

December 17, 2014

Senator Robert Cowles, Co-chair
Joint Legislative Audit Committee
P.O. Box 7882
Madison, WI 53707-7882

Representative Samantha Kerkman, Co-Chair
Joint Legislative Audit Committee
P.O. Box 8952
Madison, WI 53708-8952

Dear Senator Cowles and Representative Kerkman,

This letter is in response to the recently completed management audit of the State of Wisconsin Investment Board (SWIB) by the Legislative Audit Bureau (LAB). That report makes two recommendations that require response to the Joint Legislative Audit Committee including:

- SWIB report on the status of its partnership with the Wisconsin Alumni Research Foundation; report on the aggregate amount of the Wisconsin private equity portfolio invested in Wisconsin companies; and include this information in its biennial plan for making investments in Wisconsin by December 31, 2014; and
- the Board of Trustees clarify the target for overall compensation for investment staff established in SWIB's compensation plan; evaluate overall compensation in comparison to the established target in SWIB's compensation plan prior to approving proposed bonuses; revise, when necessary, the method for determining investment staff bonuses; and report on the status of its efforts to the Joint Legislative Audit Committee by December 31, 2014.

The following is SWIB's response to those recommendations.

Relationship with WARF

SWIB continues to work closely with WARF in overseeing the development of 4490 Ventures. The partnership between SWIB and WARF is nurturing, cultivating and assisting experienced entrepreneurial management talent by leveraging local venture ecosystem resources. Through this partnership, these initiatives, when combined, create the "double bottom line" encouraging company formation that will ultimately provide employment opportunities throughout the state. The partnership is providing support for the state's emerging and established information technology businesses, as well as attracting interest from venture capital investors outside Wisconsin. SWIB values WARF's combined understanding of investments and the information technology sector, which is the focus of 4490 Ventures. SWIB's partnership with WARF is

cultivating and fostering the formation and growth of information technology companies spun out of the University of Wisconsin or started in other areas around the state.

We believe that SWIB and WARF, through 4490 Ventures, have increased the availability of capital to Wisconsin's early stage companies. In March 2014, Greg Robinson was named partner of 4490 Ventures. Greg has over 20 years of operating and venture capital experience. With 4490 Ventures now in full operation, SWIB and WARF staff are working closely with 4490 Ventures to identify good investment opportunities. We anticipate that 4490 Ventures' effort of working in the Wisconsin early stage ecosystem will lead to additional investments for SWIB and WARF meaning more capital for start-ups. In fact, SWIB has already made an independent investment in a 4490 Ventures portfolio company.

As pointed out in LAB's audit report, SWIB's fiduciary duty is centered on responsible management of the trust fund assets. SWIB is a trusted and skilled global investment organization that contributes to the strong financial future of the Wisconsin Retirement System beneficiaries. It is to our beneficiaries that we owe this duty. While we will not be committing additional capital to 4490 Ventures Fund I beyond our initial \$15 million investment, we do expect that if 4490 Ventures' inaugural fund shows signs of success from an investment perspective, future monies will most likely be made available for subsequent funds.

Investments in Wisconsin Companies

Total holdings in Wisconsin companies, including those not headquartered but with 20 or more employees in the state, were \$17.5 billion, or 16.7 percent of assets in fiscal year 2014, and \$15.6 billion, or 16.5 percent of assets in fiscal year 2013. Over the five years ending June 30, 2014, SWIB had new investments in Wisconsin companies totaling over \$1 billion.

Annual New Wisconsin Investments Five-Year Period ending FY 2014 (In Millions)

Fiscal Year	Investment Amount
2010	\$463.1
2011	\$125.6
2012	\$249.1
2013	\$79.1
2014	\$115.6
Five-Year Total	\$1,032.5

This information will be included in SWIB's biennial plan for making investments in Wisconsin. A copy of that plan will be forwarded to the Committee.

Clarify Target for Overall Compensation

As described in the audit report, incentive compensation is a critical component in being able to attract and retain investment professionals and maintain a qualified internal staff. With the help of an external consultant, SWIB's Board of Trustees determined in 2011 that SWIB's compensation plan should pay investment staff at market median when performance exceeds the

benchmarks and above the median when performance significantly exceeds benchmarks. Conversely, if investment returns are below benchmarks, incentive compensation would not be earned and therefore compensation would be below the median. SWIB's market median is based upon a conservative defined group of peer organizations containing similar professional staff but excluding highly paid professionals working on the East and West coasts. This median has been used by SWIB since 2000.

The audit compared SWIB's 2013 incentive compensation payments to those of SWIB's peer group for 2012 and noted that overall compensation for investment staff was at 114 percent of the peer group median. This was done because, at the time of the audit, 2013 peer group data was not yet available. However, now that more current data is available, a comparison of 2013 peer group data to SWIB's 2013 incentive compensation payments shows that the investment management total cash compensation was 101.8 percent of the median. In other words, after an excellent five years of performance by SWIB staff, in which over \$2.6 billion of excess value was added above our benchmarks, investment management total cash compensation exceeded the median by less than 2 percent for 2013. Even after SWIB's strong five-year returns at the end of 2013, overall cash compensation for investment staff averaged only 86 percent of the median over the entire five year period. The Trustees approved an updated compensation philosophy document at the September Board meeting which included that "over the long-term, SWIB aims to provide total compensation levels that approximate the market median by aligning our incentive payouts to performance." This means that in any given year, based on performance, compensation levels may be above or below the market median. The compensation philosophy also clearly states the overall maximum compensation allowed under the plan. SWIB addressed the target for overall compensation for investment staff in December with the Board's Compensation Committee.

Evaluate Overall Compensation Prior to Approval

The Board of Trustees will continue to evaluate overall compensation in comparison to the established target in SWIB's compensation plan prior to approving proposed bonuses. Staff will provide documentation to Trustees at the April 2015 Board meeting that will include total compensation against previous year median compensation data. In addition, staff will also review total cash compensation using updated data in the November Board meeting as we have each year.

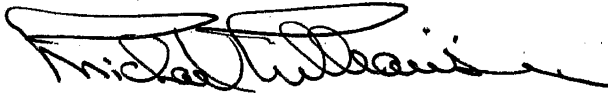
Revise Methods for Determining Maximum Incentive Opportunities

The Board will revise, when necessary, the method for determining the maximum incentive opportunity for investment staff to achieve alignment with the established target for overall compensation in SWIB's compensation plan. As noted in SWIB's response to the audit, Trustees evaluate the program and make changes as needed with the help of an independent compensation consultant. Trustees evaluate, adjust and vote on the incentive compensation plan annually. In 2013, Trustees requested an in-depth external review of the administration of SWIB's compensation plan. That analysis confirmed that SWIB's approach is reasonable for determining competitive market pay, setting market-based salary and incentive levels, and calculating incentive payouts in accordance with the terms of SWIB's approved compensation plan. In 2014, the Trustees hired a different independent compensation consultant to perform an additional review of SWIB's incentive compensation plan to determine if it was consistent with the market

and if it was fully accomplishing its purpose. This review also confirmed that the plan was reasonable and achieving its goals. SWIB will continue its current methodology of having the Board approve incentive compensation maximums prior to the start of the performance year.

We appreciate the work of the audit team to clearly present these complex topics. Please let me know if you have further questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Williamson", with a stylized flourish at the end.

Michael Williamson
Executive Director

cc: Joe Chrisman, State Auditor