

November 23, 2020

Mr. Joe Chrisman
State Auditor
Legislative Audit Bureau
22 East Mifflin, Suite 500
Madison, WI 53703

Dear Mr. Chrisman,

We appreciate the opportunity to comment on the management audit of the State of Wisconsin Investment Board (SWIB). SWIB is pleased that no significant concerns were identified during the audit, and we would like to thank the LAB staff for their hard work. SWIB will work to ensure the recommendations made in the report are addressed.

In addition to managing the State Investment Fund and other, smaller trust funds, SWIB invests the assets of the Wisconsin Retirement System (WRS), one of the only fully funded public pension plans in the United States. Over the long term, SWIB has consistently exceeded the actuarial assumed rate for the WRS, beaten its benchmarks, and provided real value to the state, all at a cost that is less than our peers. There are several ways to measure SWIB's success:

Exceeding the Target Rate of Return

The Department of Employee Trust Funds Board has set an actuarial assumed rate of return of 7.0% for the WRS to remain fully funded over the long term. The WRS's Core Trust Fund (CTF) has cleared that hurdle. As of December 31, 2019, the CTF had 5-, 10-, and 30-year net returns of 7.48%, 8.20%, and 8.25%, respectively. These consistently strong returns help drive the fully funded WRS.

Returns Far Above Traditional "60/40" Passive Index Portfolio

From 2000 through 2019, SWIB's active management and diversified investments generated CTF gross returns that are a cumulative 70% (or \$33.5 billion) above what SWIB would have earned by investing in a low cost passive portfolio of 60% global equities and 40% U.S. investment grade bonds. That 70% represents the benefit offered by employing a highly qualified staff in Madison.

Beating Benchmarks

SWIB evaluates its performance against industry benchmarks adopted by its Board of Trustees based on recommendations from an independent benchmark consultant. As of December 31, 2019, the five-year WRS investment performance beat its benchmarks and generated \$560.4 million in added value above benchmark returns after all costs have been deducted.

Favorable Performance Compared to Peers

While SWIB is not in a competition with other state pension plans, it is natural to look at its performance relative to that of its peers. According to an independent performance consultant, among public pension plans greater than \$10 billion, SWIB's 1-, 5-, and 10-year gross performance (adjusted

for asset mix) ranked in the top 22%, 31%, and 38%, respectively, as of December 31, 2019.

Cost Optimization

SWIB's costs are lower than our peers in part because SWIB attracts and retains qualified professionals to manage assets internally for multiples less than what it would cost to pay external managers. As of December 31, 2019, SWIB managed about 50% of the WRS's assets internally, compared to only 21% in 2007. In 2019 alone, those cost savings over peers translated to over \$70 million for the WRS, and over the past ten years, the savings totaled approximately \$1.3 billion. SWIB continues to expand its internal management capabilities in areas where it is prudent.

Spending on Public Pensions Is Much Less in Wisconsin Than Elsewhere

Another way to measure costs for taxpayers is to compare state and local spending on public pensions as a percentage of total government direct general spending. According to the National Association of State Retirement Administrators, average state and local government spending on pensions is 4.7% nationally. In Wisconsin, that figure is less than half, at 2.0%.

SWIB-Earned Returns Power the WRS

From 2009 through 2018, net investment income earned by SWIB represented more than 75% of the income needed to fund the WRS. The U.S. public pension average during that time was only 63%, meaning that taxpayers, public employers, and employees in Wisconsin bear less of the funding burden than those in most other states.

SWIB Benefits the State as a Whole, Not Just WRS Participants

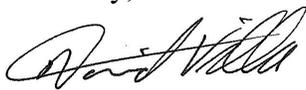
One in five Wisconsin residents (or an immediate family member) is a member of the WRS. Approximately one third of the WRS's 652,000 participants are annuitants whose modest pension payments help them retire with dignity. The WRS pays over \$5 billion in benefits annually, which are primarily spent in Wisconsin because about 85% of WRS retirees live in Wisconsin. Also, SWIB has billions of dollars invested in companies based in Wisconsin or with some level of employment or operations in the state. Finally, a strong WRS has been cited as a factor in Wisconsin's credit rating upgrades.

Skillfully Navigating Volatile Markets

Finally, I am extremely proud of how our talented and professional staff has navigated a volatile investment environment over the past few years. 2018 ended with markets suffering their worst yearly losses since 2008. Then, March 2020 saw one of the most dramatic and unexpected stock market crashes in history, but SWIB has weathered the storm and rebounded with a strong, positive year-to-date return. Without missing a beat, staff transitioned to working from home in March amid the COVID-19 pandemic and continued to apply SWIB's disciplined and diversified asset allocation and investment strategy to steer the WRS through a challenging market environment.

Thank you again for your time and consideration in completing this report. This audit and the LAB's recommendations are valuable to our continued efforts to serve the WRS and its beneficiaries.

Sincerely,



David Villa

Executive Director/Chief Investment Officer