



REPORT HIGHLIGHTS

Report 18-19
December 2018State Auditor
[Joe Chrisman](#)

State of Wisconsin Investment Board

The State of Wisconsin Investment Board (SWIB) invests assets for the Wisconsin Retirement System (WRS), the State Investment Fund (SIF), and five other funds. Assets managed by SWIB totaled \$117.0 billion as of December 2017. The WRS Core Fund and Variable Fund accounted for 92.7 percent of assets managed. The WRS is intended to provide retirement benefits for more than 632,800 current and former state and local government employee participants. The Department of Employee Trust Funds (ETF) is responsible for managing WRS operations, 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, technology projects, and internal operating expenses;
- examined staffing levels and trends in staffing, including the use of contracted staff;
- analyzed staff compensation, including salaries and bonuses;
- assessed staff retention and hiring practices; and
- reviewed investment of assets in Wisconsin.

Investment Performance

The Board of Trustees establishes market-based benchmarks with the guidance of a consultant to evaluate SWIB investment performance. The average annual investment return for the five-year period as of December 2017 was 8.6 percent for the Core Fund and 13.3 percent for the Variable Fund. Both funds exceeded their five-year benchmarks as of December 2016 and December 2017. The investment returns for the six other funds SWIB managed as of December 2017 also exceeded their five-year benchmarks.

Five-Year WRS Investment Performance Relative to Benchmarks

As of December 2017

| | Investment Benchmark | Average Annual Investment Return ¹ |
|---------------|----------------------|---|
| Core Fund | 8.2% | 8.6% |
| Variable Fund | 13.0 | 13.3 |

¹Does not include management fees and other investment expenses.

SWIB invests Core Fund assets across several asset classes and has been implementing a long-term plan intended to protect the Core Fund from significant market downturns. SWIB has worked to both increase assets managed by internal investment staff and develop internal expertise for its more-complex investment strategies, including multi-asset investments and a hedge fund strategy.

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 investment return did not meet the long-term expected rate-of-return assumption of 7.2 percent on a 20-year basis in 2016 or 2017. However, the Core Fund's 30 year investment return remained above the return assumption as of December 2017.

From 2011 through 2018, the return assumption was 7.2 percent. Based on expected market conditions, SWIB anticipates Core Fund investment returns between 6.2 percent and 6.8 percent annually for the next five to seven years. The ETF Board approved a decrease in the return assumption to 7.0 percent for the December 31, 2018 valuation.

The Core Fund's five-year investment return ranked ninth among ten large public pension plans. Plan returns are affected by differences in plan structure, such as asset allocation, return assumptions, investment styles, funding levels, and risk tolerance levels. Because the WRS is well funded, SWIB does not experience the same pressure to achieve high returns as the other plans and invested WRS assets more conservatively in order to limit risk. SWIB staff indicated that the Core Fund is positioned to perform better than its peers in less-favorable market conditions, which are anticipated in the coming years.

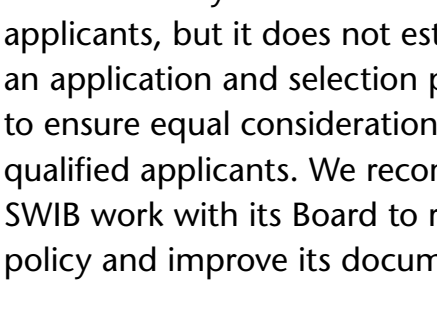
Investment and Operating Expenses

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 \$427.4 million in 2017, an increase of 21.7 percent since 2013.

After considering the effect of increases in assets managed by SWIB, we found the increase in expenses was attributable to higher management fees paid to external investment managers for more-complex investment strategies, an information systems implementation, and the hiring of additional staff. The Board authorized an additional 14.7 full-time equivalent (FTE) positions during 2017. SWIB had 188.0 authorized FTE positions as of December 2017, which included 78.0 FTE positions for investment management staff, or 41.5 percent.

Authorized FTE Positions

As of December 2017



In addition to authorized FTE positions, SWIB also had 40 contracted staff positions as of December 2017. Contracted staff assisted SWIB in effectively using newly implemented information systems and performed ongoing administrative support responsibilities. The Board authorized an additional 15.0 FTE positions in June 2018 to begin converting contracted staff positions to FTE positions.

Statutes and Board policies provide that SWIB may not exceed the Board approved internal operating budget without additional Board approval. Although Board policies require SWIB to annually submit a total budget and the Board has approved the total budget in recent years, Board policies do not require SWIB to seek additional approval when actual expenses are projected to exceed the budgeted amount. SWIB's expenses exceeded the total budget in FY 2016-17 and in FY 2017-18, largely due to higher management fees.

Compensation and Staff Retention

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 2017 performance was at 93.2 percent of this median. SWIB paid \$29.4 million in salaries and fringe benefits to staff in 2017. For 2017 performance, 150 staff also received bonuses totaling \$11.5 million. This is a lower amount than for prior years due to lower investment returns relative to benchmarks.

In response to concerns reported to our Fraud, Waste, and Mismanagement Hotline, we reviewed five recruitments SWIB conducted in early 2018. We found there were between 11 and 61 applicants for these five positions. However, SWIB conducted an in-person interview with only the one applicant who was ultimately hired for each position. Available information also indicated that SWIB staff showed preference before the positions were posted for those individuals who were ultimately hired.

In October 2018, the Board approved a hiring policy that encourages SWIB staff to identify and meet with potential applicants, but it does not establish an application and selection process to ensure equal consideration of all qualified applicants. We recommend SWIB work with its Board to revise the policy and improve its documentation.

Wisconsin Investments

SWIB invests in Wisconsin through a range of asset classes, including public equity securities, fixed income, multi-asset, private equity and debt, and real estate. SWIB has two dedicated investment strategies for investing in Wisconsin: private debt and venture capital strategies. As of December 2017, investment returns for these strategies exceeded established benchmarks. Wisconsin investments must meet the same investment standards as other investments. However, not all venture capital investments were located in Wisconsin.

Recommendations

We recommend that the State of Wisconsin Investment Board work with the Board of Trustees, as appropriate, to:

- conduct additional stress tests of the Wisconsin Retirement System and report the test results (p. 29);
- centrally track future technology project expenses and report such expenses quarterly (p. 42);
- develop policies that require Board of Trustees approval of projected expenses that exceed the total approved budget, or portions thereof (p. 49);
- more clearly identify whether reported investment returns include management fees and other investment expenses (p. 51);
- report investment returns that include management fees and other investment expenses (p. 51); and

- improve its application and selection process by revising its hiring policy to ensure equal consideration of all qualified applicants and improve its documentation (p. 63).

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