

1999 DRAFTING REQUEST

Assembly Amendment (AA-AB133)

Received: **06/7/99**

Received By: **champra**

Wanted: **Soon**

Identical to LRB:

For: **Legislative Fiscal Bureau**

By/Representing: **Mason**

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

Drafter: **champra**

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Subject: **State Finance - investment board**

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Topic:

Outside investment advisers 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 06/7/99	gilfokm 06/7/99	martykr 06/8/99	_____	lrb_docadmin 06/8/99		

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/1	champra	11-6-7-99 Kmg	Kmg	<u>2/3</u> Kmg			

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Legislative Fiscal Bureau

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June 7, 1999

Joint Committee on Finance

Paper #601

Limit on Assets Subject to Outside Management (Investment Board)

[LFB 1999-01 Budget Summary: Page 374, #5]

CURRENT LAW

Under provisions of s. 25.18(2)(e) of the statutes, the Investment Board may utilize external investment advisors to manage and control up to 15% of the total assets of both the Fixed Retirement Investment Trust Fund and the Variable Retirement Investment Trust Fund.

GOVERNOR

Increase from 15% to 25% the total amount of Fixed and Variable Trust assets that may be managed and controlled by outside investment advisors.

DISCUSSION POINTS

1. The authority for the Investment Board to use outside investment advisors to manage a portion of the Fixed and Variable was first authorized by 1987 Wisconsin Act 27. The Act 27 language set a 10% limit on the total assets of both the Fixed Trust and the Variable Trust that could be managed by outside advisors. Provisions of 1995 Wisconsin Act 274 increased this limit from 10% to 15%. By setting limits on outside investment advisor activities, the Legislature has accorded the Investment Board a degree of flexibility in portfolio management strategies. However, these limits also imply a preference by the Legislature that the principal focus of the Board should be on the internal management of invested assets.

2. The following table summarizes the Investment Board's use of external advisors for asset management since this authority was first used during the 1989-90 fiscal year.

**Percentage of Retirement Trust Assets Subject to Outside Management
(As of June 30 of Each Year)**

<u>Calendar Year</u>	<u>Fixed Trust</u>	<u>Variable Trust</u>	<u>All Assets</u>
1989	0.0%	0.0%	0.0%
1990	3.7	4.0	3.7
1991	4.6	4.9	4.7
1992	5.2	5.6	5.2
1993	5.2	5.3	5.2
1994	7.1	7.7	7.2
1995	7.1	7.7	7.2
1996 ^a	10.4	10.8	10.5
1997	10.3	10.7	10.4
1998	12.7	14.4	13.0
1999 ^b	13.7	15.1	13.9

^aProvisions of 1995 Wisconsin Act 274 increased the outside management limit from 10% to 15%.

^bThrough March 31, 1999. Investment gains have caused the amount of Variable Trust assets under outside management to exceed the statutory 15% limitation.

3. The Investment Board uses outside investment advisors primarily in the following investment portfolios: (a) international equities and emerging market funds; (b) international fixed income investments (bonds); and (c) large capitalization domestic equities where quantitative investment strategies are used. Currently, approximately 46% of the international equities and emerging markets portfolios, 71% of the international fixed income portfolio and 7% of the large capitalization domestic equity portfolio is under outside management. As of March 31, 1999, approximately \$7.8 billion of the Fixed and Variable Retirement Trusts' \$56.0 billion in assets was under external management.

4. The Investment Board indicates that outside advisors have been used to manage the above portfolios because the investments in each often require special skills, highly technical support systems, an intensity of staff attention or an actual physical presence in an overseas market locale that would make the direct management of these investments by Investment Board staff impractical or less cost effective. In recent years, the Investment Board has also found it desirable to have the ability to use outside investment advisors in certain portfolios where resignations or retirements have temporarily reduced the number of agency employees available to manage the portfolio's investment holdings. The Board also believes that emerging, complex investment strategies may also make it appropriate to assign additional assets to outside advisors for management.

5. While there appear to be a number of valid reasons why outside investment advisors

are required for the effective management of certain Investment Board portfolios, the use of these types of outside investment management resources are significantly more expensive than relying on the internal management of assets. For example, the current adjusted base budget for the entire agency is \$12,916,400 PR annually. The current total costs of external management of Fixed and Variable Investment Trust assets under the authority of s. 25.18(2)(e) has been estimated by the agency at about \$19,800,000. These costs are outside of the Board's budget and are funded by direct charges against earnings. If it were assumed that a proportionate cost increase would result if the Board were to decide to go to the proposed 25% of funds to be handled by outside investment managers, the additional cost would be estimated at \$15.3 million annually.

6. The Board would argue, however, that in order for it to meet its fiduciary responsibilities with respect to investing the assets of the Wisconsin Retirement System, the agency must have the flexibility to choose the investment management approaches that will generate the best rate of investment return. Notwithstanding the costs associated with outside investment advisors, the agency indicates that its overall investment goal is a net return (after all costs and fees are subtracted) that exceeds market returns and the returns of similarly managed funds.

7. However, for the 1997-98 fiscal year, it may be noted that with respect to the portfolios with significant external management activity, neither the international fixed income portfolio nor the large capitalization domestic equity portfolios exceeded their respective benchmarks. The international equities and emerging market portfolio did exceed its benchmark. For the preceding 1996-97 fiscal year, two of the three portfolios with significant outside management did not exceed their investment performance benchmarks.

8. In 1996 when the outside management limit was last raised from 10% to 15%, the Investment Board indicated at the time that this additional flexibility would enable it to "continue with a gradual expansion of international investments."

9. The Committee could conclude that such a more gradual approach to raising the limit on total amount of assets subject to outside management would be preferable to lifting the cap to 25% of assets, as recommended by the Governor, particularly considering the cost of such services and at least some recent investment results for managed portfolios that do not exceed the Board's investment performance benchmarks. Under this alternative, the Committee could choose to increase from 15% to 20% the amount of Fixed and Variable Trust assets that may be managed and controlled by outside investment advisors.

ALTERNATIVES TO BASE

1. Approve the Governor's recommendation to increase from 15% to 25% the amount of Fixed and Variable Trust assets that may be managed and controlled by outside investment advisors.

2. Modify the Governor's recommendation by increasing from 15% to 20% the amount of Fixed and Variable Trust assets that may be managed and controlled by outside investment

advisors.

3. Maintain current law.

Prepared by: Tony Mason



State of Wisconsin
1999 - 2000 LEGISLATURE

LRBb0573/1

RAC: King

soon

LFB:.....Mason – Outside investment advisors for SWIB

FOR 1999-01 BUDGET — NOT READY FOR INTRODUCTION

LFB AMENDMENT

TO 1999 ASSEMBLY BILL 133 AND 1999 SENATE BILL 45

WPO:
Fix request
sheet

1 At the locations indicated, amend the bill as follows:

2 ✓ 1. Page 498, line 12: delete "25%" and substitute "20%".

3 ✓ 2. Page 498, line 13: delete "25%" and substitute "20%".

4 (END)



State of Wisconsin
1999 - 2000 LEGISLATURE

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RAC:kmg:km

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