and delays in gathering accurate data for analysis. As an agency that may at times need to move swiftly to take advantage of investment opportunities, SWIB needs comprehensive and accurate data.

## **Compensation**

SWIB is authorized to compensate staff through salaries, bonuses, and fringe benefits. Pursuant to the Board approved compensation plan and compensation policy, staff salaries are to be within range of an established comparison group median. Overall compensation provided to SWIB investment management staff for 2019 performance was at 66.0 percent of this median, which decreased from 99.0 percent of the median in 2016. SWIB is currently considering changes to its compensation program to help address this decrease.

SWIB paid \$34.3 million in salaries and fringe benefits to staff in 2019. For 2019 performance, 172 staff were awarded bonuses totaling \$13.9 million, the highest total bonuses awarded in the five-year period from 2015 through 2019.

## **Recommendations**

We recommend the State of Wisconsin Investment Board report to the Joint Legislative Audit Committee by May 21, 2021, on its efforts to:

- expand the manner in which SWIB reports investment returns ([p. 28](#));
- obtain carried interest amounts in a timely manner and report them annually to the Board of Trustees ([p. 41](#));
- continue to assess its contracted positions and take steps to convert more to FTE positions ([p. 51](#)); and
- review and assess the status of its overall data management, implement improvements, and develop a plan and timeline to improve its data management maturity ([p. 55](#)).

## **Issue for Legislative Consideration**

The Legislature could consider creating a statutory requirement for SWIB related to performing and reporting the results of stress tests of the Wisconsin Retirement System ([p. 33](#)).



**Legislative Audit Bureau** | State Auditor: Joe Chrisman  
Address questions regarding this report to the State Auditor at (608) 266-2818 or  
at [AskLAB@legis.wisconsin.gov](mailto:AskLAB@legis.wisconsin.gov).