

**1999 DRAFTING REQUEST**

**Bill**

Received: **10/14/98**

Received By: **champra**

Wanted: **Soon**

Identical to LRB:

For: **Administration-Budget**

By/Representing: **Holden**

This file may be shown to any legislator: **NO**

Drafter: **champra**

May Contact:

Alt. Drafters:

Subject: **State Finance - investment board**

Extra Copies:

**Topic:**

DOA:.....Holden - Outside Investment Advisors for SWIB

**Instructions:**

See Attached.

**Drafting History:**

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/1	champra 10/14/98	gilfokm 10/14/98	lpaasch 10/14/98	_____	lrb_docadmin 10/14/98		
/2	champra 01/11/99	gilfokm 01/11/99	hhagen 01/12/99	_____	lrb_docadmin 01/12/99		

FE Sent For:

<END>

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FE Sent For: *1/2 = 1-13 kmq* *1/12* *1/15 '12*

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**Instructions:**

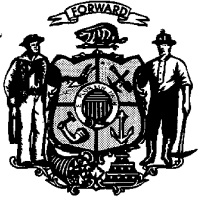
See Attached.

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1?	champra	1-10-14 Kmg	10-14 LP.	10-14 L.P. JK			

FE Sent For:

<END>



STATE OF WISCONSIN  
DEPARTMENT OF ADMINISTRATION  
101 East Wilson Street, Madison, Wisconsin

TOMMY G. THOMPSON  
GOVERNOR  
MARK D. BUGHER  
SECRETARY

Mailing Address:  
Post Office Box 7864  
Madison, WI 53707-7864



**Date:** October 8, 1998

**Priority:** High

**To:** Steve Miller  
Legislative Reference Bureau

**From:** Kerry Holden, SBO, 6-8593

**Subject:** Draft for Governor's 1999-2001 Budget Bill -- Outside Investment Advisors

Please draft the following for inclusion in the Governor's 1999-2001 budget bill.

I have attached a drafting proposal relating to SWIB's use of outside investment advisors.  
Please call me with any questions. Thanks.

Use of Outside Investment Advisors

Section 25.18 (2) (e) of the statutes is amended to read:

25.18 (2) (e) Contract with and delegate to investment advisors the management and control over assets from any fund or trust delivered to such investment advisers for investment in real estate, mortgages, equities, debt of foreign corporations and debt of foreign governments, and pay such advisors fees from the current income of the fund or trust being invested. No more than 15% 50% of the total assets of the fixed retirement investment trust or 15% 50% of the total assets of the variable retirement investment trust may be delivered to investment advisors. The board shall set performance standards for such investment advisors, monitor such investments to determine if performance standards are being met and if an investment advisor does not consistently meet the performance standards then terminate the contract with such investment advisor.

EXPLANATORY NOTE: The statutes currently permit the Investment Board to utilize external advisors to manage up to 15% of the total assets of the Fixed and Variable Retirement Funds. As of June 30, 1998, external advisors managed 12.7% of the Fixed Fund and 14.4% of Variable Fund holdings.

The Board has an obligation to the trust funds to seek the best rate of investment return with appropriate risk. Our goal is a net return (return after all costs and fees are subtracted) that exceeds market returns and returns of similarly managed funds.

It is typically cheaper for SWIB to manage most assets with our own staff. For that reason, SWIB emphasizes active, internal portfolio management. Outside advisors are used to manage investments that involve skills, locations, support systems or intensity of staff attention that make direct management by SWIB staff impractical or less cost effective. This dual approach has enabled SWIB to surpass performance benchmarks over the last one-, five- and ten-year periods.

SWIB uses the current outside management authority in four areas: (1) international equities; (2) emerging market funds; (3) international fixed income; and (4) quantitative domestic equities portfolios. A recent analysis by Cost Effectiveness Measurement, Inc. confirms that SWIB uses outside advisors to a lesser degree than other large pension funds. (On average, a peer group of 11 large public pension funds uses outside advisors to actively manage 35% of assets.)

SWIB selects outside managers based on their investment style, performance, experience, size and fee structure. We annually evaluate each outside manager using performance criteria similar to internal portfolios. The ability to earn a superior investment return after management fees is a critical factor when making outside management decisions.

The Board requests that the outside limit be increased to 50% of the assets of the Fixed and Variable Funds. SWIB expects to continue to maintain an emphasis on internal management of assets. However, to meet its fiduciary responsibility to the trust funds, SWIB needs the

flexibility to choose investment management approaches that will generate the best net returns as circumstances and markets change. Four factors in particular contribute to this request:

- The flexibility for trustees to delegate management of investments to advisors is a recognized principle of trust law, particularly as it pertains to the management of a large, diversified investment portfolio\*. A survey of other large public pension funds indicates that most states do not restrict the extent to which their trustees may use external advisors. Because SWIB is rapidly approaching the current 15% limit, there is the potential that the Board will not have the ability to make the most prudent strategic choices in the future unless the current limit is increased.
- Five of SWIB's internally managed portfolios are each at or nearing 8% of total Fixed Fund assets. As a fiduciary, SWIB is particularly concerned about the need to ensure there are immediate and effective alternatives to manage internal portfolios should one or more key staff depart. It is not always possible to anticipate when and how departures will occur. In such situations, it may be prudent to utilize outside management until an appropriate internal staffing level and knowledge base are attained. An increase in outside management authority will, in effect, provide an "insurance policy" for management of funds during these periods.
- SWIB has access to strategies and analysis developed by outside managers that can benefit our internally managed portfolios and the trust funds as a whole. For example, the outside advisors who manage the quantitative domestic equities portfolios are providing advice as to how their techniques can be incorporated into the strategies for our other portfolios.
- Our strategic business plan has identified a number of new investment initiatives for consideration during the next two years. It will be impractical to manage some of these initiatives (such as a high yield convertible bond portfolio) internally because of the specialized resources that are required.

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\*See the Prudent Investor Rule describe in s. 227 and related commentary of the Restatement, Third, of Trusts



State of Wisconsin  
1999 - 2000 LEGISLATURE

LRB-0576/1

RAC: King

Seon

DOA:.....Holden - Outside Investment Advisors for SWIB

FOR 1999-01 BUDGET - NOT READY FOR INTRODUCTION

1 AN ACT <sup>Don't</sup> <sup>Gen Coat</sup> ...; relating to: the budget.

*Analysis by the Legislative Reference Bureau*

**STATE GOVERNMENT**

**STATE FINANCE**

Currently, the state investment board may contract with outside investment advisers for the management of assets from any fund or trust under its control for investment in real estate, mortgages, equities, debt of foreign corporations and debt of foreign governments. Under current law, however no more than 15% of the total assets of the fixed retirement investment trust or 15% of the total assets of the variable retirement investment trust may be so contracted. This bill increases the cap from 15% to 50% of such funds.

*The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:*

2 SECTION 1. 25.18 (2) (e) of the statutes is amended to read:

3 25.18 (2) (e) Contract with and delegate to investment advisers the

4 management and control over assets from any fund or trust delivered to such

1 investment advisers for investment in real estate, mortgages, equities, debt of  
2 foreign corporations and debt of foreign governments, and pay such advisers fees  
3 from the current income of the fund or trust being invested. No more than ~~15%~~ 50%  
4 of the total assets of the fixed retirement investment trust or ~~15%~~ 50% of the total  
5 assets of the variable retirement investment trust may be delivered to investment  
6 advisers. The board shall set performance standards for such investment advisers,  
7 monitor such investments to determine if performance standards are being met and  
8 if an investment adviser does not consistently meet the performance standards then  
9 terminate the contract with such investment adviser.

History: 1975 c. 39; 1983 a. 27, 192; 1985 a. 29; 1987 a. 27, 399; 1989 a. 119, 338, 366; 1991 a. 39; 1993 a. 112; 1995 a. 274.

10

(END)





State of Wisconsin  
1999 - 2000 LEGISLATURE

LRB-0576/1-2

RAC:kmg:lp

Redraft index has  
been run

Sean

DOA:.....Holden - Outside Investment Advisors for SWIB

FOR 1999-01 BUDGET — NOT READY FOR INTRODUCTION

do not gen. cap

1 AN ACT ...; relating to: the budget.

*Analysis by the Legislative Reference Bureau*

**STATE GOVERNMENT**

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Currently, the state investment board may contract with outside investment advisers for the management of assets from any fund or trust under its control for investment in real estate, mortgages, equities, debt of foreign corporations and debt of foreign governments. Under current law, however no more than 15% of the total assets of the fixed retirement investment trust or 15% of the total assets of the variable retirement investment trust may be so contracted. This bill increases the cap from 15% to ~~50%~~ 70% of such funds.

259

*The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:*

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- 3 25.18 (2) (e) Contract with and delegate to investment advisers the
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2 foreign corporations and debt of foreign governments, and pay such advisers fees  
3 from the current income of the fund or trust being invested. No more than 15% ~~50%~~  
4 of the total assets of the fixed retirement investment trust or 15% ~~50%~~ of the total 25%  
5 assets of the variable retirement investment trust may be delivered to investment  
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7 monitor such investments to determine if performance standards are being met and  
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9 terminate the contract with such investment adviser.

10

(END)



State of Wisconsin  
1999 - 2000 LEGISLATURE

LRB-0576/2  
RAC:kmg:hmh

DOA:.....Holden - Outside Investment Advisors for SWIB

FOR 1999-01 BUDGET -- NOT READY FOR INTRODUCTION

1 **AN ACT ...; relating to:** the budget.

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*Analysis by the Legislative Reference Bureau*

**STATE GOVERNMENT**

**STATE FINANCE**

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*The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:*

2 **SECTION 1.** 25.18 (2) (e) of the statutes is amended to read:

3 25.18 (2) (e) Contract with and delegate to investment advisers the  
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4 of the total assets of the fixed retirement investment trust or ~~15%~~ 25% of the total  
5 assets of the variable retirement investment trust may be delivered to investment  
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7 monitor such investments to determine if performance standards are being met and  
8 if an investment adviser does not consistently meet the performance standards then  
9 terminate the contract with such investment adviser.

10 (END)