STATE OF WISCONSIN
Legislative Audit Bureau
Report 24-18 • November 2024
SUMMARY
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State of Wisconsin Investment Board

The State of Wisconsin Investment Board (SWIB) invests assets for the Wisconsin Retirement System (WRS) and six other funds. On December 31, 2023, SWIB managed $155.1 billion in assets, including $132.4 billion in WRS assets. SWIB is governed by a nine-member Board of Trustees, which establishes SWIB's investment, budgeting, and staffing policies.

Statutes require us to biennially conduct a performance evaluation audit of SWIB's policies and management practices. To do so, we analyzed SWIB's operations in 2022 and 2023.

As of December 2023, the Core Fund exceeded its five-year benchmark, but the Variable Fund did not

SWIB manages WRS assets in two funds. The Core Fund is a diversified fund that typically is invested for the long term, and the Variable Fund is a public equities fund. SWIB uses market-based benchmarks to measure the performance of WRS assets.

For the five-year period ending in December 2023:

- the Core Fund exceeded its benchmark, which was 8.7 percent, and had an average annual investment return of 9.3 percent, which ranked fourth among a peer group of nine other large public pension plans; and

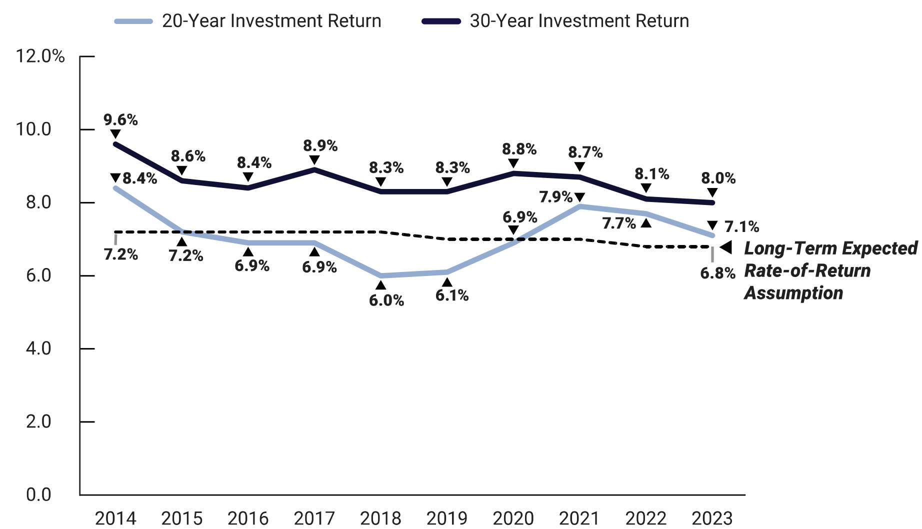
- the Variable Fund did not exceed its benchmark, which was 12.9 percent, and had an average annual investment return of 12.7 percent.

The 20-year average annual investment return of the Core Fund declined over the past decade

SWIB seeks WRS investment returns that meet the long-term expected rate-of-return assumption, which is approved by the Employee Trust Funds Board. This assumption was 7.2 percent from 2011 through 2018, but was reduced to 7.0 percent from 2019 through 2021 and has been 6.8 percent since 2022.

The 20-year average annual investment return of the Core Fund declined from 8.4 percent as of December 2014 to 7.1 percent as of December 2023. The 20-year average annual investment return was higher than the long-term expected rate-of-return assumption as of December 2023.

Core Fund 20- and 30-Year Investment Returns, Compared to the Long-Term Expected Rate-of-Return Assumption[1]
As of December 31

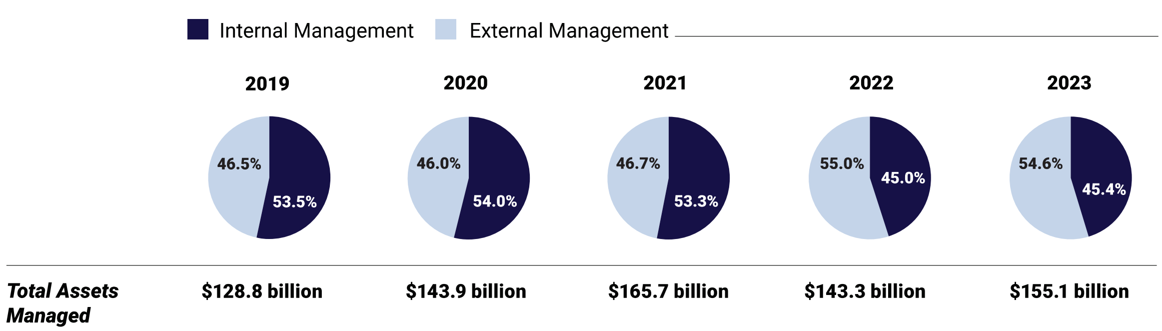


[1] The 20-year returns include management fees but exclude internal operating and other expenses. The 30-year returns exclude all fees and expenses.

The proportion of assets SWIB managed internally decreased from 53.5 percent in December 2019 to 45.4 percent in December 2023

As we noted in report 16-15, report 18-19, report 20-23, and report 22-8, SWIB had intended to increase the proportion of assets managed internally, which are less expensive to manage than assets managed externally.

Proportion of Assets Managed Internally and Externally
As of December 31



In 2022 and 2023, the proportion of assets that SWIB managed externally increased. SWIB indicated this increase resulted, in part, from its decision to increase investments in private market assets that are managed externally. SWIB indicated its decision, which it plans to continue over the coming decade, is intended to help it meet the long-term expected rate-of-return assumption for the WRS.

In February 2021, SWIB reported that the cost of external management was between 1.5 and 4.0 times more expensive than internal management for numerous public market portfolios.

SWIB indicated it is not required to comply with at least 17 statutory requirements pertaining to its management of WRS assets

2007 Wisconsin Act 212 created s. 25.182, Wis. Stats., which indicates that notwithstanding any limitation on SWIB's management authority provided under any other legal provisions, SWIB may manage the money and property of the WRS in any manner that does not violate the statutory requirement for SWIB to provide prudent and cost-effective management of WRS assets.

As a result of s. 25.182, Wis. Stats., and opinions from two Attorneys General, SWIB indicated it is not required to comply with at least 17 statutory provisions pertaining to its management of WRS assets, as long as it provides prudent and cost-effective management of these assets and invests Variable Fund assets primarily in public equities.

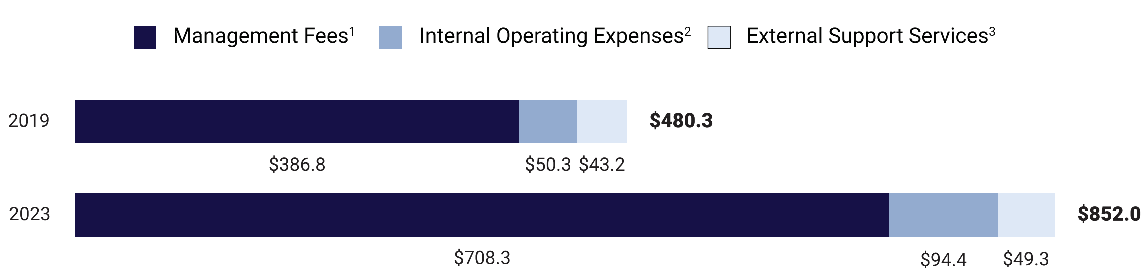
The Legislature could consider modifying statutes to clarify SWIB's obligations regarding its management of WRS assets.

SWIB's expenses increased from $480.3 million in 2019 to $852.0 million in 2023, or by 77.4 percent

SWIB's expenses increased primarily because of an increase in management fees paid to external investment managers.

SWIB Expenses

(in millions)



[1] Excludes carried interest.

[2] Includes salaries and fringe benefits, bonuses, supplies, travel, and facilities.

[3] Includes fees for asset custody, consulting, external investment research, external IT services, and legal services.

In addition to these expenses, some private equity and real estate investments incur performance fees in the form of carried interest, which is paid when an external fund manager liquidates an investment and the rate of return exceeds an agreed-upon minimum rate. In 2023, SWIB's carried interest costs totaled $120.2 million.

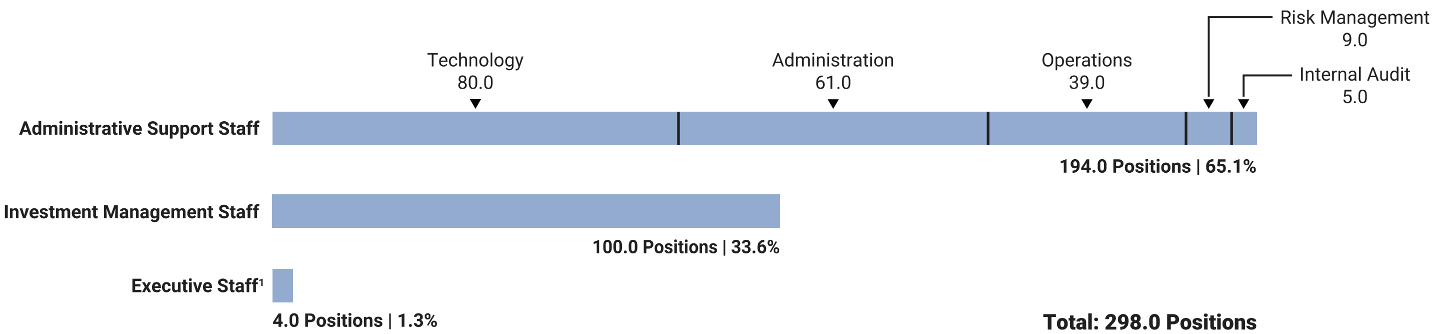
We analyzed the total investment expenses per $100 of assets that SWIB managed. SWIB's total investment expenses, including carried interest costs, for each $100 of assets managed increased from $0.57 in 2019 to $0.65 in 2023. This increase occurred primarily because of the amount of fees SWIB paid to external investment managers.

To assess the cost effectiveness of investment management, SWIB hires a consultant to annually compare the Core Fund's expenses to the expenses of a peer group of 14 other large public pension plans. SWIB had annual cost savings compared to the peer group from 2018 through 2020, but Core Fund expenses per $100 of assets exceeded those of the peer group in 2021 and 2022. The consultant attributed the decline in SWIB's cost savings primarily to the increased proportion of assets under external and active management.

SWIB's staff increased by 63.0 full-time equivalent positions from December 2019 to December 2023

In December 2023, SWIB had 298 full-time equivalent (FTE) positions, including 194.0 FTE administrative support positions, 100.0 FTE investment management positions, and 4.0 FTE executive positions. In addition, SWIB employed 17 contract staff.

Authorized FTE Positions
December 31, 2023

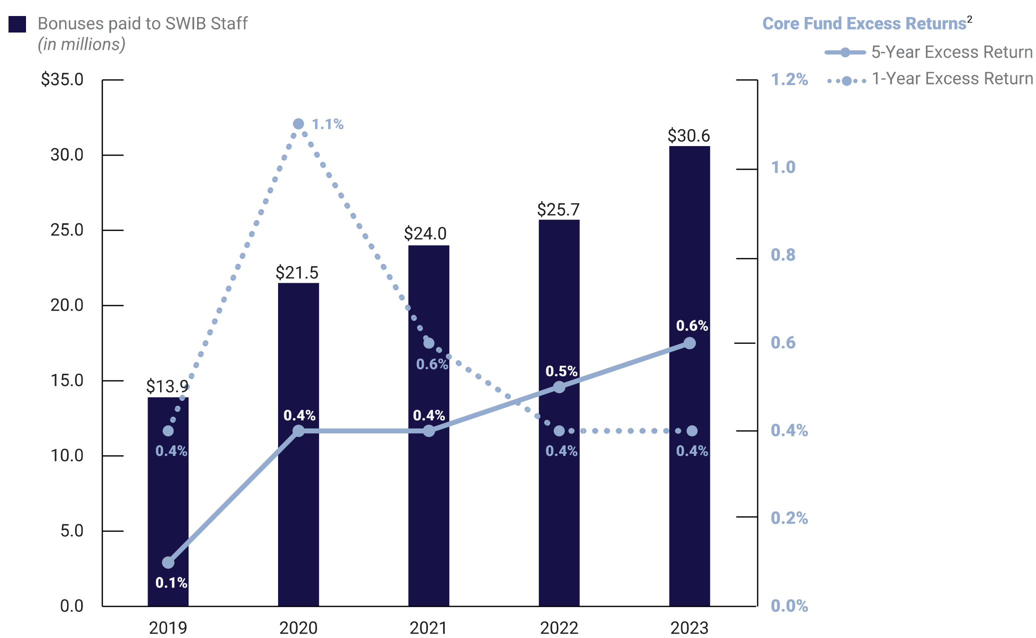


[1] Includes the executive director/chief investment officer, deputy executive director/chief operating officer, chief of staff and strategy, and head of risk management.

For 2023 performance, SWIB staff received $30.6 million in annual bonuses, which was the highest amount awarded from 2019 through 2023

For 2023 performance, SWIB staff were paid $59.2 million in salaries and fringe benefits, signing bonuses, retention bonuses, and severance payments. In addition, 262 staff received a total of $30.6 million for annual bonuses. Salaries and bonuses reduce WRS assets and the amounts paid to annuitants.

Total Annual Bonuses Awarded Compared to Core Fund Excess Returns, by Performance Year[1]



[1] Bonuses are paid in the following calendar year.

[2] Excess returns are the portion of investment returns that exceed market-based benchmarks, based on returns net-of-all-costs.

One way to assess investment performance is by considering excess returns, which are the portion of investment returns that exceed market-based benchmarks. The annual bonuses for 2023 performance increased 19.1 percent from the prior year, while the five-year excess return for the Core Fund increased by an annualized 0.1 percent (from 0.47 percent to 0.57 percent).

In October 2022, the Board of Trustees approved new policies for awarding long-term bonuses to staff in senior positions. Long-term bonuses are in addition to annual bonuses and are intended to make compensation more competitive with SWIB's peers, retain staff, and encourage long-term sustained investment performance for the WRS. For 2023 performance, 65 staff received a total of $4.2 million in long-term bonuses.

SWIB should improve its strategic planning

As noted, SWIB previously had intended to increase the proportion of assets managed internally. To help facilitate this increase, SWIB obtained approval from the Board of Trustees to create additional staff positions and undertake IT projects. In our current audit, we found that SWIB now expects the proportion of assets it manages internally to decrease, as a result of market conditions.

In recent years, the Core Fund's investment returns decreased, and SWIB's staffing and other expenses increased considerably. Particularly in circumstances such as these, a multiyear strategic plan that includes the estimated costs and anticipated benefits of specific investment strategies it plans to manage internally and externally can help to ensure SWIB maximizes investment returns at a reasonable cost.

We make 12 recommendations to SWIB for improvements

Please see the complete list of our recommendations on our website. We also include two issues for legislative consideration.