



STATE OF WISCONSIN
Legislative Audit Bureau
NONPARTISAN • INDEPENDENT • ACCURATE

Report 24-5
June 2024

Retirement Funds Investment Activity

Calendar Year 2023

State of Wisconsin Investment Board



Joint Legislative Audit Committee Members

Senate Members:

Eric Wimberger, Co-chairperson
Jesse James
Howard Marklein
Robert Wirch
Tim Carpenter

Assembly Members:

Robert Wittke, Co-chairperson
John Macco
Mark Born
Francesca Hong
Ryan Clancy

Retirement Funds Investment Activity
Calendar Year 2023

State of Wisconsin Investment Board



STATE OF WISCONSIN
Legislative Audit Bureau
NONPARTISAN • INDEPENDENT • ACCURATE

Report 24-5
June 2024

State Auditor
Joe Chrisman

**Deputy State Auditor
for Financial Audit**
Carolyn Stittleburg

Team Leaders
Keri Ware
Elizabeth Spiker

Auditors
Kasey Bernard
Nicholas Dorey
Paul Newkirk
Malvina Nyanjo
Mathew Soares
Phillip Stapel
Ger Vang
Elizabeth Voelz-Temple
Audrey Woller
Chloe Zhang

**Publications Designer
and Editor**
Susan Skowronski

The Legislative Audit Bureau supports the Legislature in its oversight of Wisconsin government and its promotion of efficient and effective state operations by providing nonpartisan, independent, accurate, and timely audits and evaluations of public finances and the management of public programs. Bureau reports typically contain reviews of financial transactions, analyses of agency performance or public policy issues, conclusions regarding the causes of problems found, and recommendations for improvement.

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.

The Bureau accepts confidential tips about fraud, waste, and mismanagement in any Wisconsin state agency or program through its hotline at 1-877-FRAUD-17.

For more information, visit www.legis.wisconsin.gov/lab.

Contents

Letter of Transmittal	1
Introduction	3
SWIB Administration	3
Audit Results	4
Total Investment Assets	4
Net Investment Income	5
Net Investment Position	6
External Management of Investments	7
Future Considerations	10
Auditor's Report	11
Appendix	
Members of the SWIB Board of Trustees	

Opinions Published Separately

The financial statements and our unmodified opinions on them are included in the State of Wisconsin Investment Board's *2023 Retirement Funds Annual Report*.



STATE OF WISCONSIN

Legislative Audit Bureau

Joe Chrisman
State Auditor

22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703

Main: (608) 266-2818
Hotline: 1-877-FRAUD-17

www.legis.wisconsin.gov/lab
AskLAB@legis.wisconsin.gov

June 5, 2024

Senator Eric Wimberger and
Representative Robert Wittke, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Wimberger and Representative Wittke:

As required by ss. 13.94 (1) (df) and 25.17 (51), Wis. Stats., we have completed an audit of the financial statements of the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable Fund) administered by the State of Wisconsin Investment Board (SWIB) as of and for the year ended December 31, 2023. SWIB invests the assets of the Wisconsin Retirement System 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 *2023 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 \$114.4 billion as of December 31, 2022, to \$122.5 billion as of December 31, 2023. The Core Fund reported a net investment loss of \$17.4 billion in 2022 and net investment income of \$12.7 billion in 2023. The reported one-year investment return, net of all fees and costs, increased from a negative 12.9 percent in 2022 to 11.4 percent in 2023. The Core Fund investment return in 2023 is largely attributed to strong investment returns from public equity and fixed income investments.

The net investment position of the Variable Fund increased from \$8.4 billion as of December 31, 2022, to \$9.8 billion as of December 31, 2023. The Variable Fund reported a net investment loss of \$1.9 billion in 2022 and net investment income of \$1.8 billion in 2023. The reported one-year investment return, net of all fees and costs, increased from a negative 17.8 percent in 2022 to 22.2 percent in 2023. The Variable Fund investment return in 2023 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 13.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Joe Chrisman'.

Joe Chrisman
State Auditor

JC/CS/ag

SWIB Administration
Audit Results
Total Investment Assets
Net Investment Income
Net Investment Position
External Management of Investments
Future Considerations

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.

The Wisconsin Retirement System (WRS) provides postemployment benefits to participating state and local government employees. The Department of Employee Trust Funds (ETF) is responsible for administering the WRS, including collecting employee and employer contributions and paying benefits. The State of Wisconsin Investment Board (SWIB) invests the assets of the 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 *2023 Retirement Funds Annual Report*, which may be found on SWIB's website. SWIB prepares these financial statements using generally accepted accounting principles (GAAP) prescribed by the Governmental Accounting Standards Board (GASB).

SWIB Administration

SWIB is governed by a nine-member Board of Trustees.

SWIB is governed by a nine-member Board of Trustees, which has a fiduciary responsibility to administer the assets of each fund solely for the purpose of the fund at a reasonable cost and to manage investments with care, skill, prudence, and diligence. Board members include the Department of Administration's Secretary, six individuals appointed by the Governor and confirmed by the Senate to serve six-year terms, and two WRS participants. Four members appointed

by the Governor must have at least 10 years of experience making investments, and one must have at least 10 years of financial experience, including in local government. The two WRS participants, who serve six-year terms, include one teacher appointed by the Teacher Retirement Board and one individual who is not a teacher and is appointed by the Wisconsin Retirement Board. The Appendix shows the members as of December 2023.

The Board of Trustees appoints the executive director/chief investment officer and the internal audit director. Although the Board establishes an overall investment plan for SWIB-managed funds, it delegated day-to-day investment management decisions to the executive director/chief investment officer and investment staff. In addition, the Board delegated certain investment decisions to a SWIB staff investment committee that is chaired by the executive director/chief investment officer. The committee meets regularly to make investment decisions, including changes to investment guidelines and strategies. SWIB senior managers work with the executive director/chief investment officer to make organizational decisions to ensure staff operate within the policies, objectives, and guidelines established by the Board.

Audit Results

We provided unmodified opinions on the financial statements of the Retirement Funds investment activity as of and for the year ended December 31, 2023.

As required by Wisconsin Statutes, we have completed an audit of the financial statements and related notes of the Retirement Funds as of and for the year ended December 31, 2023. The financial statements include information on the investment activity of the Retirement Funds, including important disclosures, such as those related to deposit and investment risk and fair value measurements as of December 31, 2023. 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, 2023.

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 13.

Total Investment Assets

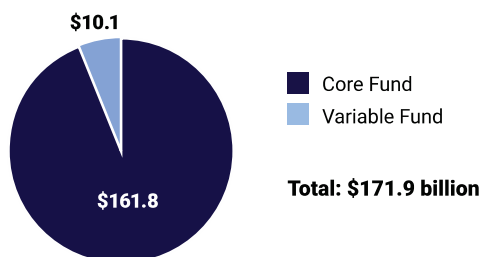
The Core Fund accounted for 94.1 percent of the total investment assets of the Retirement Funds as of December 31, 2023.

On a GAAP basis, total investment assets of the Retirement Funds increased from \$155.3 billion as of December 31, 2022, to \$171.9 billion as of December 31, 2023, or by 10.7 percent. As of December 31, 2023, the Core Fund accounted for \$161.8 billion (94.1 percent) of the total investment assets of the Retirement Funds and the Variable Fund accounted for \$10.1 billion (5.9 percent), as shown in Figure 1.

Figure 1

Total Investment Assets Retirement Funds

As of December 31, 2023
(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, and private fund investments, which are made up largely of private equity and real estate limited partnerships. 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.

Net Investment Income

The Core Fund and the Variable Fund reported net investment income in 2023 of \$12.7 billion and \$1.8 billion, respectively.

On a GAAP basis, the net investment income reported by the Core Fund increased from a net investment loss of \$17.4 billion in 2022 to net investment income of \$12.7 billion in 2023 or by 173.0 percent. The reported one-year investment return, net of all fees and costs, increased from a negative 12.9 percent in 2022 to 11.4 percent in 2023. The Core Fund investment return in 2023 is largely attributed to strong investment returns from public equity and fixed income investments. One-year investment returns exceeded the Core Fund benchmark of 11.0 percent in 2023. On a GAAP basis, the net investment income reported by the Variable Fund increased from a net investment loss of \$1.9 billion in 2022 to net investment income of 1.8 billion in 2023, or by 194.7 percent. The reported one-year investment return, net of all fees and costs, increased from a negative 17.8 percent in 2022 to 22.2 percent in 2023. The Variable Fund investment return in 2023 is largely attributed to strong investment returns from public equity investments. One-year investment returns lagged the Variable Fund benchmark of 23.1 percent in 2023.

SWIB reported that the 20-year investment return for the Core Fund was 7.1 percent as of December 31, 2023.

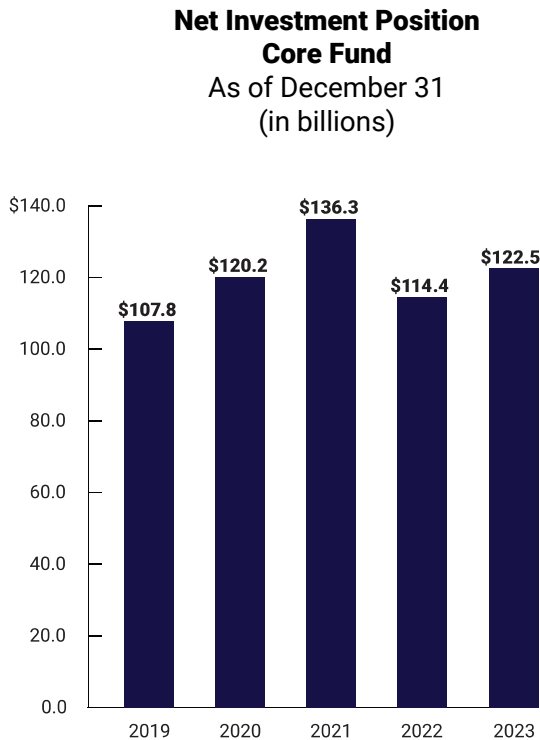
SWIB has a fiduciary responsibility to prudently invest the assets of the Retirement Funds in a diversified manner to meet WRS funding needs, while minimizing the risk of large losses. SWIB’s investment strategy is to meet the long-term expected rate-of-return assumption, which is 6.8 percent. As of December 31, 2023, SWIB’s 20-year return for the Core Fund, net of external management fees but not other costs, was 7.1 percent. SWIB reported that the one-year, five-year, and 10-year returns for the Core Fund as of December 31, 2023, also exceeded the long-term expected rate-of-return assumption.

Net Investment Position

The net investment position of the Core Fund increased from \$114.4 billion as of December 31, 2022, to \$122.5 billion as of December 31, 2023.

Net investment position, which is the investment assets less investment liabilities, is a measure of overall financial condition. As shown in Figure 2, the net investment position of the Core Fund increased on a GAAP basis from \$114.4 billion as of December 31, 2022, to \$122.5 billion as of December 31, 2023, or by 7.1 percent. From December 31, 2019, through December 31, 2023, the net investment position of the Core Fund increased by \$14.7 billion, or by 13.6 percent.

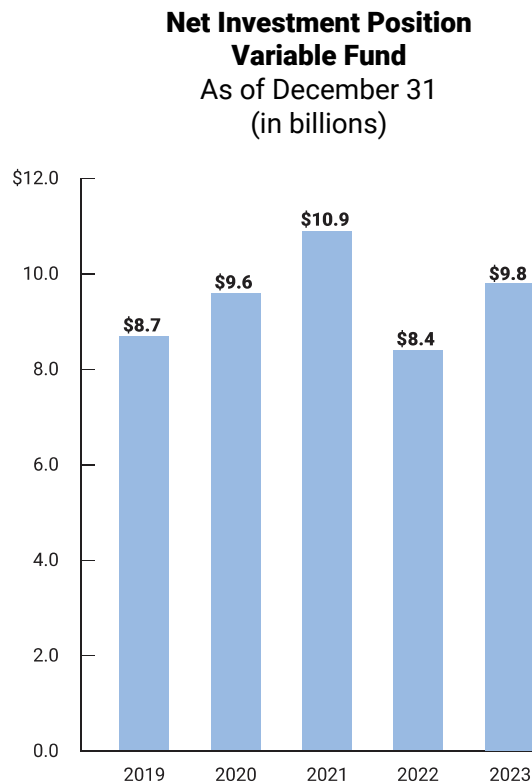
Figure 2



The net investment position of the Variable Fund increased from \$8.4 billion as of December 31, 2022, to \$9.8 billion as of December 31, 2023.

As shown in Figure 3, the net investment position of the Variable Fund increased from \$8.4 billion as of December 31, 2022, to \$9.8 billion as of December 31, 2023, or by 16.7 percent. From December 31, 2019, through December 31, 2023, the net investment position of the Variable Fund increased by \$1.1 billion, or by 12.6 percent.

Figure 3



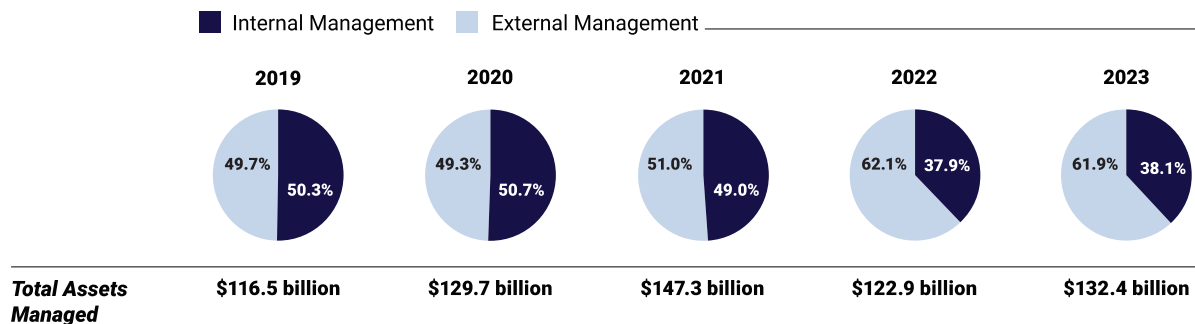
External Management of Investments

As of December 31, 2023, 38.1 percent of the assets of the Retirement Funds were managed internally by SWIB.

SWIB's investment strategy for the assets of the Retirement Funds employs a mix of internal and external management of assets. Total assets managed, which are the total investment assets less related investment liabilities, are reported by SWIB in quarterly reports, which are required to be submitted to the Legislature under s. 25.17 (13m), Wis. Stats. As shown in Figure 4, the percentage of assets managed internally by SWIB has decreased from 50.3 percent as of December 31, 2019, to 38.1 percent as of December 31, 2023.

Figure 4

**Internal and External Management
Retirement Funds' Total Assets Managed¹**
As of December 31



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

The decrease in internal management of assets from December 31, 2019, to December 31, 2023, was largely the result of increases in allocations to private fund investments.

SWIB staff attributed the decrease in internal management of assets from December 31, 2019, to December 31, 2023, to a number of factors, including increases in the overall allocation to private fund investments, such as private equity limited partnerships, which are managed externally. Private fund investments as reported on the financial statements increased from \$16.1 billion as of December 31, 2019, to \$34.3 billion as of December 31, 2023, or by 113.0 percent. Further, as noted in report 23-13, SWIB staff also attributed the decrease in internal management of assets from December 31, 2021, to December 31, 2022, to relatively strong performance in externally managed investments, such as private fund investments, compared to public market investments, such as public equities, which are largely managed internally.

Historically, SWIB's goal had been to increase the percentage of assets managed internally because external management is more expensive. However, SWIB did not establish a target or target ranges for the proportion of assets to manage internally, and it did not have a written plan for moving certain investment strategies to internal management. In report 22-8, we recommended SWIB develop a multi-year strategic plan that includes goals for the proportion of assets managed internally. In the October 2023 SWIB Board meeting materials, SWIB reported that a cross-functional working group developed a general framework for decision-making on strategy implementation to select active versus passive investment strategies and internal versus external investment management strategies. SWIB indicated it is not targeting a certain threshold for internal versus external management of assets.

Management fees are charged by external investment managers who invest in assets, including private equity limited partnerships and

hedge funds. Management fees typically include two components: base fees and performance fees. Base fees are calculated as a proportion of assets invested, and performance fees are typically calculated based on investment returns. Most external investment management fees are reported in the Net Increase (Decrease) in the Fair Value of Investments account as these fees are not directly paid by SWIB, but are reported to SWIB by external managers net of the value of the investments. As shown in Table 1, external investment management fees reported by SWIB were \$827.4 million as of December 31, 2023, compared to \$1,059.8 million as of December 31, 2022.

Table 1

External Investment Management Fees¹
For the Year Ended December 31
(in millions)

Investment Type	2023	2022
Private Equity	\$430.6	\$ 461.6
Hedge Funds	273.6	252.5
Public Market ^{2,3}	104.7	109.8
Real Estate Limited Partnerships	18.5	235.9
Total	\$827.4	\$1,059.8

¹ Includes carried interest, which is a type of performance fee paid when a fund manager liquidates an investment and the rate-of-return exceeds an agreed-upon minimum rate.

² Includes investments in separately managed accounts and commingled investments, largely in equities and public fixed income.

³ Includes \$29.0 million for the year ended December 31, 2023, and \$46.9 million for the year ended December 31, 2022, in external investment management fees reported in the External Investment Management Fees account on the Statement of Changes in Net Investment Position.

The decrease in external investment management fees related largely to real estate limited partnership management fees, which decreased by 92.2 percent from 2022 to 2023. SWIB staff attributed this decrease to the decline in performance of real estate investments in 2023. SWIB reported investment returns for real estate investments of a negative 7.1 percent for 2023, compared to 16.8 percent for 2022.

Future Considerations

In August 2022, the Attorney General issued opinion OAG-02-22, and indicated that SWIB has the authority to issue debt.

In December 2021, SWIB requested an opinion from the Wisconsin Attorney General regarding SWIB's authority to issue public debt. SWIB noted in its request that issuing debt is one of many methods an investor may use to generate leverage, which is an investment strategy of using borrowed money to increase the potential return of an investment. The SWIB Board of Trustees first approved the use of leverage for the Core Fund in 2012. In making its request to the Attorney General, SWIB indicated it was seeking clarification on its authority to issue debt to ensure it had clear documentation of its authority for stakeholders involved in the debt issuance process, such as credit rating agencies and underwriters. In August 2022, the Attorney General issued opinion OAG-02-22, and indicated that SWIB has the authority to issue debt provided that the statutory prudent person standard, as defined in s. 25.15 (2), Wis. Stats., is met. This standard requires SWIB to manage the assets with the care, skill, prudence, and diligence of a prudent person acting in a similar capacity.

In June 2023, S&P Global Ratings provided the WRS a AAA credit rating. In May 2024, SWIB staff indicated there are no plans to prioritize the issuance of debt in the near future. It will be important that SWIB carefully considers financial reporting and disclosure requirements at such time as it begins to issue debt.

■ ■ ■ ■



Auditor's Report





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

Senator Eric Wimberger and
Representative Robert Wittke, 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) of the State of Wisconsin, administered by the State of Wisconsin Investment Board (SWIB), as of and for the year ended December 31, 2023, and have issued our report thereon dated June 3, 2024. 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 *2023 Retirement Funds Annual Report*.

Report on Internal Control over Financial Reporting

Management of SWIB is responsible for establishing and maintaining effective internal control over financial reporting (internal control) for the Retirement Funds. 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 circumstances 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 SWIB's financial statements 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 or significant deficiencies may exist that have not been identified.

Report on 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 direct and 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



June 3, 2024

Appendix

Appendix

Members of the SWIB Board of Trustees

December 2023¹

Department of Administration, Secretary

Kathy Blumenfeld

Public Members

Barbara Nick (Chair), term expires 2027,
Dairyland Power Cooperative,
President and Chief Executive Officer (Retired)

Clyde Tinnen (Vice-Chair), term expires 2027,
Foley & Lardner LLP, Corporate Partner

Tom Merfeld, term expires 2029,
CUNA Mutual Group,
Chief Risk Officer and Chief Financial Officer (Retired)

Esther Ancel, term expires 2027,
University of Wisconsin-Milwaukee,
Emeritus Professor of Finance

Jeff DeAngelis, term expires 2029,
Northwestern Mutual Wealth Management Company,
Former Chief Investment Officer;
Mason Street Advisors, Former President

Local Government Representative

Kristi Palmer, term expires 2029,
Marathon County, Finance Director

Wisconsin Retirement System Participants

John Voelker, term expires 2027,
Department of Employee Trust Funds, Secretary

Dave Schalow, term expires 2025,
University of Wisconsin-Stevens Point,
Professor of Finance

¹ Barbara Nick resigned from the Board at the end of 2023; and Barb Bolens, Director of the Nicholas Center for Corporate Finance and Investment Banking at the University of Wisconsin-Madison School of Business, joined the Board as a public member at the March 2024 board meeting.