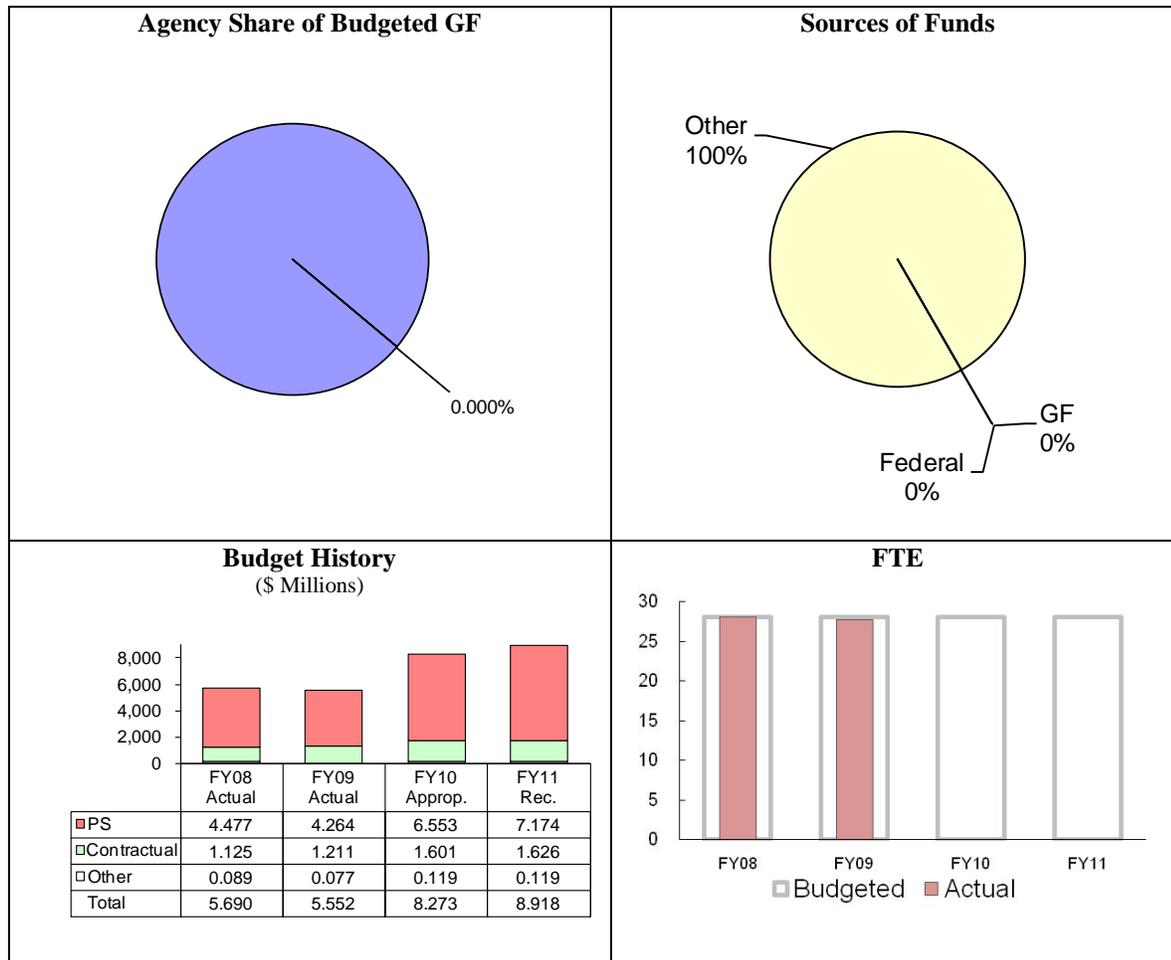


FY11 Budget Briefing

State Investment Council



Key Responsibilities

The State Investment Council manages the investments for the South Dakota Retirement System, the South Dakota Cement Plant Retirement Fund, the cash flow fund, the School and Public Lands Fund, the Dakota Cement Trust, the Health Care Trust Fund, and the Education Enhancement Trust Fund. The council also oversees the Higher Education Savings Plan.

Investment Council

The State Investment Council, authorized by SDCL 4-5-12 to 4-5-39, inclusive, is composed of eight members, five of whom are appointed by the Executive Board of the Legislative Research Council. The remaining three members are the State Treasurer, the Commissioner of School and Public Lands, and a representative of the state retirement system. The council appoints the state investment officer and formulates investment policy pertaining to the kinds and the methods of investment.

The agency is funded primarily from the interest and investment earnings derived from the managed funds. For FY11, the Governor recommends \$8,917,882 and 28.0 FTEs. This is an increase of \$644,845 (7.8%) from FY10.

	Actual	Budgeted	Agency Req.	Gov Rec.	Inc/Dec	% Change
	FY08	FY09	FY10	FY10	FY10	from FY09
Personal Services	4,263,771	6,553,353	7,330,315	7,173,564	620,211	9.5%
Travel	45,132	73,000	73,000	73,000	-	0.0%
Contractual Services	1,211,240	1,601,156	1,625,790	1,625,790	24,634	1.5%
Supplies & Materials	12,655	14,148	14,148	14,148	-	0.0%
Grants And Subsidies	-	-	-	-	-	0.0%
Capital Outlay	19,401	31,380	31,380	31,380	-	0.0%
Other	-	-	-	-	-	0.0%
Total	5,552,199	8,273,037	9,074,633	8,917,882	644,845	7.8%
Funding Types						
General	-	-	-	-	-	0.0%
Federal	-	-	-	-	-	0.0%
Other	5,552,198	8,273,037	9,074,633	8,917,882	644,845	7.8%
Total	5,552,198	8,273,037	9,074,633	8,917,882	644,845	7.8%
FTE	27.7	28.0	28.0	28.0	-	0.0%

Salary Policy

	General Funds	Federal Funds	Other Funds	Total
0% PACE Movement	-	-	-	-
0% Across-the-Board	-	-	-	-
Health Insurance	-	-	10,136	10,136
Total	-	-	10,136	10,136

Excess Personal Services Agency History

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>All Funds</u>	<u>FTE</u>
FY09	0.00	0.00	2,289,582.07	2,289,582.07	0.3
FY08	0.00	0.00	1,374,226.34	1,374,226.34	-
FY07	0.00	0.00	1,370,393.38	1,370,393.38	1.6
FY06	0.00	0.00	1,300,590.07	1,300,590.07	0.8
FY05	0.00	0.00	1,231,642.37	1,231,642.37	1.8
5 Yr Avg.	0.00	0.00	1,513,286.85	1,513,286.85	0.9

Department's FY10 Highest Priorities

None presented.

Expansions and Reductions

Budget Item	Governor's Recommendation		
	State General Fund	All Funds	FTE
A. Agency salary policy		620,211	
B. Contractual Services		24,634	
Total	0	644,8455	

- A. Salary policy based on prior Deloitte study and approved by Executive Council. See narrative appended to this analysis for more detail.
- B. A combination of several items with the largest part being to support investment research services. See narrative appended to this analysis for more detail.

Revenues -12/2/08

	Actual FY08	Actual FY09	Estimated FY10	Estimated FY11
Investment Management Fees:				
Retirement System (SDRS)	4,698,633	5,121,712	4,314,676	7,000,173
Cement Plant	29,549	33,970	27,801	45,373
Cash Flow Fund (CFF)	522,557	580,583	698,813	1,133,422
School and Public Lands (S&PL)	111,196	118,081	108,178	175,140
Dakota Cement Trust (DCT)	173,404	179,930	155,655	253,182
Education Enhancement Trust (EET)	250,581	262,232	227,174	368,430
Health Care Trust (HCT)	63,660	69,159	61,125	98,913
TOTALS	5,849,580	6,365,667	5,593,422	9,074,633

Selected Statistical Data -12/2/08

	Actual FY07	Actual FY08	Estimated FY09	Estimated FY10
SDRS Yr-End Assets/Inv Income (Millions)	7,300/-693	5,640/-1,478		0
SDRS Total Fund Return	-8.65%	-20.36%		0
SDRS Capital Mkt Benchmark/Mellon Corp	-4.20%/-5.02%	-18.0%/-17.64%		0
CPRF Yr-End Assets/Inv Income (Millions)	47.3/-4.6	35.6/-9.3		0
CPRF Total Fund Return/Benchmark Return	8.35%/-4.12%	19.98%/-17.89%		0
CFF Average Amount Invested (Millions)	898.00	966.00		0
CFF Investment Income (Millions)	56.10	57.60		0
CFF Average Yield/Benchmark Yield	4.96%/4.25%	4.51%/1.63%		0
S&PL Yr-End Assets/Invest Income (Millions)	168.9/-10.6	139.1/-26.0		0
S&PL Total Fund Return/Benchmark Return	-5.85%/-1.51%	-14.6%/-12.7%		0
DCT Yr-End Assets/Invest Income (Millions)	250.9/-16.9	195.0/-41.7		0
DCT Total Fund Return/Benchmark Return	-6.13%/-1.51%	-16.6%/-12.7%		0
EET Yr-End Assets/Invest Income (Millions)	383.8/-27.3	302.5/-64.5		0
EET Total Fund Return/Benchmark Return	-6.65%/-2.02%	-17.5%/-12.6%		0
HCT Yr-End Assets/Invest Income (Millions)	101.5/-6.2	82.3/-15.0		0
HCT Total Fund Return/Benchmark Return	-5.74%/-1.51%	-15.4%/-12.7%		0

Other Departmental Issues

None.

Salary Policy Narrative – Prepared by Investment Council

Though the budget is broken out by line item, the Investment Officer uses individual discretion for compensation increases based upon assessments of the competitive nature of the position within the investment industry, as well as individual performance and changing job responsibilities.

The full time/salaries budget includes FY 2011 base salaries of \$3,461,154, a maximum potential investment performance incentive amount of \$2,808,345, and longevity of \$6,335.

BASE SALARIES: The base salaries budget is increasing 8.92%. This includes a 3% increase for all 28 positions. The senior investment positions (7) increase by an additional 1.8% in accordance with our long-term plan to keep up with investment industry compensation. The newer to intermediate level investment team members (15) increase the additional 1.8% plus a further 5.2% to 15% for promotion increases as they transition through the steep learning curve from entry level to senior investment team members. The investment accounting positions (4) are increasing an additional 2.6% to 5.4% above the 3% to more closely reflect industry compensation levels for accountants with CPA designations and their increased years of experience. It is the intent that the 3% across the board increase will be adjusted to the level of the approved salary policy for state employees. It is also the intent that if a zero state-wide salary policy is approved, the 1.8% percent portion of increases for investment positions would be removed, thus senior investment positions would receive no base salary increase of any kind.

INVESTMENT INCENTIVE: The \$2,808,345 for potential investment incentives totals 100% of FY2010 base salaries of the qualifying positions as the incentive is a function of the prior year's base salary. Included is \$388,356 for the Investment Officer's potential incentive. This plan was negotiated and adopted by the Investment Council and Executive Board of the LRC in 1982 and most recently modified in 2006. It is reviewed annually by the Investment Council and the Executive Board. The investment incentive is paid only if earned by superior performance versus capital market benchmarks (one-third of incentive tied to one year results, two-thirds to four-year results). The remaining \$2,419,989 is allocated to an incentive pool affecting 21 investment positions. These incentives will reward outperformance of capital market benchmarks and will range from 0% to a maximum of 100%. Although incentives are budgeted at 100% of the prior year's base salary, the newer qualifying positions are phased into the program over the first few years at lower maximum percentages. The incentive funds unearned remain part of the cash balance and are applied to the next year's budget authorization. Typically, due to historically superior performance, the average earned incentive across all positions in total has averaged 40% to 60% of the maximum.

LONGEVITY: It is anticipated that the 16 employees receiving longevity pay in FY2010 will continue their employment with the Investment Office in FY2011. Six additional employees will be eligible in FY 2011.

BOARD & COMM MEMBERS: Five of the eight Investment Council members receive the daily rate (\$75) for all Investment Council meeting days, all telephone conference calls, subcommittee meetings and appearances at legislative committee meetings.

BENEFITS: Benefit adjustments were made to current staff according to the calculations provided by the Bureau of Finance and Management. Twenty-one positions reach the maximum for social security in their base salaries plus incentives.

GOVERNOR'S SALARY POLICY RECOMMENDATION: Due to the Governor's recommended 0% salary policy, the request has been reduced by \$166,887 for the 3% across the board increase and the 1.8% increase for senior investment staff. The total personal services increase recommended is \$610,075 for promotion, incentive, and longevity pay.

Contractual Services Narrative – Prepared by Investment Council

Increase in subscriptions by \$200 to current expenditures. Computer services increasing by \$2,498 and Audit Services by \$1,082 to reflect the expected costs as provided by BIT and Legislative Audit, respectively. Increase of \$180 for the Public Entity Pool for Liability Fund (\$195 per 28 FTE & 8 board members).

Other Contractual Services for all investment research services netted to an increase of \$20,674. Pension Fund Data Exchange increased by \$500, S&P 1200 by \$2,000, Bloomberg by \$7,938, quote fees by \$11,387, Dow Jones News by \$1,657, to reflect the expected costs. Vista Research decreased by \$20,000 due to negotiations. Center for Financial Research/Analysis was cancelled (\$27,783). Thomson One, Thomson Analytics, and Research Insight, were replaced by FactSet and Reuters for an additional \$17,715. Three investment research products were added, First

Rain \$14,000, Morningstar Equity \$30,000 and The Markets.com \$13,260. The flexibility line item for independent research was decreased by \$30,000.

In FY 2008, the Investment Office began shifting some of its brokerage research (provided through brokerage relationships/trading commissions) to independent research and has used \$104,000 of the \$310,000 designated for this purpose. The brokerage industry is shifting away from providing research, partly in response to the investment scandals of recent years. It is believed necessary to improve our research sources through independent services. No additional increase is being requested in the FY 2011 budget request, although our expectation is that over time we will continue to shift further toward independent research and additional funding will be needed.