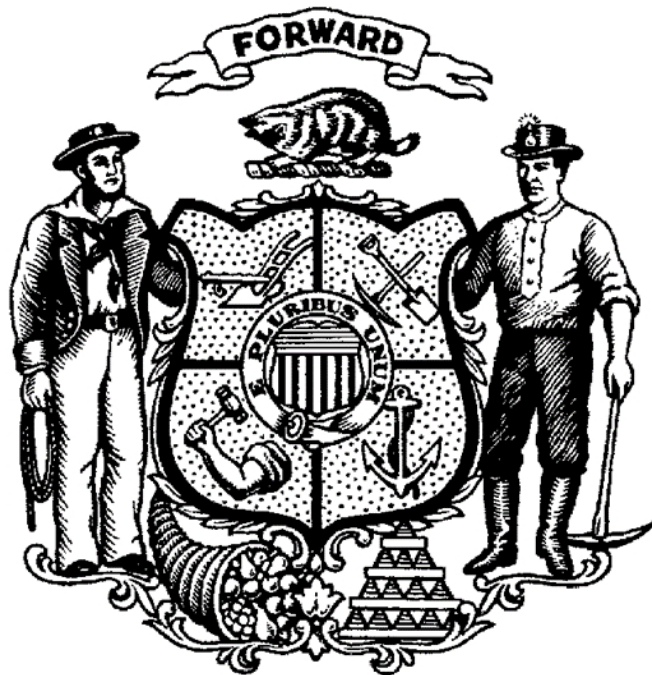


State of Wisconsin

Investment Board



Agency Budget Request

2023 – 2025 Biennium

September 15, 2022

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Date: September 13, 2022

To: Kathy Blumenfeld, Secretary
Brian Pahnke, Administrator, Executive Budget & Finance
Department of Administration

Robert Lang, Director
Legislative Fiscal Bureau

From: Edwin Denson, Executive Director/Chief Investment Officer
Investment Board

Re: **2023-25 Biennial Budget Request**

Attached is SWIB's budget submission for the 2023-25 biennium. Our budget is funded entirely by charges to the funds under management (program revenue). Our submission includes a \$35,066,400 increase in budget authority and 54 staff positions. Under Wis. Stats. 25.187(2)(b), the Board of Trustees establishes and monitors SWIB's operating budget each fiscal year. The annual operating budget is developed to provide the necessary resources to manage trust fund assets and for the Board to fulfill its fiduciary duty to manage the assets in the best interest of the beneficiaries.

Performance Goals and Achievements

SWIB has surpassed most of the performance goals established in our 2021-23 biennial budget request. As can be seen in the attached Performance Measures, SWIB's net of fee performance exceeded investment benchmarks for the one-, five-, and ten-year periods ending December 31, 2021, for the Core Fund and for the ten-year period ending December 31, 2021, for the Variable Fund, which combined make up the Wisconsin Retirement System (WRS). The WRS funds represent approximately \$124.9 billion, or 86 percent, of the total assets managed by SWIB of \$145.8 billion as of June 30, 2022. From 2011 through 2020, net investment income earned by SWIB approximated 80 percent of total funding for the WRS. The WRS continues to be one of the few fully funded public pension plans in the U.S.

SWIB's performance goal for the next biennium is to increase active return through improved investment strategies. SWIB is launching new and restructuring existing strategies to optimize active risk and provide direct access to new markets. In addition, SWIB is further diversifying our sources of liquidity and implementing new instruments to provide more opportunities to achieve our performance goal.

Budget Flexibility Leads to Net Cost Savings

With the support of the Governor and the Legislature, SWIB has used the budget flexibility granted by the Legislature to build a strong internal investment management program that is providing a significant financial benefit to the WRS. Internally managing approximately 50 percent of WRS assets helps keep SWIB's costs lower than its peers, according to CEM Benchmarking, an independent provider of objective cost benchmarking for public pension plans. In addition to cost savings, SWIB's active management has created billions in additional income for beneficiaries when compared to a simple passively constructed portfolio. Over the last 20 years, SWIB's active management and diversified holdings generated \$34.3 billion for the Core Fund above what SWIB would have earned by investing in a passive portfolio consisting of 60% global equities and 40% domestic bonds. SWIB's total investment costs have increased in recent years, but they have remained consistently and materially lower than its peers. Compared to peers, SWIB saved approximately \$1.1 billion from 2011 to 2020.

Investment Strategies and Managing Risk

SWIB's asset allocation and investment decisions are based on selecting the best opportunities to meet the long-term investment objectives of the WRS and the other trust funds under management while taking an appropriate level of risk. Having a long-term view of performance and the investment markets is crucial when considering the amount of volatility in investment markets over the past several years. As a result, SWIB is continuing to explore and implement new investment strategies to help stabilize investment returns and, in turn, contribution rates for active employees and pension adjustments for retirees. Asset allocation and investment diversification are essential components of SWIB's long-term investment strategy.

Investment in Wisconsin Businesses

When economically appropriate, SWIB continues to invest in Wisconsin businesses ranging from small, family-owned companies to billion-dollar manufacturers with worldwide sales. For the fiscal year ending June 30, 2021, SWIB held assets of \$746.1 million in companies headquartered in Wisconsin or with significant operations in the state. SWIB has also invested in venture capital funds designed to identify and invest in promising young technology businesses in Wisconsin and the region.

SWIB will continue to be diligent in our efforts to keep the WRS system stable and well-funded.

We look forward to working with your staff as the budget progresses. If you have any questions, please contact Jameson Greenfield, Chief Financial Officer, at 608-266-9857.

AGENCY DESCRIPTION

As of June 30, 2022, the board managed approximately \$145.8 billion in assets. The trust funds of the Wisconsin Retirement System (WRS) comprise nearly 86 percent of the funds under management at \$124.9 billion in assets. The WRS is a risk-sharing defined benefit plan. It is a hybrid model in that it contains elements of a defined benefit plan and a defined contribution plan, like a 401(k). SWIB works to protect and grow the assets of the WRS for the benefit of the approximately 652,000 participants who count on the pension for a more secure financial future. The WRS consistently ranks among the 10 largest public pension funds in the U.S and 25th largest public or private pension fund in the world.

The board also manages the State Investment Fund, which invests the commingled cash balances of the state and its agencies, local governments and the WRS. Funds are managed to protect principal, provide liquidity and enhance returns. In addition, the board manages several separate trust funds. Each separate fund has investment objectives to fulfill specific financial needs and requirements.

The board comprises nine trustees, selected as follows:

- Five public members appointed by the Governor with the advice and consent of the Senate to staggered six-year terms. Four of these five members must possess at least ten years of investment experience.
- One member representing a local government that participates in the Local Government Investment Pool. This member is appointed by the Governor with the advice and consent of the Senate to a six-year term and must meet prescribed statutory eligibility criteria.
- Two members must be WRS participants. One member is appointed by the Teachers Retirement Board from among WRS teacher participants and the other is appointed by the WRS from among WRS nonteacher participants, for six-year terms.
- One member is the secretary of the Department of Administration, or his or her designee.

MISSION

To be a trusted and skilled global investment organization contributing to a strong financial future for the beneficiaries of the funds entrusted to us.

PROGRAMS, GOALS, OBJECTIVES AND ACTIVITIES

Program 1: Investment of Funds

Goal: Earn a reasonable rate of investment return, with an appropriate level of risk, for each fund managed.

Objective/Activity: The board strives to exceed measurable investment goals for each fund. SWIB's overall objective for each fund it manages is to seek aggregate investment returns in excess of the applicable benchmarks over all cumulative time periods constructed with a prudent level of risk. The investment objective for the Wisconsin Retirement System trust funds is to achieve a long-term rate of return that will help the system meet pension obligations to current and future beneficiaries. Successful investment performance reduces the amount that participants contribute to the funding of system benefits and provides for increases in pension benefits. The investment objective for the State Investment Fund is to exceed its established performance benchmark while ensuring the safety of principal and liquidity. The investment objective for the Separately Managed Funds is to meet annual fund cash flow requirements, as established by their governing boards.

PERFORMANCE MEASURES

FY2021 AND FY2022 GOALS AND ACTUALS

Prog. No.	Performance Measure	Goal FY2021	Actual FY2021	Goal FY2022	Actual FY2022
1.	Investment returns for the Core and Variable Retirement Funds exceed market index returns for the asset classes in which the funds are invested on a net basis. ^{1,2}	Net investment returns exceed market performance benchmarks on a one-, five- and ten-year basis	<u>CY2020</u> Core: 1 Year: Yes 5 Year: Yes 10 Year: Yes Variable: 1 Year: No 5 Year: Yes 10 Year: Yes	Net investment returns exceed market performance benchmarks on a one-, five- and ten-year basis	<u>CY2021</u> Core: 1 Year: Yes 5 Year: Yes 10 Year: Yes Variable: 1 Year: No 5 Year: No 10 Year: Yes
1.	Long-term investment returns for the Core Retirement Fund meet or exceed the rate of return assumed by Wisconsin Retirement System actuary. ³	Net return averages at least 7.0% annually over the long term (ten years)	Met goal CY2020 Ten-year net return was 8.5%	Net return averages at least 7.0% annually over the long term (ten years) ⁷	Met goal CY2021 Ten-year net return was 10.1%
1.	Total costs to manage the Core Retirement Fund are reasonable when compared to peer funds with a similar asset mix and size. ⁴	Total costs are at or below the normal cost paid by peers to manage a similar asset mix	Met goal SWIB's total investment costs were below the benchmark cost.	Total costs are at or below the normal cost paid by peers to manage a similar asset mix	Met goal SWIB's total investment costs were below the benchmark cost.
1.	Core Retirement Fund investment returns are in the top half of its peer group. ⁵	Core Fund's five-year investment return exceeds the peer group median on an asset allocation adjusted basis	CY2020 Met goal Gross return of 11.13% vs median of 10.82%	Core Fund's five-year investment return exceeds the peer group median on an asset allocation adjusted basis	CY2021 Met goal Gross return of 12.81% vs median of 12.64%
1.	State Investment Fund returns exceed investment performance benchmarks. ^{1,2}	Exceed benchmarks	<u>FY2021</u> 1 Year: Yes 5 Year: Yes 10 Year: Yes	Exceed benchmarks	<u>FY2022</u> 1 Year: No 5 Year: Yes 10 Year: Yes
1.	State Investment Fund returns exceed the median of comparable money market mutual funds. ⁶	Above the median	Met goal	Above the median	Met goal

Prog. No.	Performance Measure	Goal FY2021	Actual FY2021	Goal FY2022	Actual FY2022
1.	Meet annual fund cash flow requirements as established by the governing boards for the State Historical Society Trust Fund, Injured Patients and Families Compensation Fund, State Life Insurance Fund, and UW System Trust Fund.	Meet the cash flow needs of the funds	Met goal	Meet the cash flow needs of the funds	Met goal

Note:

¹ Returns reported net of fee, except where noted.

² Core and Variable Trust Fund official investment performance and measures are reported on a calendar year basis. State Investment Fund official investment performance and measures are reported on a fiscal year basis.

³ The assumed rate of return is established by the Employee Trust Funds (ETF) Board, acting on recommendation of its independent consulting actuary.

⁴ As reported by CEM Benchmarking, Inc. Cost effectiveness reporting is performed on a calendar year basis and is available on annual calendar year lag.

⁵ Peer group Public Funds with over \$10 billion in assets compiled by Callan Associates, Inc. Returns measured at Gross of Fee and reported on an asset allocation adjusted basis.

⁶ As measured by the appropriate market index or peer data.

⁷ The rate of return assumed by the Wisconsin Retirement System actuary was reduced to 6.8% in December 2021 effective for the 2021 Wisconsin Retirement System valuation and for use in determining contribution rates for 2023.

FY2023, FY2024 AND FY2025 GOALS

Prog. No.	Performance Measure	Goal FY2023⁴	Goal FY2024	Goal FY2025
1.	Investment returns for the Wisconsin Retirement System exceed market index returns for the asset classes in which the funds are invested on a net basis. ^{1,2}	Net investment returns exceed market performance benchmarks on a one-, five- and ten-year basis	Net investment returns exceed market performance benchmarks on a one-, five- and ten-year basis	Net investment returns exceed market performance benchmarks on a one-, five- and ten-year basis
1.	Long-term investment returns for the Core Retirement Fund meet or exceed the rate of return assumed by Wisconsin Retirement System actuary. ³	Net return averages at least 6.8% annually over the long term (five and ten years)	Net return averages at least 6.8% annually over the long term (five and ten years)	Net return averages at least 6.8% annually over the long term (five and ten years)

¹ Returns reported net of fee, except where noted.

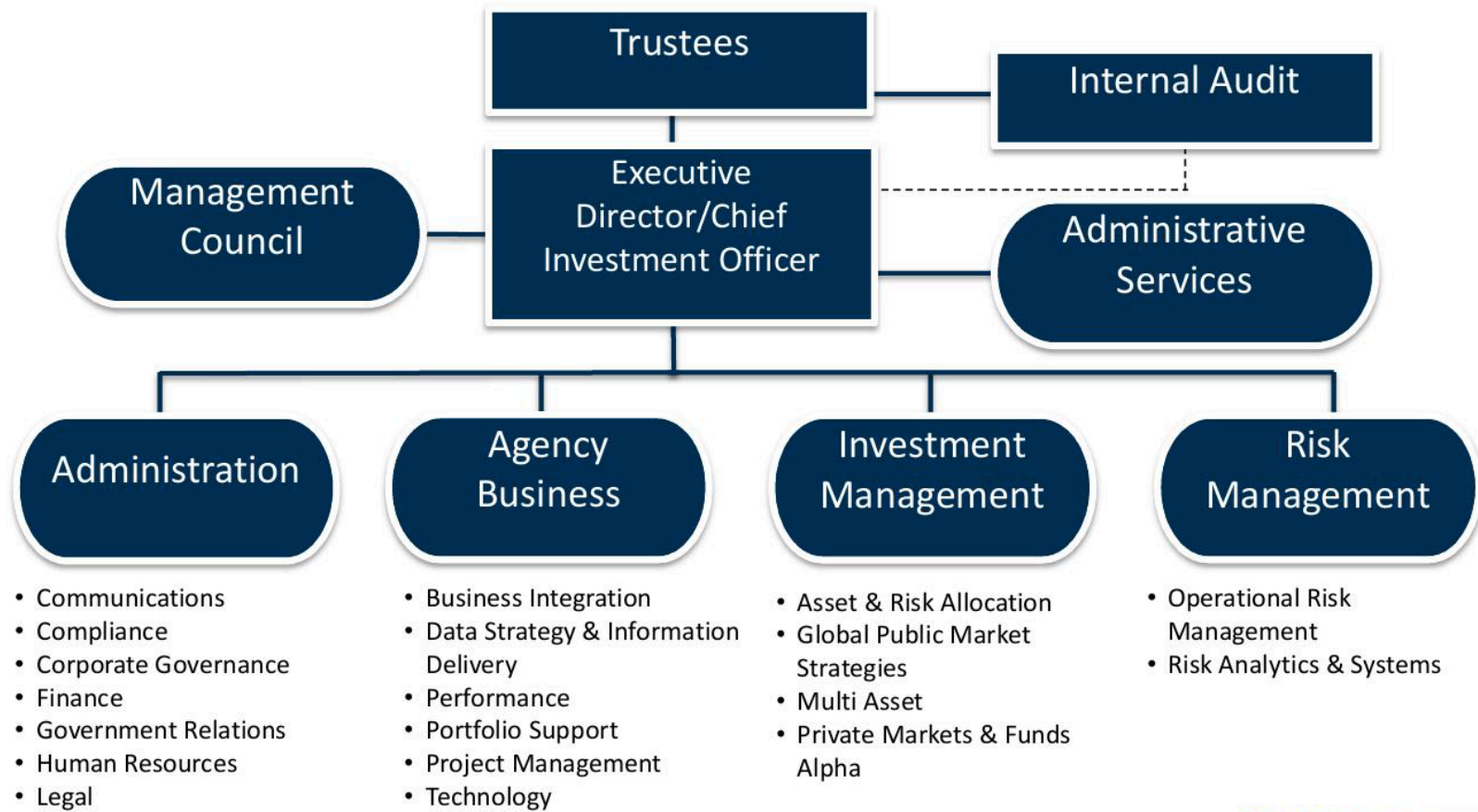
² The Wisconsin Retirement System official investment performance and measures are reported on a calendar year basis.

³ The assumed rate of return is established by the Employee Trust Funds (ETF) Board, acting on recommendation of its independent consulting actuary.

⁴ Previously stated FY2023 goals have been modified to reflect the above.

SWIB Organizational Structure

290 FTE as of June 30, 2022



Agency Total by Fund Source

Investment Board

2325 Biennial

		ANNUAL SUMMARY						BIENNIAL SUMMARY			
Source of Funds		Prior Year Total	Adjusted Base	1st Year Total	2nd Year Total	1st Year FTE	2nd Year FTE	Base Year Doubled (BYD)	Biennial Request	Change From (BYD)	Change From BYD %
PR	S	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
Total		\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
Grand Total		\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%

Agency Total by Program

Investment Board

2325 Biennial Budget

Source of Funds	Prior Year Total	ANNUAL SUMMARY					BIENNIAL SUMMARY			
		Adjusted Base	1st Year Total	2nd Year Total	1st Year FTE	2nd Year FTE	Base Year Doubled (BYD)	Biennial Request	Change From (BYD)	Change From BYD %
01 Investment of funds										
Non Federal										
PR	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
S	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
Total - Non Federal	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
S	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
PGM 01 Total	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
PR	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
S	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
TOTAL 01	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
S	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%
AGENCY TOTAL	\$84,072,751	\$102,731,100	\$102,731,100	\$102,731,100	290.00	290.00	\$205,462,200	\$205,462,200	\$0	0.00%

Agency Total by Decision Item

Investment Board

2325 Biennial Budget

Decision Item	1st Year Total	2nd Year Total	1st Year FTE	2nd Year FTE
2000 Adjusted Base Funding Level	\$102,731,100	\$102,731,100	290.00	290.00
TOTAL	\$102,731,100	\$102,731,100	290.00	290.00

Decision Item (DIN) - 2000

Decision Item (DIN) Title - Adjusted Base Funding Level

NARRATIVE

Adjusted Base Funding Level

Decision Item by Line

2325 Biennial Budget

DEPARTMENT	CODES	TITLES
	536	Investment Board
DECISION ITEM	CODES	TITLES
	2000	Adjusted Base Funding Level

	Expenditure Items	1st Year Cost	2nd Year Cost
01	Permanent Position Salaries	\$78,867,200	\$78,867,200
02	Turnover	\$0	\$0
03	Project Position Salaries	\$0	\$0
04	LTE/Misc. Salaries	\$376,000	\$376,000
05	Fringe Benefits	\$14,365,200	\$14,365,200
06	Supplies and Services	\$9,122,700	\$9,122,700
07	Permanent Property	\$0	\$0
08	Unallotted Reserve	\$0	\$0
09	Aids to Individuals & Organizations	\$0	\$0
10	Local Assistance	\$0	\$0
11	One-time Financing	\$0	\$0
12	Debt service	\$0	\$0
13		\$0	\$0
14		\$0	\$0
15		\$0	\$0
16		\$0	\$0
17	TOTAL	\$102,731,100	\$102,731,100
18	Project Positions Authorized	0.00	0.00
19	Classified Positions Authorized	0.00	0.00
20	Unclassified Positions Authorized	290.00	290.00

Decision Item by Numeric

2325 Biennial Budget

Investment Board

Program	Decision Item/Numeric	1st Year Total	2nd Year Total	1st Year FTE	2nd Year FTE
	2000 Adjusted Base Funding Level				
01	Investment of funds				
	31 General program operations	\$102,731,100	\$102,731,100	290.00	290.00
	Investment of funds Sub Total	\$102,731,100	\$102,731,100	290.00	290.00
	Adjusted Base Funding Level Sub Total	\$102,731,100	\$102,731,100	290.00	290.00
	Agency Total	\$102,731,100	\$102,731,100	290.00	290.00

Decision Item by Fund Source

2325 Biennial Budget

Investment Board

Decision Item/Source of Funds		1st Year Total	2nd Year Total	1st Year FTE	2nd Year FTE
2000 Adjusted Base Funding Level					
PR	S	\$102,731,100	\$102,731,100	290.00	290.00
Adjusted Base Funding Level Total		\$102,731,100	\$102,731,100	290.00	290.00
Agency Total		\$102,731,100	\$102,731,100	290.00	290.00

ACT 201

Proposal under s. 16.42(4)(b)2.: 0% change in each fiscal year

FY: **FY24 & 25**

Agency: **SWIB - 536**

Exclusions: Federal
Debt Service

Columns A-G were repopulated for agencies to reflect state operations adjusted base and reductions agreed to by DOA and LFB. See Appendix H for instructions on how to complete these templates.

Proposed \$ and Proposed FTE columns reflect total agency proposed spending and positions for indicated fiscal year. These amounts should include standard budget adjustments (SBAs), any proposed reallocations or reductions to meet the target, and any other requests that the agency would want considered under this proposal.

Appropriations with zero dollars and zero FTEs are not loaded into the template. If you have any questions, contact your SBO analyst.

IF YOUR AGENCY PLANS TO TAKE THE SAME CUTS OVER BOTH YEARS, YOU SHOULD ONLY FILL OUT ONE GRID FOR 0% GROWTH AND ONE GRID FOR 5% REDUCTION, THEN CHANGE "FY24" TO "FY24 AND 25".

Agency	Appropriation		Fund Source	Adjusted Base \$	FTE	(See Note 1) 0% Change Target	Proposed Budget 2023-24		Item Ref.	Change from Adj Base		(See Note 2) Remove SBAs		Change from Adjusted Base after Removal of SBAs	
	Alpha	Numeric					Proposed \$	Proposed FTE		\$	FTE	\$	FTE	\$	FTE
536	1k	131	PR	\$102,731,100.00	290.00	0	102,731,100	290.00		0	0.00	0	0.00	0	0.00
Totals				102,731,100	290.00	0	102,731,100	290.00		0	0.00	0	0.00	0	0.00

Note 1: Reduction target must be met within state operations appropriations, but may be allocated across those appropriations and fund sources.

Note 2: Amounts should be SBAs (DINs 3001 - 3011) from agency request multiplied by -1.

Target Reduction =

0

Difference =

0

Should equal \$0

Items - Describe proposed changes (excl. SBAs) to reach target or other priorities of agency

- 1
- 2
- 3

ACT 201

Proposal under s. 16.42(4)(b)1.: 5% change in each fiscal year

FY: **FY24 & 25**

Agency: **SWIB - 536**

Exclusion Federal
Debt Service

Columns A-G were prepopulated for agencies to reflect state operations adjusted base and reductions agreed to by DOA and LFB. See Appendix H for instructions on how to complete these templates.

Proposed \$ and Proposed FTE columns reflect total agency proposed spending and positions for indicated fiscal year. These amounts should include standard budget adjustments (SBAs), any proposed reallocations or reductions to meet the target, and any other requests that the agency would want considered under this proposal.

Appropriations with zero dollars and zero FTEs are not loaded into the template. If you have any questions, contact your SBO analyst.

IF YOUR AGENCY PLANS TO TAKE THE SAME CUTS OVER BOTH YEARS, YOU SHOULD ONLY FILL OUT ONE GRID FOR 0% GROWTH AND ONE GRID FOR 5% REDUCTION, THEN CHANGE "FY24" TO "FY24 AND 25".

Agency	Appropriation		Fund Source	Adjusted Base		(See Note 1)	Proposed Budget 2023-24		Item Ref.	Change from Adj Base		(See Note 2)	Change from Adjusted Base after Removal of SBAs	
	Alpha	Numeric		\$	FTE	5% Reduction Target	Proposed \$	Proposed FTE		\$	FTE	Remove SBAs	\$	FTE
536	1k	131	PR	\$102,731,100.00	290.00	(5,136,600)	97,594,500	275.50		(5,136,600)	(14.50)	0	0.00	(5,136,600) (14.50)
Totals				102,731,100	290.00	(5,136,600)	97,594,500	275.50		(5,136,600)	(14.50)	0	0.00	(5,136,600) (14.50)

Note 1: Reduction target must be met within state operations appropriations, but may be allocated across those appropriations and fund sources.

Note 2: Amounts should be SBAs (DINs 3001 - 3011) from agency request multiplied by -1.

Target Reduction = (5,136,600)

Difference = **0**
Should equal \$0

Items - Describe proposed changes (excl. SBAs) to reach target or other priorities of agency

- 1 The targeted \$5.1 million reduction would equate to a staffing reduction of approximately 15 total FTEs (10 investment services staff, 5 investment management staff)
- 2 This would require an estimated movement of \$4.6 billion in assets from internal management by SWIB staff to external management by asset management firms.
- 3 While costs from internal management would decrease by \$5.1 million, SWIB's total costs would increase an estimated \$5.3 million (net of internal cost savings) due to the higher fee structure for external management.
- 4 Particularly since 2007, SWIB has increased internal management when possible to optimize costs without giving up returns. SWIB currently manages approximately 50% of total assets with internal staff. For CY2021, external manager base fees were approximately 3.4 times higher than internal costs. Viewed in this context, an arbitrary 5% cut in the operating budget does not make fiscal sense because it forces SWIB to incur greater external fees or to risk lower returns, or both.