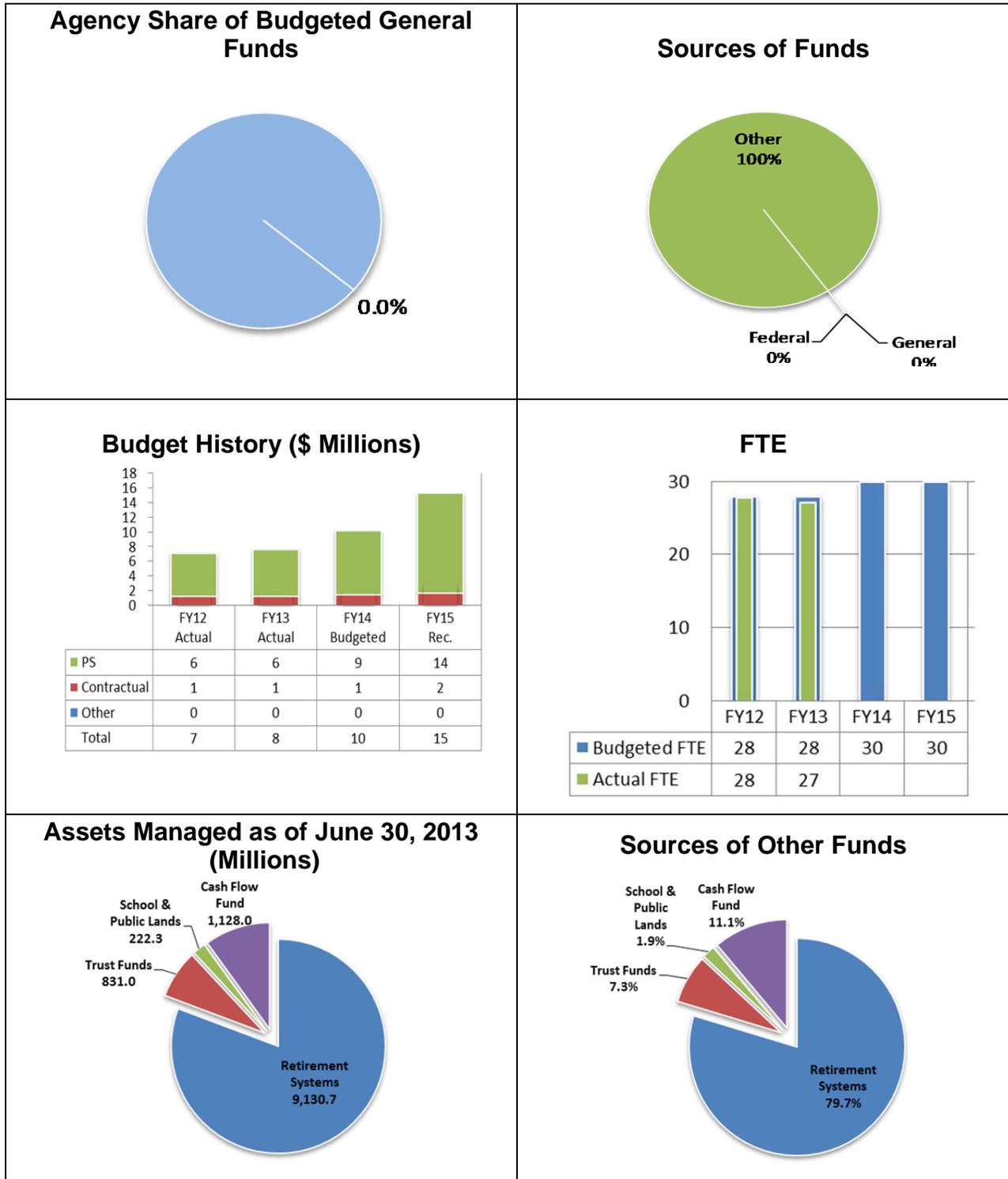


FY15 Budget Briefing

State Investment Council

Information contained in this document is based on the Governor's original FY15 recommended budget.
This document may not correspond with the FY15 budget adopted by the Legislature.



Key Personnel

- Matthew L. Clark, State Investment Officer
- Christopher L. Nelson, Assistant Investment Officer
- Laurie A. Riss, Business Manager
- Brett D. Fligge, Assistant Investment Officer
- Tammy V. Otten, Assistant Investment Officer

Investment of State Funds

	Actual FY2012	Actual FY2013	Budgeted FY2014	Gov Rec FY2015	Rec % Change Inc/Dec FY2015	From FY2014
Personal Services						
Employee Salaries	3,419,356	3,469,230	4,191,927	4,452,358	260,431	6.2%
Employee Benefits	644,429	694,375	792,397	821,886	29,489	3.7%
FTE	27.9	27.2	30.0	30.0	0.0	0.0%
Funding Types						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other	4,063,785	4,163,605	4,984,324	5,274,244	289,920	5.8%
Total PS	4,063,785	4,163,605	4,984,324	5,274,244	289,920	5.8%
Operating Expenses						
Travel	60,739	57,086	85,000	85,000	0	0.0%
Contractual Services	1,207,608	1,221,329	1,434,815	1,555,875	121,060	8.4%
Supplies & Materials	9,150	12,131	12,733	12,733	0	0.0%
Capital Outlay	13,011	27,970	48,500	43,000	(5,500)	(11.3%)
Funding Types						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other	1,290,509	1,318,516	1,581,048	1,696,608	115,560	7.3%
Total OE	1,290,509	1,318,516	1,581,048	1,696,608	115,560	7.3%
Totals						
Funding Types						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other	5,354,294	5,482,121	6,565,372	6,970,852	405,480	6.2%
Total	5,354,294	5,482,121	6,565,372	6,970,852	405,480	6.2%

Performance Based Compensation

	<u>Actual</u> <u>FY2012</u>	<u>Actual</u> <u>FY2013</u>	<u>Budgeted</u> <u>FY2014</u>	<u>Gov Rec</u> <u>FY2015</u>	<u>Rec % Change</u> <u>Inc/Dec</u> <u>FY2015</u>	<u>From</u> <u>FY2014</u>
Personal Services						
Employee Salaries	1,595,763	1,985,287	3,261,124	7,323,946	4,062,822	124.6%
Employee Benefits	219,418	273,969	448,582	1,010,705	562,123	125.3%
FTE	0.0	0.0	0.0	0.0	0.0	0.0%
Funding Types						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other	1,815,181	2,259,256	3,709,706	8,334,651	4,624,945	124.7%
Total PS	1,815,181	2,259,256	3,709,706	8,334,651	4,624,945	124.7%
Totals						
Funding Types						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other	1,815,181	2,259,256	3,709,706	8,334,651	4,624,945	124.7%
Total	1,815,181	2,259,256	3,709,706	8,334,651	4,624,945	124.7%

Budget Notes:

Performance Based Compensation allows the Investment Council to:

- Link a portion of total compensation to investment return relative performance;
- To motive investment team members and retain those who add value;
- To focus on long-term investing; and
- To encourage adding value in all financial market conditions.

Department Object Detail

Item	Actual FY2012	Actual FY2013	Budgeted FY2014	Governor		% Change FY2014
				Rec FY2015	Inc/Dec FY2014	
PERSONAL SERVICES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	5,878,966	6,422,861	8,694,030	13,608,895	4,914,865	56.5%
Total Personal Services	5,878,966	6,422,861	8,694,030	13,608,895	4,914,865	56.5%
FTE	27.9	27.2	30.0	30.0	0.0	0.0%
TRAVEL						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	60,739	57,086	85,000	85,000	0	0.0%
Total Travel	60,739	57,086	85,000	85,000	0	0.0%
CONTRACTUAL SERVICES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	1,207,608	1,221,329	1,434,815	1,555,875	121,060	8.4%
Total Contractual Services	1,207,608	1,221,329	1,434,815	1,555,875	121,060	8.4%
SUPPLIES AND MATERIALS						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	9,150	12,131	12,733	12,733	0	0.0%
Total Supplies and Materials	9,150	12,131	12,733	12,733	0	0.0%
GRANTS AND SUBSIDIES						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	0	0	0	0	0	0.0%
Total Grants and Subsidies	0	0	0	0	0	0.0%
CAPITAL OUTLAY						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	13,011	27,970	48,500	43,000	(5,500)	(11.3%)
Total Capital Outlay	13,011	27,970	48,500	43,000	(5,500)	(11.3%)
OTHER						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	0	0	0	0	0	0.0%
Total Other	0	0	0	0	0	0.0%
TOTAL						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	7,169,474	7,741,377	10,275,078	15,305,503	5,030,425	49.0%
Total All Funds	7,169,474	7,741,377	10,275,078	15,305,503	5,030,425	49.0%

Major Expansions and Reductions

Budget Item	Governor's Recommendation	
	Other Funds	FTE
A. Investment Council		
Personnel Services	289,920	-
Operating Expenses	115,560	-
Performance Based Compensation	4,624,945	-
Total	5,030,425	-

Budget Notes:

The Governor is recommending an increase of \$289,920 in other fund expenditure authority for personal services promotional development and salary adjustments based on the SDIC's long-term compensation plan and \$115,560 for operating expenses in FY15.

The Governor is also recommending an increase of \$4,624,945 in other fund expenditure authority for Performance Based Compensation within the SDIC.

INVESTMENT COUNCIL

The mission of the Investment council is to:

- To professionally manage the South Dakota Retirement System and South Dakota Cement Plant Retirement Fund portfolios in order to obtain long-term maximum total returns consistent with prudent risk;
- To professionally manage the state's cash flow fund in order to obtain long-term maximum total returns consistent with the liquidity needs of the fund, the legal list and prudent risk;
- To professionally manage the investment portfolios of the School and Public Lands Fund, the Dakota Cement Trust, the Health Care Trust and the Education Enhancement Trust to obtain the highest risk adjusted return over the long term and to provide income payouts;
- To oversee the Higher Education Savings Plan per SDCL 13-63-1 to 13-63-31 by establishing the program and monitoring the selected program manager, Allianz Global Investors Distributors LLC; and
- To comply with SDCL 3-13-51.2 regarding Section 457 deferred compensation plan investment options; and, to comply with the requirements of SDCL 4-5-12 to 4-5-39, "Investment of State Funds Law".

Narrative – Provided by Investment Council

✓ **Personal Services:**

This FY 2014 budget request was approved by the Investment Council and the LRC Executive Board on August 20, 2012.

For investment position salaries, total compensation consists of base salaries and investment performance based incentive pay. The Investment Council targets a 30% discount after cost-of-living adjustments to the private sector for investment positions total compensation. The compensation study completed in April 2013 indicated total compensation is at 55% rather than the 70% cost-of-living adjusted industry median. To get back to target level, the Investment Council is expanding the incentive compensation plan as opposed to adjusting base compensations (see Performance Based Compensation). Base pay increases for FY2015 are in line with the Council's long-term plan.

BASE SALARIES: The base salaries budget increases 8.6%. This includes a 1.8% increase for the 24 investment positions according to our long-term plan, plus promotional increases of between 2% to 15% for newer level and intermediate level investment team members as they transition through the steep learning curve to senior investment team members. The investment accountant positions increase between 2.3% and 9.3% to move toward compensation levels for CPA designations.

LONGEVITY: It is anticipated that the 24 employees budgeted for longevity pay in FY2014 will continue their employment with the Investment Office in FY2015.

BOARD MEMBERS & COMMISSION: Five of the eight Investment Council members receive the daily rate (\$75) for all Investment Council related activities including Council meetings, subcommittee meetings, meetings with Investment Office staff, and appearances at legislative committee meetings. Budget allows up to 15 such meetings each year.

BENEFITS: Benefit adjustments were made to current staff according to the calculations provided by the Bureau of Finance and Management.

✓ **Operating Expenses:**

ATTORNEY GENERAL FEES: Increase of \$539 for legal fees as indicated by the Attorney General's office.

CENTRAL SERVICES: Increase to Central Services of \$649 to expected amount.

LEGISLATIVE AUDIT FEES: Decrease of \$5,700 in Legislative Audit fees to estimated amount.

RENT: Decrease in rent of \$13,977 due to renegotiation of office lease to a lower amount than expected.

BANK CUSTODIAL FEES: Increase in bank custodial fees by \$12,525 which is the expected increase beginning May of 2014.

OTHER CONTRACTUAL: Other Contractual Services for all investment research services netted to an increase of \$123,636. Of the increase, \$85,000 is for a new Trade Order Management System for equity trading to prevent trading errors and integrate pre-trade diversification rules; \$12,000 is for an upgrade to the Portia investment accounting system; \$17,678 for additional users of Factset data system; and \$10,550 for expanded use of Credit Sights research. Whenever research services are newly acquired or renewed, we negotiate aggressively to get the best price possible. At times, an investment service may be replaced by another provider if a better price or quality product is found.

BUREAU BILLINGS: Bureau billings increases are due to the budget recommendations.

CAPITAL OUTLAY: Purchases to be made in FY 2015 include:

- Three desktop computers at \$1,100 each to replace older computers
- Three replacement monitors at \$279 each
- Ten mobile computer devices at \$1,160 each
- Three phone headsets at \$208 each
- Furniture for some upgrades to current workstations and to outfit new office space
- In addition to the miscellaneous books purchased during the year (approximately \$300), it is expected that two of the newer FTE's will be involved in the Chartered Financial Analyst program resulting in approximately \$600 of CFA books.

✓ **Performance Based Compensation:**

The Investment Council targets a 30% discount after cost-of-living adjustments to the private sector for investment positions total compensation. The compensation study completed in April 2013 indicated total compensation is at 55% rather than the 70% cost-of-living adjusted industry median. To get back to target level, the Investment Council is increasing the incentive compensation plan from 100% maximum with an average of 50% over time, to 200% maximum with an of average 80% over time. The revised plan includes longer term and stretch incentives.

The incentive compensation plan includes funding for potential maximum incentives of 200% of FY 2014 base salaries of investment positions. The incentive plans are annually reviewed by the Investment Council, and the Investment Officer's plan is approved by the LRC Executive Board each year in setting the Investment Officer's compensation. The incentive compensation is based on a formula that pays only for outperformance versus capital market benchmarks tied to one-year and multi-year returns. These incentives will reward outperformance and range from 0% to a maximum of 200%. Any incentive compensation 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 compensation across all positions in total has averaged 40% to 60% of the maximum. The goal of the revised plan is to average 80% over time which will accomplish meeting the Council's target total compensation of 70% of the cost-of-living adjusted industry median.

Other Fund Balances

Company and Fund Name	Blue Book Page			60-Month Average	Lowest Monthly Cash Balance in Past Five Years	
		FY2012	FY2013	Cash Balance	Amount	Month
Company 3017 - Investment Council Expense Fund	307	\$ 1,529,813	\$ 1,043,941	\$ 3,562,393	\$ 392,912	August 2012
Company 8000 - Agency Fund	308	\$ 17,198,665	\$ 11,736,137	N/A	N/A	N/A

The Agency Fund (8000) is used for deposit of pooled investment earnings of the Cash Flow Portfolio. These earnings are distributed to the participating agency funds based upon their average daily cash balance in the portfolio in accordance with SDCL 4-5-30. Per SDCL 4-5-30.1 by no later than June 15th, the General Fund is distributed 90% of the estimated proration due to the fund for the next fiscal year.

Governor's Proposed Salary Policy – BFM Pool

For FY15, the Governor recommends the state employee compensation plan be distributed from a pool in the BFM. *Therefore, individual agency budgets do not reflect the changes for the compensation plan.*

	General	Federal	Other	Total
Across the Board Increase and Market Adjustments	\$0	\$0	\$153,420	\$153,420
Health Insurance	\$0	\$0	\$38,366	\$38,366
Movement Toward Job Worth (PACE)	\$0	\$0	\$0	\$0
Pay for Performance (Career Band Families)	\$0	\$0	\$0	\$0
Targeted Compensation Adjustments	\$0	\$0	\$0	\$0
Total of all Components	\$0	\$0	\$191,786	\$191,786

- Recommended FY15 - 3.0% PACE; 0%-4.5% Pay for Performance for Career Banding; 3% Across-the-Board/Market; 18.6% Health Insurance; Targeted compensation adjustments for a small number of hard-to-fill, below market vocational jobs.
- FY14 – 3.5% PACE; 0%-4.5% Pay for Performance for Career Banding; 3% Across-the-Board; 3.5%-4% Market Adjustment for Career Banding; 14.7% Health Insurance
- FY13 – 2.5% PACE; up to 7.0% Market Adjustment for Career Banding; 3% Across-the-Board; 3.3% Health Insurance.
- FY12 – 0% PACE; 0% Across-the-Board; 0% Health Insurance. One-time payment to permanent, non-probationary state employees equaling 5%, 3.4%, or 1.7% of the individual's annual salary depending on their longevity. (No increase to base in FY12.)
- FY11 – 0% PACE; 0% Across-the-Board; 6.3% Health Insurance
- FY10 – 0% PACE; 0% Across-the-Board; 0% Health Insurance

Cash & Investment Balances in State Reserve & Trust Funds as of December 31, 2013

**State of South Dakota
Cash and Investment Balances in State Reserve
and Trust Funds as of December 31, 2013**

Estimates - Unaudited
Total Balance \$1,050,066,076

