



WISCONSIN LEGISLATIVE AUDIT BUREAU AUDIT SUMMARY

Report 99-16

October 1999

STATE OF WISCONSIN INVESTMENT BOARD

The State of Wisconsin Investment Board manages \$60.6 billion in assets, including \$55.6 billion for the Wisconsin Retirement System, \$4.4 billion for the State Investment Fund, and \$0.6 billion for five other state insurance and trust funds that have long-term investment needs. The Investment Board is governed by a nine-member board of trustees. They have delegated day-to-day investment decisions to the Investment Board's staff, which consist of the Executive Director, 95 professional staff in the unclassified service system, and 7 support staff in the classified service.

The Investment Board Has Responded to a 1995 Derivatives Loss

In March 1995, the Investment Board disclosed that the State Investment Fund, which provides short-term investment and cash management for all state funds, the Wisconsin Retirement System, and several local governments, had incurred a \$95 million loss as a result of investments in derivative instruments. Subsequent to this disclosure, the Investment Board has taken a number of steps to improve its operations, including increasing its reporting to the Legislature; improving management oversight of investing strategies; increasing the board of trustees' involvement in investment activities; and improving communication with State Investment Fund participants.

Remaining payments, including interest, associated with the State Investment Fund derivatives loss total \$41.7 million as of June 30, 1999. However, even with the loss, the State Investment Fund's returns have exceeded its investment performance goals, or benchmarks, and they compare favorably to those of similar funds.

The Fixed Retirement Trust Fund Has Not Consistently Met Its Performance Benchmarks

The Fixed Retirement Trust Fund, which accounts for approximately 80 percent of the Investment Board's \$60.6 billion in assets, did not meet its one-year and five-year benchmarks as of December 31, 1998. In addition, since 1994, it has met its December 31 one-year benchmark only once.

One reason for the Fund's lagging performance has been the Investment Board's emphasis on small cap stocks, which represent investments in companies that have a capitalization level of approximately \$1 billion or less. The \$2.7 billion small cap portfolio, which the Investment Board indicates is more than three times larger than the average small cap portfolio of \$880 million, has fallen short of its one-year, five-year, and ten-year benchmarks both because of its size and because of individual investment decisions. The five-year return, for example, was 9.8 percent, compared to a benchmark of 14.4 percent. Investments in large cap stocks that are actively managed have also not met the Board's one-year, five-year, or ten-year investment benchmarks.

The Investment Board's Returns Lag Those of Other Public Pension Funds

We surveyed other large public pension funds and found that the Investment Board's Fixed Retirement Trust Fund's five-year return ranked 10th among the 12 funds surveyed. Its five-year return was 14.2 percent, compared to a median return for all 12 funds of 15.0 percent. The Investment Board's decision to allocate more funds to international investments and less to domestic equities contributed to the Board's lower overall returns. The Investment Board's allocation of 40 percent of Fixed Retirement Trust Fund assets to domestic equities is less than the average allocation of 52 percent in other public pension funds surveyed. In addition, the Investment Board allocated 19 percent of its assets to international investments, compared to an average of 14 percent for the public pension funds we surveyed.

Changes in The Board's Investment Strategies May Be Needed

The Investment Board currently invests a large portion of the assets it manages in areas that, by their nature, tend to be more staff intensive and have higher risk, such as small cap stocks, international investments, private placements, and a non-traditional portfolio. While higher levels of returns could be expected to justify the costs and risks associated with these investments, returns have been mixed and have generally not exceeded the returns of more traditional domestic equity and fixed-income portfolios. To address performance that is lagging both established benchmarks and that of other large public pension funds, we recommend the Investment Board reassess its investment strategy and report to the Joint Legislative Audit Committee on steps it plans to take to improve investment performance.

[full report, PDF file \(321KB\)](#)