



State Investment Fund
Fiscal Year Ended June 30, 2013



State Investment Fund

Management Discussion and Analysis

Management Discussion and Analysis provides general information on the financial activities of the State Investment Fund (SIF). The SIF temporarily invests the operating funds of the State of Wisconsin and agencies, the Wisconsin Retirement System (WRS), and various local government units (Local Government Investment Pool – LGIP). The table below provides information about ownership at June 30.

Following this section are the financial statements and notes to the financial statements. The **Statement of Net Position** provides information on the types of assets and the liabilities of the SIF. The **Statement of Operations and Changes in Net Position** provides information on the net income of the SIF and its net position at year end. The **Notes to the Financial Statements** provide additional information that is essential to a full understanding of the data provided in the SIF financial statements. The table entitled **SIF Condensed Financial Information** contains a summary for the fiscal years ended June 30, 2013 and 2012 (for comparison).

Because the SIF is used to temporarily invest participants' operating cash flows, investments are in

highly liquid, short-term fixed income securities. At June 30, 2013, SIF Net Position had increased by \$2.311 billion from the prior year due to the combined increase in the State of Wisconsin and agencies (+\$1.290 billion), the WRS (+\$693 million), and the LGIP (+\$328 million) balances. The SIF Average Daily Balance increased by \$1.226 billion in the current fiscal year compared to the prior year. The monthly average balance peaked at \$10.229 billion in March 2013.

The Net Income increase of 31.4% from the previous fiscal year was largely due to an Average Daily Balance increase of 17.3% to \$ 8.318 billion. The Time Weighted Return remained low at 0.15% due to the ongoing low interest rate environment caused by the Federal Reserve continuing to maintain the federal funds rate "target range" to between zero and 0.25% since December 16, 2008. For fiscal year 2013, the average federal funds effective rate was 0.14%. Investment Expenses increased by 356.2% during fiscal year 2013 because \$1,201,076 of Management Operating Expenses allocated to the SIF in the prior year were charged against a reserve balance which had accumulated over the years. During fiscal year 2013, Management Operating Expenses allocated to the SIF were charged against the remaining reserve balance of \$84,329.

SIF Condensed Financial Information

| Fiscal Year Ended | 2013 | 2012 | % Change |
|-------------------------------|------------------|------------------|----------|
| Total Assets | \$ 9,273,688,319 | \$ 6,951,887,107 | 33.4 |
| Total Liabilities | 122,614,319 | 111,505,107 | 10.0 |
| Net Position | \$ 9,151,074,000 | \$ 6,840,382,000 | 33.8 |
| Investment Income | \$ 13,976,289 | \$ 10,504,745 | 33.0 |
| Investment Expenses | 1,580,035 | 346,315 | 356.2 |
| State Working Bank Charges | 2,843,631 | 2,889,287 | (1.6) |
| Net Income | \$ 9,552,623 | \$ 7,269,143 | 31.4 |
| Average Daily Balance | \$ 8,317,930,810 | \$ 7,091,886,359 | 17.3 |
| Weighted Avg. Maturity (WAM) | 34 DAYS | 75 DAYS | |
| SIF Ownership: | | | |
| State of Wisconsin & Agencies | 46% | 42% | |
| Wisconsin Retirement System | 24% | 23% | |
| Local Govt Investment Pool | 30% | 35% | |
| Total | 100% | 100% | |

SIF Annualized Time Weighted Returns

| Fiscal Year Ended | % Return |
|-------------------|----------|
| 2004 | 1.03 |
| 2005 | 2.08 |
| 2006 | 4.23 |
| 2007 | 5.40 |
| 2008 | 4.02 |
| 2009 | 1.33 |
| 2010 | 0.25 |
| 2011 | 0.19 |
| 2012 | 0.14 |
| 2013 | 0.15 |

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Statement of Net Position

As of June 30, 2013 (with Comparative Amounts as of June 30, 2012)

| | June 30, 2013 | June 30, 2012 |
|---|-------------------------|-------------------------|
| Assets | | |
| Investments (at fair value): | | |
| Repurchase Agreements | \$ 5,291,000,000 | \$ 1,631,000,000 |
| Government & Agencies | 3,910,778,873 | 4,075,664,223 |
| Certificates of Deposit | 25,800,000 | 24,150,000 |
| Banker's Acceptances | 45,987,078 | 19,537,012 |
| Bank Demand Deposits | <u>0</u> | <u>1,200,000,000</u> |
| Total Investments | 9,273,565,951 | 6,950,351,235 |
| Other Assets: | | |
| Accrued Interest Receivable | <u>122,368</u> | <u>1,535,872</u> |
| Total Assets | <u>9,273,688,319</u> | <u>6,951,887,107</u> |
| Liabilities | | |
| Payable for Investments Purchased | 3,572,424 | 0 |
| Check Float Invested | 118,483,270 | 110,675,048 |
| Earnings Distribution Payable | 430,105 | 710,737 |
| Accrued Expenses | <u>128,520</u> | <u>119,322</u> |
| Total Liabilities | <u>122,614,319</u> | <u>111,505,107</u> |
| NET POSITION | <u>\$ 9,151,074,000</u> | <u>\$ 6,840,382,000</u> |
| Net Position consist of: | | |
| Participating Shares | \$ 9,151,074,000 | \$ 6,840,382,000 |
| Undistributed Unrealized Gains (Losses) | <u>0</u> | <u>0</u> |
| NET POSITION | <u>\$ 9,151,074,000</u> | <u>\$ 6,840,382,000</u> |

The accompanying notes are an integral part of this statement.

State Investment Fund

Financial Statements

State Investment Fund

Statement of Operations and Changes in Net Position

For the Fiscal Year Ended June 30, 2013 (with Comparative Amounts for June 30, 2012)

| | 2013 | 2012 |
|---|-------------------------|-------------------------|
| Investment Income | \$ 13,976,289 | \$ 10,504,745 |
| Investment Expenses | | |
| Management Operating Expenses (Note 2E) | 1,229,545 | 0 |
| Custodial Bank Charges | 181,120 | 121,864 |
| Electronic Services | 168,370 | 222,451 |
| Legal and Consulting Fees | 1,000 | 2,000 |
| Total Expenses | <u>1,580,035</u> | <u>346,315</u> |
| Net Investment Income | 12,396,254 | 10,158,430 |
| State Working Bank Charges | <u>2,843,631</u> | <u>2,889,287</u> |
| Net Income | 9,552,623 | 7,269,143 |
| Distributions Paid and Payable | <u>9,552,623</u> | <u>7,269,143</u> |
| Change in Undistributed Unrealized Gains (Losses) | 0 | 0 |
| Beginning of Period Undistributed Unrealized Gains (Losses) | <u>0</u> | <u>0</u> |
| End of Period Undistributed Unrealized Gains (Losses) | <u>0</u> | <u>0</u> |
| Participant Transactions: | | |
| Receipts by Transfer to Fund | 32,115,484,000 | 31,960,280,000 |
| Disbursements by Transfer from Fund | <u>29,804,792,000</u> | <u>31,660,903,000</u> |
| Net Change in Participating Shares | 2,310,692,000 | 299,377,000 |
| Beginning of Period Participating Shares | <u>6,840,382,000</u> | <u>6,541,005,000</u> |
| End of Period Participating Shares | <u>9,151,074,000</u> | <u>6,840,382,000</u> |
| NET POSITION | <u>\$ 9,151,074,000</u> | <u>\$ 6,840,382,000</u> |

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements

1. Description of Funds

The State Investment Fund (SIF) pools the cash of the State of Wisconsin and its agencies, the Wisconsin Retirement System (WRS), and various local government units (Local Government Investment Pool – LGIP) into a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. Only State of Wisconsin agencies are required to invest their operating cash in the SIF. In the State's Comprehensive Annual Financial Report (CAFR), the SIF is not reported as a separate fund; rather, each State fund's share in the "pool" is reported on the balance sheet as "Cash and Cash Equivalents." Shares of the SIF belonging to other participating public institutions are presented in the Local Government Pooled Investment Fund, an investment trust fund. The staff of the State of Wisconsin Investment Board (SWIB) manages the SIF with oversight by the Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. The SWIB is not registered with the SEC as an investment company.

Wisconsin Statutes 25.17(3)(b), (ba), (bd), and (dg) enumerate the various types of securities in which the SIF can be invested, which include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, the unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States including solvent financial institutions in Wisconsin and bankers acceptances. The Board of Trustees may specifically approve other prudent legal investments.

2. Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements of the investment activity of the SIF are prepared in conformity with accounting principles generally accepted in the United States as prescribed by the Governmental Accounting Standards Board (GASB).

B. Basis of Accounting

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Interest income is accrued as earned.

C. Comparative Information

The financial statements include certain prior year comparative information, but not at the level of detail required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the State Investment Fund's prior year financial statements, from which the comparative information was derived, available at www.swib.state.wi.us.

D. Valuation of Securities

Generally, securities are valued at fair value for financial statement purposes and amortized cost for purposes of calculating income to participants (See Note 3). BNY Mellon, as custodial bank, compiles fair value information for applicable securities by utilizing third party pricing services. The fair value of investments is determined at the end of each month.

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Notes to Financial Statements

U.S. Government/Agency securities and Commercial Paper are priced using matrix pricing. This method estimates a security's fair value by using quoted market prices for securities with similar interest rates, maturities, and credit ratings. Further, short-term debt investments with remaining maturities of up to 90 days are valued using amortized cost to estimate fair value, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors.

Bank Demand Deposits, Repurchase Agreements, non-negotiable Certificates of Deposit and Banker's Acceptances are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. The table entitled **Summary of Information by Investment Classification** contains additional information on SIF holdings as of June 30, 2013.

E. Management Operating Expenses

Management Operating Expenses are SWIB's investment and administrative costs that are allocated to the SIF participants. During fiscal years 2000 to 2011, the billed expense was determined by between 2.75 and 3.25 basis points of assets under management. Unspent billed budget authority was allowed to be carried forward in a reserve held in the

General Fund. In 2011, Wisconsin Act 32 eliminated SWIB's basis point budget process and authorized SWIB's Board to approve the internal operating budget based on operating and staffing needs. In September 2011, the Board approved eliminating the reserve. As a result, the fiscal year 2013 and 2012 Management Operating Expenses allocated to the SIF of \$84,329 and \$1,201,076, respectively, were charged against the reserve, eliminating the reserve balance.

F. State Working Bank Charges

State Working Bank Charges represent charges for various state banking services such as lockbox, ePay, and depository services. These expenses are allocated to SIF participants based on their proportionate usage of banking services and, accordingly, reduce the participant's share of the Net Investment Income.

G. New Accounting Standard

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources as required elements of the financial statements. The implementation of this statement did not impact the

Summary of Information by Investment Classification

June 30, 2013

| Investment Type | Interest Rates % | Maturity Dates | Book Value (Amort. Cost) | Fair Value |
|-----------------------------------|------------------|---------------------|--------------------------|-------------------------|
| Repurchase Agreements | 0.10 - 0.12 | 07/01/13 | \$ 5,291,000,000 | \$ 5,291,000,000 |
| Government & Agencies | 0.02 - 0.46 | 07/01/13 - 05/31/15 | 3,910,778,873 | 3,910,778,873 |
| Certificates of Deposit | 0.20 - 1.00 | 07/15/13 - 06/16/14 | 25,800,000 | 25,800,000 |
| Banker's Acceptances | 0.15 - 0.33 | 07/05/13 - 12/23/13 | 45,987,078 | 45,987,078 |
| Total Investments | | | <u>\$ 9,273,565,951</u> | <u>\$ 9,273,565,951</u> |
| Ratio of Fair Value to Book Value | | | | 100% |

financial position of the SIF. However, the adoption of this statement resulted in presentation changes to replace net assets with net position on the financial statements.

3. SIF Investment Income and Pool Shares

For purposes of calculating earnings to each participant, all investments are valued at amortized cost. Specifically, the SIF distributes income to pool participants monthly, based on their average daily share balance. Distributions include interest income based on stated rates (both paid and accrued), amortization of discounts and premiums on a straight-line basis, realized investment gains and losses calculated on an amortized cost basis, and investment expenses. This method differs from the fair value method used to value investments in these financial statements because the amortized cost method is not designed to distribute to participants unrealized gains and losses generated by the pool's investments. The total difference between the fair values of the investments in the pool and the values distributed to the pool participants using the amortized cost method described above is reported in the equity section of the Statement of Net Position as "Undistributed Unrealized Gains (Losses)".

SIF pool shares are bought and redeemed at \$1.00 based on the amortized cost of the investments in the SIF. The State of Wisconsin does not provide any legally binding guarantees to support the value of pool shares.

4. Deposit and Investment Risk

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. For the SIF, evaluations of levels of diversification,

nominal risk exposures including sector, maturity, and interest rate exposures, and risk/return plots form the core of the monitoring process. In addition, the portfolio is reviewed daily for compliance with investment guidelines. At least quarterly, comprehensive reporting is presented to SWIB's Investment Committee and the Board of Trustees.

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the SIF. The Board established SIF investment guidelines with maximum exposure limits by security type based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations (NRSROs). As of June 30, 2013, these credit ratings and aggregate exposures by investment type are found in the table entitled **Credit Quality Distribution for Securities**.

B. Custodial Credit Risk

Deposits — Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. SWIB does not have a deposit policy specifically for custodial credit risk. As of June 30, 2013, the SIF held Certificates of Deposit (CD) with a value of \$25,800,000 invested pursuant to the Wisconsin Certificate of Deposit Program (administered by Bankers' Bank) established in July 1987. Investment guidelines provide that to be accepted into this program, banks must accept deposits in Wisconsin and meet credit-screening criteria designed to assure the safety of the deposits.

The Federal Deposit Insurance Corporation (FDIC) insures the pro rata share of Certificates of Deposit held by the LGIP up to \$250,000, and the State of Wisconsin appropriation for losses on public deposits protects a depositing municipality up to \$400,000 if the local governing body has designated the LGIP

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Notes to Financial Statements

Credit Quality Distribution for Securities

As of June 30, 2013

| Investment Type | Rating | Fair Value | % |
|--|--------|-------------------------|--------------|
| Repurchase Agreements (Collateral): | | | |
| U.S. Government Debt | AA | \$ 4,686,000,000 | 50.5 |
| Government Sponsored Entity U.S. Agency | AA | 605,000,000 | 6.5 |
| U.S. Treasury: | | | |
| Short-Term (Bills) | A-1+ | 699,785,556 | 7.6 |
| Long-Term (Notes) | AA+ | 49,943,965 | 0.5 |
| Government Sponsored Entity U.S. Agency: | | | |
| Federal Home Loan Bank (FHLB) | A-1+ | 913,428,575 | 9.9 |
| Federal Home Loan Mortgage Corp (FHLMC) | A-1+ | 1,121,860,966 | 12.1 |
| Federal Home Loan Mortgage Corp (FHLMC) | AA+ | 25,000,000 | 0.3 |
| Federal National Mortgage Association (FNMA) | A-1+ | 1,050,759,811 | 11.3 |
| Federal National Mortgage Association (FNMA) | AA+ | 50,000,000 | 0.5 |
| Certificates of Deposit: | | | |
| Non-Negotiable (Wisconsin CD Program) | NR | 25,800,000 | 0.3 |
| Banker's Acceptances | A-1+ | 45,987,078 | 0.5 |
| Total Investments | | <u>\$ 9,273,565,951</u> | <u>100.0</u> |

as a public depository. Approximately \$25,800,000 is insured through FDIC insurance and the State of Wisconsin appropriation for losses on public deposits. The actual coverage of these deposits can fluctuate daily based on the allocable share of participants' accounts.

C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The SIF's investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or issue exposure limits based on credit rating. These guidelines do

not place a limit on maximum exposure for any U.S. Treasury or Agency securities. As of June 30, 2013 the SIF has more than five percent of its investments in FHLB (9.9%), FHLMC (12.4%), FNMA (11.8%), and Repurchase Agreement collateral consisting of various securities issued by these same three U.S. Agencies (6.5%). Since the Repurchase Agreements mature each day, new collateral, consisting of a different blend of U.S. Treasury and Agency securities, is assigned each night.

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an

Weighted Average Maturities (WAM) for Securities

June 30, 2013

| Investment Type | Fair Value | WAM (Days) |
|--|-----------------------------|---------------|
| Repurchase Agreements | \$ 5,291,000,000 | 1 |
| Government & Agencies | 3,910,778,873 | 78 |
| Certificates of Deposit | 25,800,000 | 125 |
| Banker's Acceptances | <u>45,987,078</u> | 77 |
| Total Investments | <u>\$ 9,273,565,951</u> | |
| Portfolio Weighted Average Maturity (Days) | | <u>34</u> |

investment. The SIF uses the Weighted Average Maturity (WAM) method to analyze interest rate risk and investment guidelines mandate that the WAM for the entire portfolio will not exceed one year. SIF WAM summary by investment type is found in the table entitled **Weighted Average Maturities (WAM) for Securities**.

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SIF guidelines allow the investment in U.S. dollar denominated issues only.

5. Related Party Transactions

Wisconsin Statutes Chapter 20.002 (11) provides for the short-term temporary reallocation of surplus moneys between statutory funds, provided that the borrowing fund anticipates receiving future revenues to pay back the temporary loan. For Fiscal Year 2013, Chapter 20.002 (11) (b) 2 provides that General Fund borrowings may not exceed 9% of defined revenues (estimated borrowing cap of \$1.329 billion). Chapter 20.002 (11) (b) 3 permits an

additional temporary allocation not to exceed 3% of defined revenues for a period of up to 30 days (estimated total borrowing cap of \$1.772 billion). Further, Chapter 20.002 (11) (b) 1 limits the total amount of any temporary reallocations to a fund other than the General Fund to \$400 million. The borrowing fund is charged interest on the inter-fund loan at the SIF monthly interest rate. As of June 30, 2013 the amount of inter-fund borrowings between statutory funds invested in the SIF is listed in the table entitled **Inter-Fund Loans**.

Inter-Fund Loans

June 30, 2013

| Fund | Loan Amount |
|-------------------------------|---------------------------|
| Medical Assistance Trust Fund | \$ 232,817,000 |
| Environmental Fund | 7,991,000 |
| Democracy Trust Fund | <u>1,000</u> |
| Total Loans | <u>\$ 240,809,000</u> |