



Appropriations Committee FY 2020 Budget Hearing January 17, 2019

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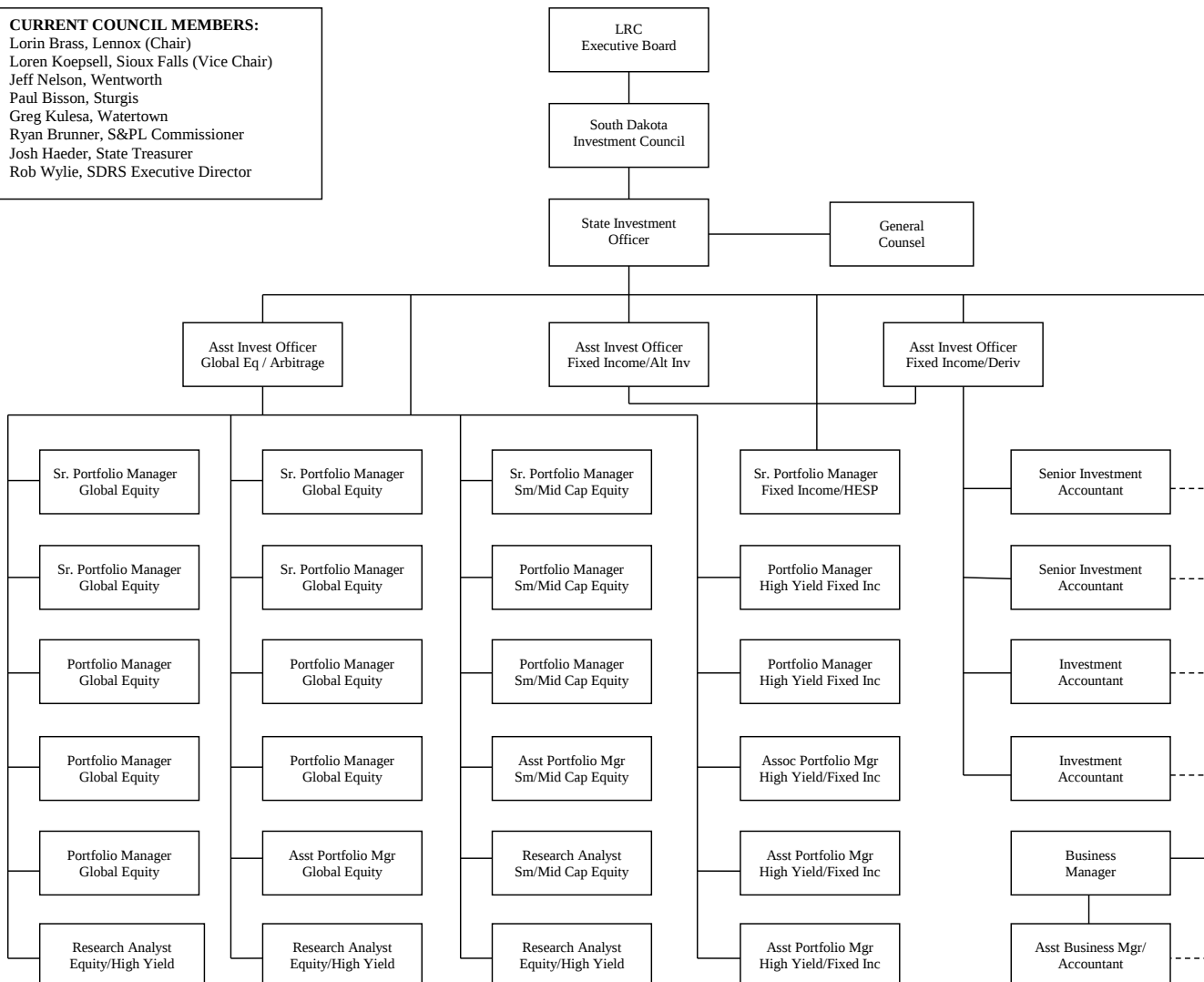
- **BUDGET BRIEFING** (separate document)

- o Budget Funding Sources
- o FY 2020 Budget & Governor's Recommendation
- o Trust Funds Summary
- o Internal Management & Use of External Managers

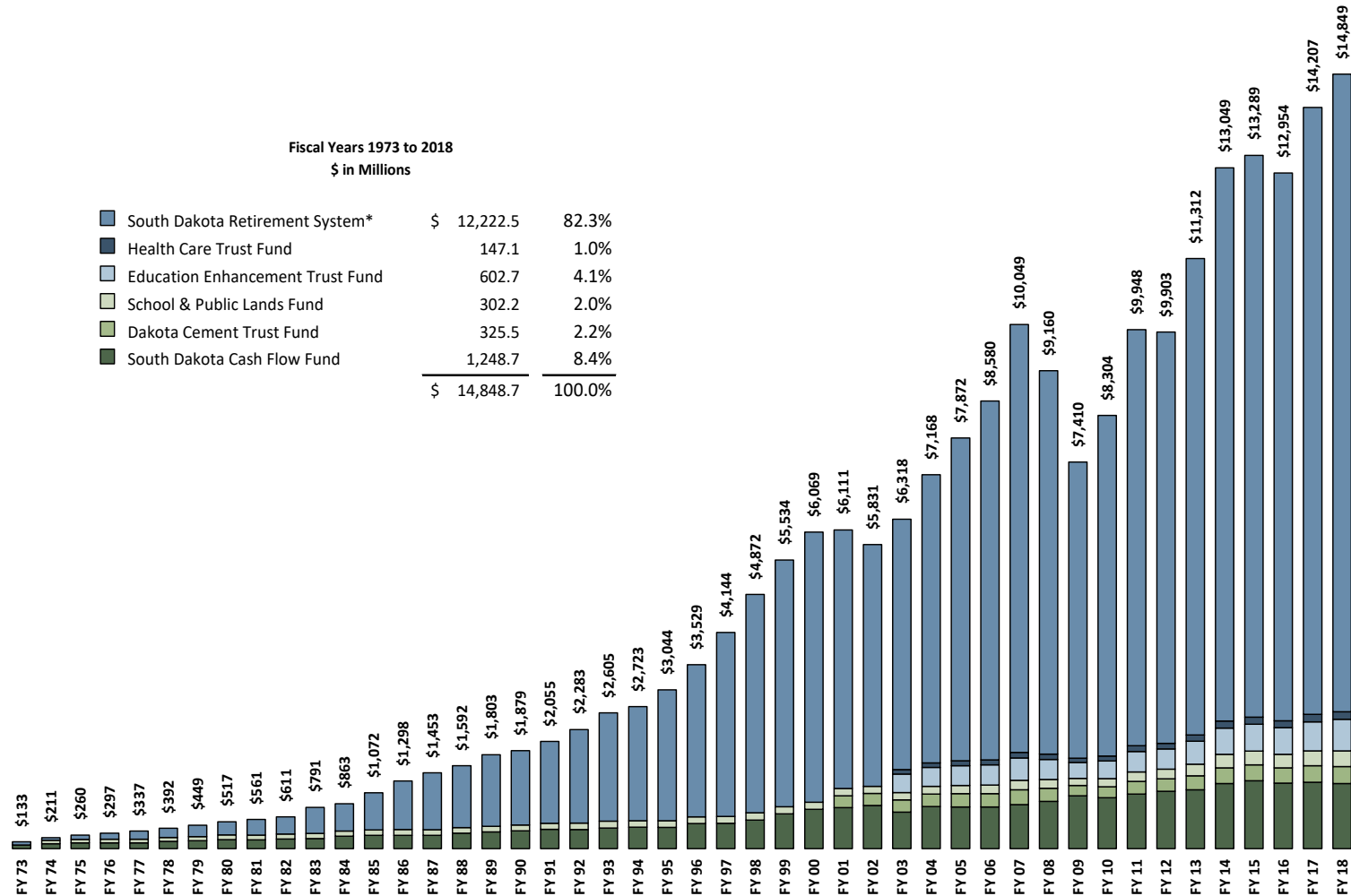
Organization Chart

CURRENT COUNCIL MEMBERS:

Lorin Brass, Lennox (Chair)
Loren Koepsell, Sioux Falls (Vice Chair)
Jeff Nelson, Wentworth
Paul Bisson, Sturgis
Greg Kulesa, Watertown
Ryan Brunner, S&PL Commissioner
Josh Haeder, State Treasurer
Rob Wylie, SDRS Executive Director



Assets



*The South Dakota Cement Plant Retirement Fund (CPRF) was consolidated into the South Dakota Retirement System (SDRS) on April 1, 2014, per SDCL 3-12-217. For purposes of this exhibit, CPRF Assets for Fiscal Years 1973 - 2013 are included with SDRS.

Investment Performance

Returns vs. Benchmarks

	<u>FY 2018</u>	<u>4 Years Annualized FY 15 – 18</u>	<u>10 Years Annualized FY 09 – 18</u>
▪ SDRS Total Fund	7.94%	6.44%	7.97%
▪ Capital Market Benchmark	7.33%	5.76%	6.52%
Added Value	.61%	.68%	1.46%
▪ State Fund Universe	8.89%	6.39%	6.70%
Added Value	-.95%	.05%	1.27%
▪ Beginning FY 2018 SDRS Assets		\$11.632 billion	
▪ Ending FY 2018 SDRS Assets		\$12.222 billion	

Note: All time-weighted rates of return are net of fees

Investment Performance

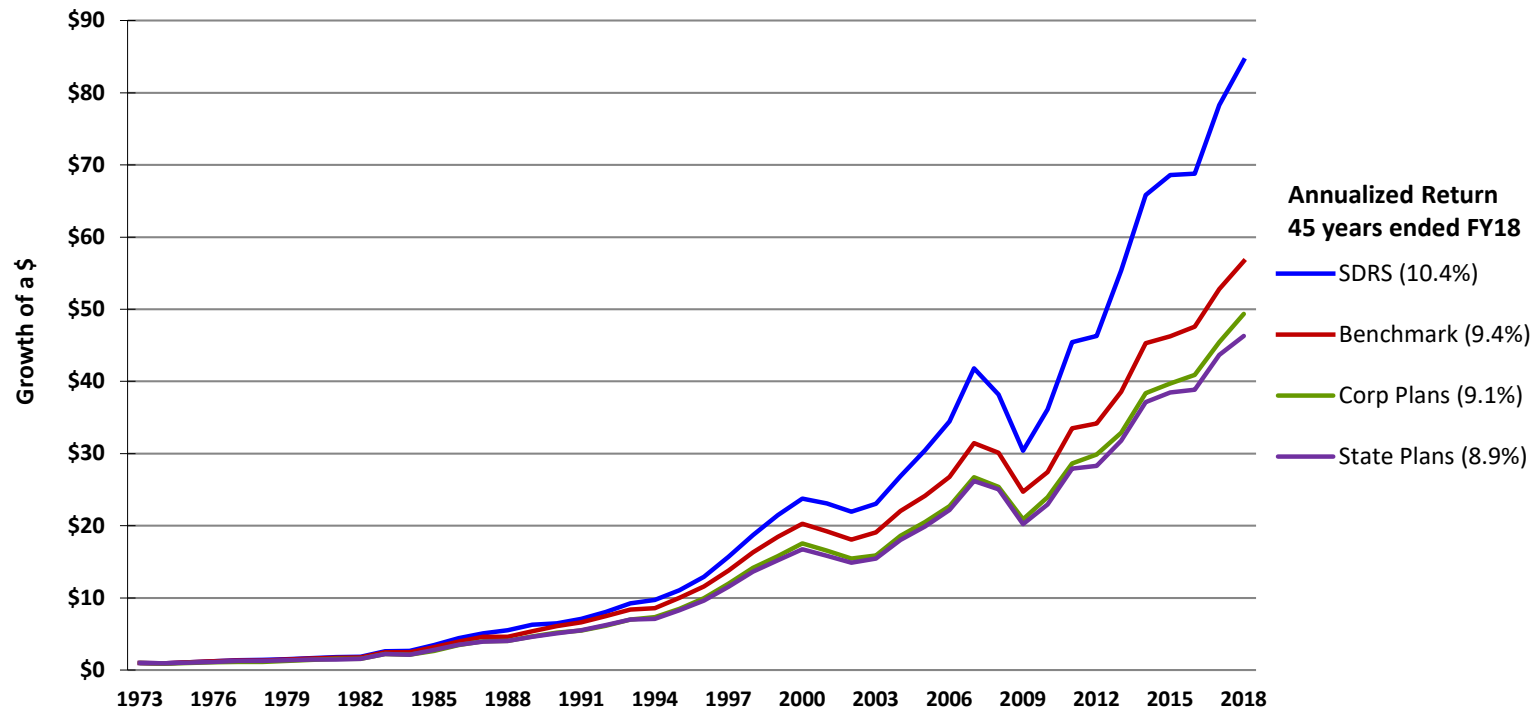
Returns vs. Benchmarks

- Total SDRS dollars earned Fiscal Year 2018 \$ 957 million
- Total SDRS dollars earned last 4 years \$2.935 billion
- Total SDRS dollars earned last 10 years \$7.535 billion
- **Extra earnings** resulting from last 1, 4 and 10 years of performance over benchmark (not including compounding):

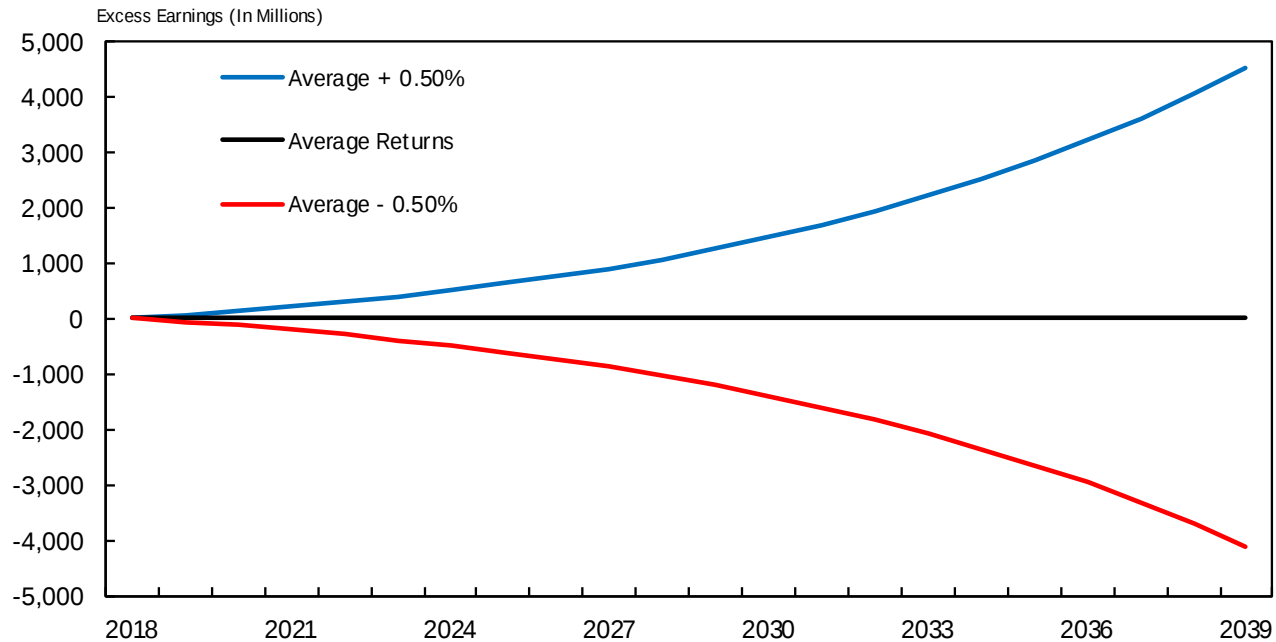
	<u>1 year</u>	<u>4 years</u>	<u>10 years</u>
o vs. Capital Markets Benchmark	\$ 71 million	\$313 million	\$1.466 billion
o vs. State Funds	\$-111 million	\$ 26 million	\$1.325 billion

Superior returns add up over time

Cumulative returns for SDRS, Benchmark, Corporate Plans, and other States



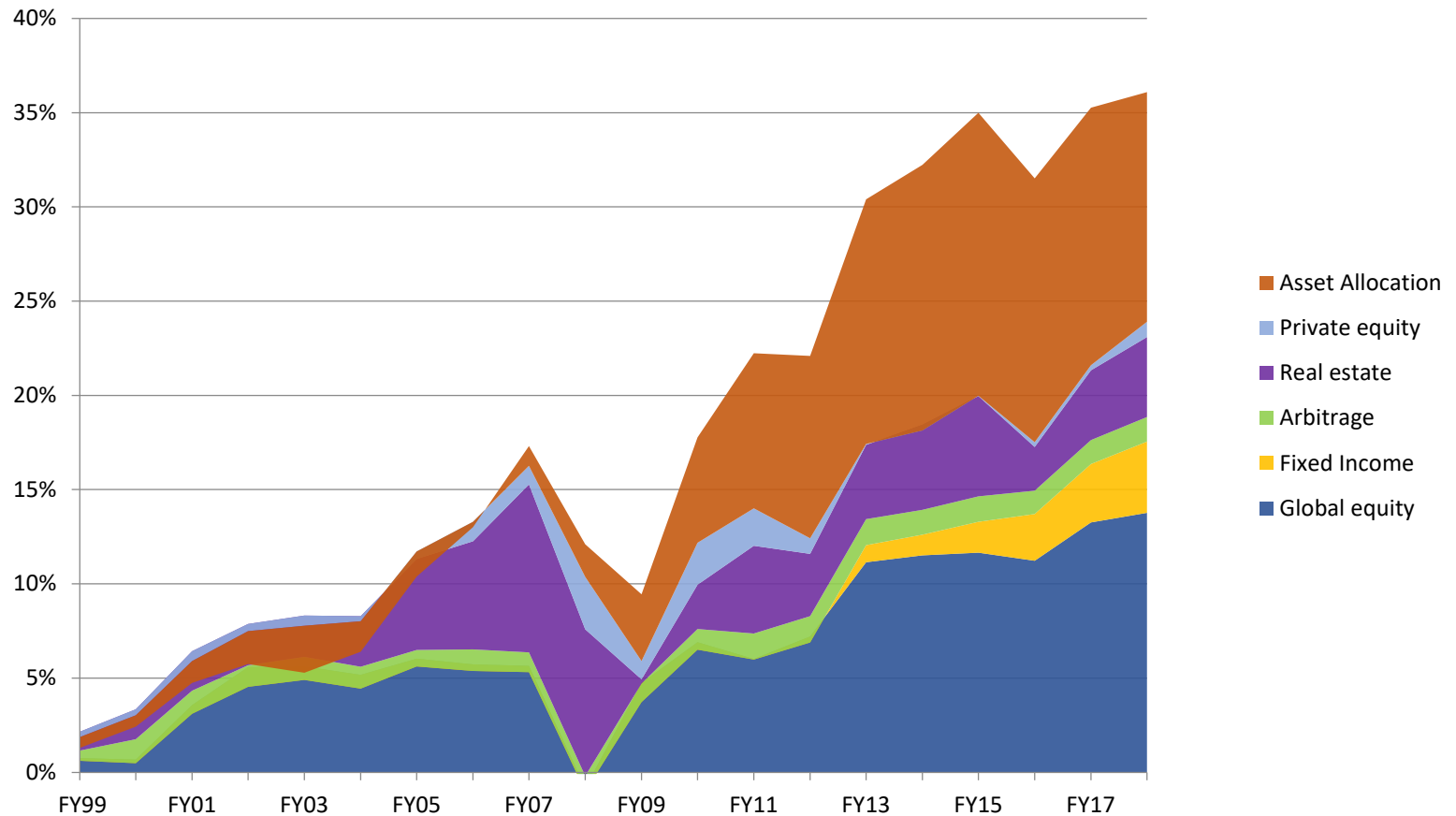
Potential Excess Earnings



- SDIC 45-year outperformance = 1% annualized vs. benchmark
- Outperformance of .5% next 20 years = extra \$4.5 billion
- Underperformance of .5% = cost to retirement system of \$4.1 billion.

Many pistons contribute

Cumulative added value by source FY99 to FY18

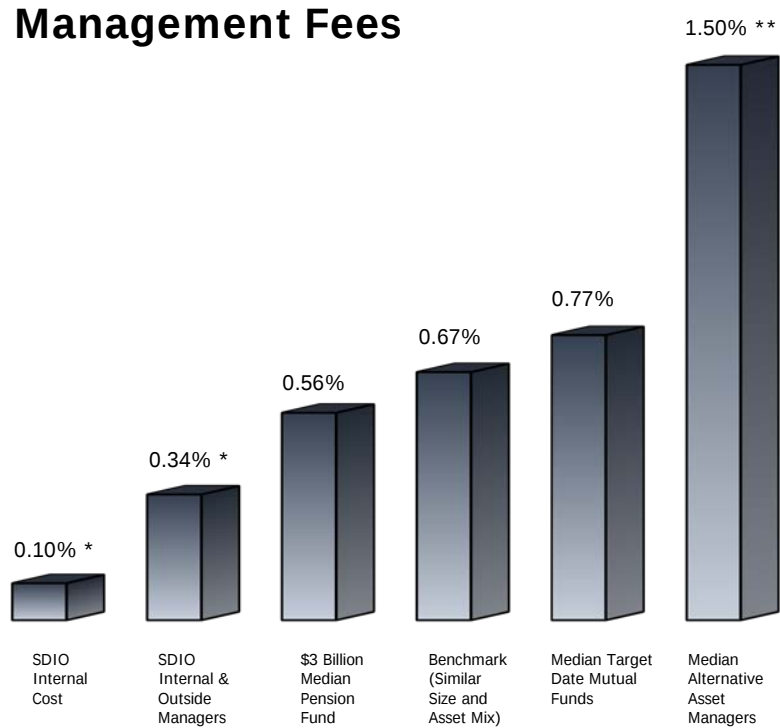


Every asset category has good and bad years

Annual added or detracted value by source

Asset Class	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Global equity	0.8%	-0.1%	2.9%	1.9%	0.0%	-0.4%	0.8%	-0.3%	-0.1%	-6.2%	5.6%	2.1%	-0.8%	1.1%	3.7%	0.3%	0.1%	-0.4%	1.8%	0.5%
Fixed Income	-0.1%	-0.1%	-0.3%	-0.6%	0.3%	0.0%	0.3%	0.1%	0.0%	0.2%	-0.9%	0.6%	0.4%	-0.3%	1.2%	0.2%	0.5%	0.8%	0.6%	0.7%
Arbitrage	0.5%	0.7%	0.0%	-0.1%	0.1%	-0.1%	-0.3%	0.3%	-0.1%	-0.2%	0.2%	0.1%	0.3%	0.0%	0.0%	-0.1%	0.0%	-0.1%	0.1%	0.0%
Real estate	1.0%	0.6%	0.5%	0.1%	0.0%	0.5%	2.1%	0.9%	3.0%	-1.0%	-7.0%	2.1%	2.3%	-1.3%	0.6%	0.6%	0.8%	-2.9%	1.4%	0.5%
Private equity	-0.3%	0.0%	-0.2%	0.2%	-0.2%	0.3%	0.7%	0.6%	-0.1%	1.8%	-1.8%	1.2%	-0.2%	-1.1%	-0.8%	-0.4%	0.3%	0.3%	0.0%	0.5%
Asset Allocation	-0.6%	0.0%	-0.6%	-0.6%	-0.7%	0.8%	0.1%	0.8%	1.0%	1.0%	1.5%	1.4%	1.9%	1.5%	2.1%	0.8%	0.3%	-0.3%	-1.0%	-1.6%
Total	1.3%	1.1%	2.3%	1.0%	-0.4%	1.1%	3.7%	2.4%	3.8%	-4.5%	-2.4%	7.6%	3.8%	-0.1%	6.8%	1.4%	2.1%	-2.6%	2.9%	0.6%

Cost Efficiency



Difference between SDIC cost of .34% and benchmark cost of .67% is \$49 million per year

* SDIC projected expenses for FY 2020 using adjusted assets and expected average performance incentives

** Plus 20% profit participation after preferred return

Long-Term Plan Executive Summary

Projected LTP Budget

	<u>FY 2020</u>	<u>FY 2025</u>	<u>FY 2030</u>
INVESTMENT OFFICE BUDGET			
Personal Services			
Number of Employees	35.25	37.00	35.00
Base Compensation - Total Staff	5,879,642	7,864,836	9,659,299
Staff Attorney (1/4 FTE) & Interns	64,700	27,773	31,041
Investment Council	6,444	7,202	8,049
Flexibility funds-Retirements & Resignations	160,493	179,379	200,488
Investment Incentive Maximum	9,954,950	13,538,532	16,823,113
Benefits	2,499,691	3,301,720	4,043,586
Total Personal Services	18,565,919	24,919,443	30,765,578
Operating Expenses			
Contractual Services	2,117,259	2,338,286	2,585,323
Travel	85,000	95,003	106,182
Office Supplies & Postage	7,000	7,824	8,744
Capital Assets	40,520	52,653	59,484
Total Operating Expenses	2,249,779	2,493,766	2,759,733
Total Investment Council Budget	20,815,698	27,413,209	33,525,311
ASSET SUMMARY *			
Internal Assets	12,513,357,002	15,434,849,543	19,048,502,107
External Assets	3,632,910,097	4,481,085,351	5,530,210,289
Total Assets	16,146,267,100	19,915,934,894	24,578,712,396
EXPENSE SUMMARY			
Internal Expenses	20,815,698	27,413,209	33,525,311
External Manager Fees	39,962,011	49,291,939	60,832,313
Total Expenses	60,777,709	76,705,148	94,357,624
UNIT COST SUMMARY **			
Internal Expenses as % of Total Assets	0.094%	0.099%	0.097%
Total Expenses as % of Total Assets	0.341%	0.346%	0.344%

* Projections based on long-term assumed returns applied to 6/30/18 assets. Updated each June 30.

**Unit Cost Summary uses assumed average investment performance incentives

Note: FY 20 amounts differ from actual budget request. The LTP includes an assumed 2.25% salary policy

Compensation Overview

- Long term results have significantly exceeded benchmarks
 - Added 35% beyond benchmark to SDRS assets in the past 20 years
- Continued success dependent on high caliber team
 - Internally manage most assets using internally generated research
- Future team depends on retention of talent pipeline and trainers
 - Develop internally as cannot compete for top tier experienced talent
- Compensation plan aligned with goal of adding value over long term
 - Motivate superior long-term performance and retain successful staff
- Compensation plan updated in 2013
 - Council target is 70% of cost of living adjusted median industry pay to balance getting a good deal for South Dakota without losing the good deal if we cannot keep our people
 - Incorporates performance incentives
 - 2013 study showed compensation had fallen to 55%.

Compensation Overview, continued

- Council changes implemented in 2014 to get back to target
 - Expanded incentive compensation plan as opposed to adjusting base compensation
 - Incentives expanded to include longer term and stretch incentives and expected to average 80% (0% to 200%)
 - Incentives aligned with the goal of adding value and only paid if add value
- Compensation study updated in 2016
 - Indicated only modest slippage from target
- Cost efficient due to internal management capabilities
 - Securing team to preserve internal capabilities best chance to remain cost efficient
 - Internal cost .1% with expected average incentives

FY 2018 Budget and Actual

	Expended FY 2018	Received FY 2018	Unexpended
PERSONAL SERVICES			
TOTAL FTEs	34.25	34.25	
BASE COMPENSATION			
Base Compensation - Investment Staff	4,528,558	4,965,754	437,196 *
Base Comp - Accountants, Admin, Longevity	427,722	428,982	1,260
TOTAL STAFF - FULL TIME	4,956,280	5,394,736	438,456
P/T Staff Attorney & Interns	57,453	62,527	5,074
Investment Council	2,850	6,227	3,377
Retirement & resignation flexibility funds	0	155,100	155,100
Benefits	1,018,601	1,076,434	57,833
Total Base Compensation	6,035,183	6,695,024	659,840
Investment Performance Incentives			
Maximum Potential Investment Perf Incentive	4,072,212	9,461,327	5,389,115
Benefits	426,748	1,305,663	878,915
Total Investment Performance Incentives	4,498,960	10,766,990	6,268,030
Total Personal Services	10,534,143	17,462,014	6,927,871
OPERATING EXPENSES			
Contractual Services	1,572,594	1,729,197	156,603
Travel	56,549	85,000	28,451
Office Supplies & Postage	3,948	12,733	8,785
Capital Assets	59,194	40,520	(18,674)
Total Operating Expenses	1,692,285	1,867,450	175,165
TOTAL BUDGET	12,226,429	19,329,464	7,103,035

* Includes \$55,634 Allianz reimbursement & unused compensation

Note: Budget is funded as needed and ended year with a cash balance of \$2,451,347 which is credited against FY 2019 authorized budget

FY 2020 Budget Request

Summary

	<u>Received FY 2019</u>	<u>Request FY 2020</u>	<u>% change</u>
PERSONAL SERVICES			
TOTAL FTEs	34.25	35.25	
BASE COMPENSATION			
Base Compensation - Investment Staff	4,977,473	5,161,675	3.70%
Base Comp - Accountants, Atty, Admin, Longevity	601,764	597,219	-0.76%
TOTAL STAFF - FULL TIME	5,579,237	5,758,894	3.22%
P/T Staff Attorney & Interns	63,277	63,277	0.00%
Investment Council	6,301	6,301	0.00%
Retirement & resignation flexibility funds	156,961	156,961	0.00%
Benefits	1,075,711	1,108,847	3.08%
Total Base Compensation	6,881,487	7,094,281	3.09%
Investment Performance Incentives			
Maximum Potential Investment Perf Incentive	9,931,508	9,954,945	0.24%
Benefits	1,370,548	1,373,782	0.24%
Total Investment Performance Incentives	11,302,056	11,328,728	0.24%
Total Personal Services	18,183,543	18,423,009	1.32%
OPERATING EXPENSES			
Contractual Total (see next page for further details)	1,864,960	2,117,259	13.53%
Travel	85,000	85,000	0.00%
Office Supplies & Postage	9,000	7,000	-22.22%
Capital Assets	40,520	40,520	0.00%
Total Operating Expenses	1,999,480	2,249,779	12.52%
TOTAL BUDGET	20,183,023	20,672,788	2.43%
UNIT COST SUMMARY *			
Internal Expenses as % of Total Adjusted Assets	0.094%	0.094% **	
Total Expenses as % of Total Adjusted Assets	0.341%	0.341%	

* Based on total assets adjusted to long-term value and expenses using assumed average investment performance incentives

** Unit cost includes an assumed 2.25% salary policy

FY 2020 Budget Request

Contractual services detail

	<u>Received</u> <u>FY 2019</u>	<u>Request</u> <u>FY 2020</u>	<u>% chng</u>
CONTRACTUAL SERVICES			
Investment Services			
Consulting Services	80,000	130,000	62.50%
Accounting, Benchmarking, Risk Systems	113,100	292,977	159.04%
Investment Databases, Newsfeeds, Quote Fees	553,636	555,436	0.33%
Investment Research Services	387,525	394,025	1.68%
Flexibility - From Brokerage to Independent Research	100,000	100,000	0.00%
Total Investment Services	<u>1,234,261</u>	<u>1,472,438</u>	<u>19.30%</u>
Administrative Expenses			
Office Rent	134,609	139,019	3.28%
Bond/Liability Insurance	8,190	8,385	2.38%
Telephone	18,000	18,000	0.00%
Office Equip Rental/Maintenance/Misc	6,003	10,000	66.58%
Bureau of Info & Telecommunications (BIT)	73,530	73,530	0.00%
State Central Services	12,858	12,858	0.00%
Legislative Audit	51,500	51,500	0.00%
Attorney General's Office - Legal Services	18,509	18,509	0.00%
Custodial Fees - Global	271,000	276,520	2.04%
Seminars/Educational Programs	33,500	33,500	0.00%
Business Publications	3,000	3,000	0.00%
Total Administrative Expenses	<u>630,699</u>	<u>644,821</u>	<u>2.24%</u>
TOTAL CONTRACTUAL SERVICES	<u>1,864,960</u>	<u>2,117,259</u>	<u>13.53%</u>