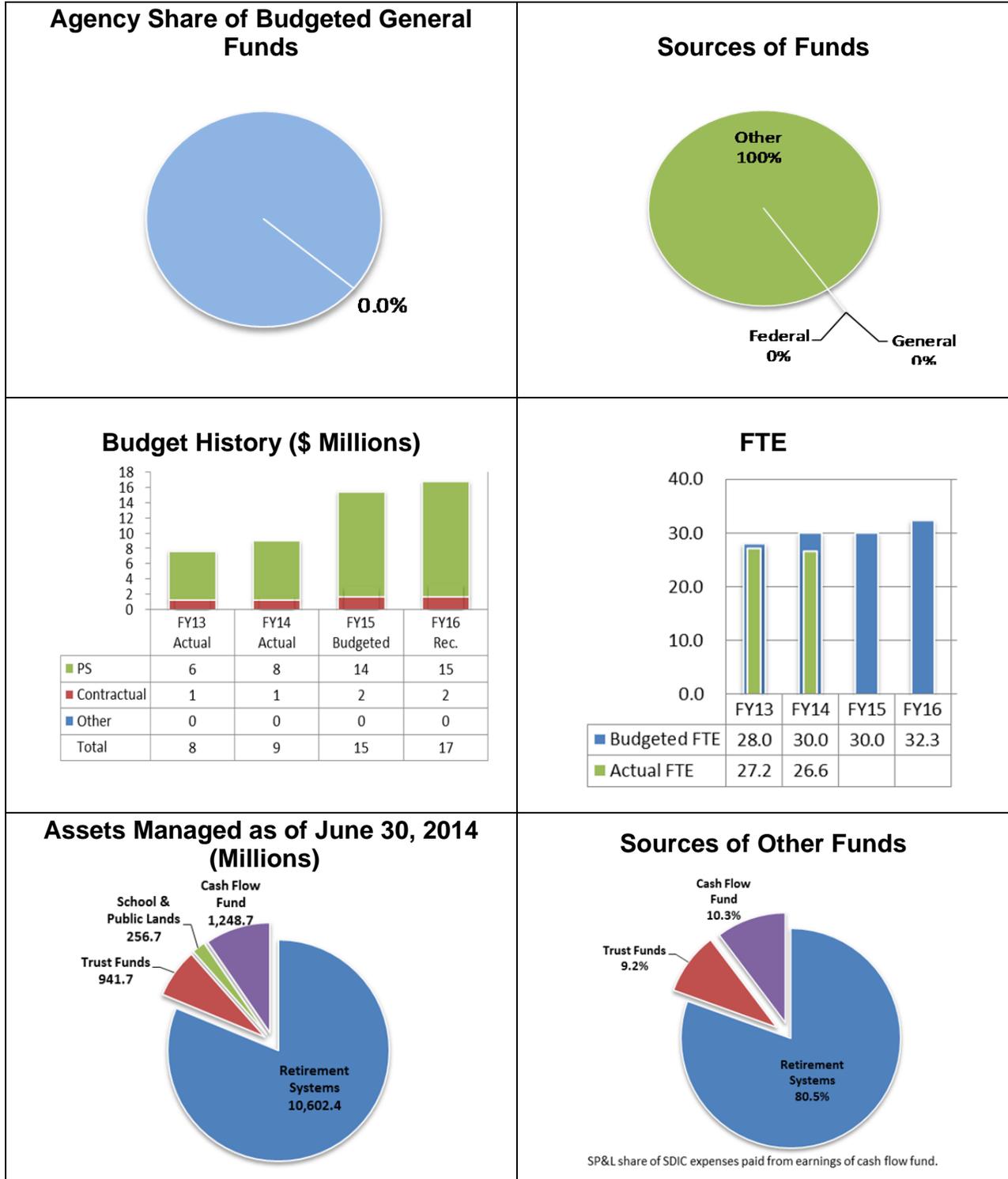


# FY16 Budget Briefing

# State Investment Council

Information contained in this document is based on the Governor's original FY16 recommended budget.  
This document may not correspond with the final FY16 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

To manage the South Dakota Retirement System assets in order to obtain long-term maximum total returns consistent with prudent risk; to 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 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 determine investment options for the 457 deferred compensation savings plan; and to establish and oversee the Higher Education Savings Plan.

	Actual FY13	Actual FY14	Budgeted FY15	Agency Request FY16	Gov Rec FY16	Gov Rec Inc/Dec for FY16	% Change From FY2015
<b>Personal Services</b>							
Employee Salaries	3,469,230	3,718,524	4,585,928	4,975,719	4,975,719	389,791	8.5%
Employee Benefits	694,375	803,609	868,082	950,144	950,144	82,062	9.5%
<b>FTE</b>	27.2	26.6	30.0	32.3	32.3	2.3	7.7%
<b>Funding Types</b>							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	4,163,605	4,522,133	5,454,010	5,925,863	5,925,863	471,853	8.7%
<b>Total PS</b>	4,163,605	4,522,133	5,454,010	5,925,863	5,925,863	471,853	8.7%
<b>Operating Expenses</b>							
Travel	57,086	70,871	85,000	85,000	85,000	0	0.0%
Contractual Services	1,221,329	1,228,596	1,557,693	1,599,548	1,599,548	41,855	2.7%
Supplies & Materials	12,131	8,567	12,733	12,733	12,733	0	0.0%
Capital Outlay	27,970	46,338	43,000	47,192	47,192	4,192	9.7%
<b>Funding Types</b>							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	1,318,516	1,354,373	1,698,426	1,744,473	1,744,473	46,047	2.7%
<b>Total OE</b>	1,318,516	1,354,373	1,698,426	1,744,473	1,744,473	46,047	2.7%
<b>Totals</b>							
<b>Funding Types</b>							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	5,482,121	5,876,506	7,152,436	7,670,336	7,670,336	517,900	7.2%
<b>Total</b>	5,482,121	5,876,506	7,152,436	7,670,336	7,670,336	517,900	7.2%

## **Performance Based Compensation**

To focus on adding value over the long term in all financial market conditions and to motivate and retain successful investment team members by linking a portion of total compensation to investment return performance relative to benchmarks.

	<u>Actual</u> <u>FY13</u>	<u>Actual</u> <u>FY14</u>	<u>Budgeted</u> <u>FY15</u>	<u>Agency</u> <u>Request</u> <u>FY16</u>	<u>Gov Rec</u> <u>FY16</u>	<u>Gov Rec</u> <u>Inc/Dec for</u> <u>FY16</u>	<u>% Change</u> <u>From</u> <u>FY2015</u>
<b>Personal Services</b>							
Employee Salaries	1,985,287	2,813,173	7,323,946	8,034,522	8,034,522	710,576	9.7%
Employee Benefits	273,969	338,219	1,022,536	1,108,764	1,108,764	86,228	8.4%
<b>FTE</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0%
<b>Funding Types</b>							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	2,259,256	3,151,392	8,346,482	9,143,286	9,143,286	796,804	9.5%
<b>Total PS</b>	2,259,256	3,151,392	8,346,482	9,143,286	9,143,286	796,804	9.5%
<b>Totals</b>							
<b>Funding Types</b>							
General	0	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0	0.0%
Other	2,259,256	3,151,392	8,346,482	9,143,286	9,143,286	796,804	9.5%
<b>Total</b>	2,259,256	3,151,392	8,346,482	9,143,286	9,143,286	796,804	9.5%

### **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 FY2013	Actual FY2014	Budgeted FY2015	Governor		% Change FY2015
				Rec FY2016	Inc/Dec FY2015	
<b>PERSONAL SERVICES</b>						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	6,422,861	7,673,525	13,800,492	15,069,149	1,268,657	9.2%
Total Personal Services	6,422,861	7,673,525	13,800,492	15,069,149	1,268,657	9.2%
<b>FTE</b>	27.2	26.6	30.0	30.0	0.0	0.0%
<b>TRAVEL</b>						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	57,086	70,871	85,000	85,000	0	0.0%
Total Travel	57,086	70,871	85,000	85,000	0	0.0%
<b>CONTRACTUAL SERVICES</b>						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	1,221,329	1,228,596	1,557,693	1,599,548	41,855	2.7%
Total Contractual Services	1,221,329	1,228,596	1,557,693	1,599,548	41,855	2.7%
<b>SUPPLIES AND MATERIALS</b>						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	12,131	8,567	12,733	12,733	0	0.0%
Total Supplies and Materials	12,131	8,567	12,733	12,733	0	0.0%
<b>GRANTS AND SUBSIDIES</b>						
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%
<b>CAPITAL OUTLAY</b>						
General	0	0	0	0	0	0.0%
Federal	0	0	0	0	0	0.0%
Other Funds	27,970	46,338	43,000	47,192	4,192	9.7%
Total Capital Outlay	27,970	46,338	43,000	47,192	4,192	9.7%
<b>OTHER</b>						
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%
<b>TOTAL</b>						
<b>General</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0.0%</b>
<b>Federal</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0.0%</b>
<b>Other Funds</b>	<b>7,741,377</b>	<b>9,027,897</b>	<b>15,498,918</b>	<b>16,813,622</b>	<b>1,314,704</b>	<b>8.5%</b>
<b>Total All Funds</b>	<b>7,741,377</b>	<b>9,027,897</b>	<b>15,498,918</b>	<b>16,813,622</b>	<b>1,314,704</b>	<b>8.5%</b>

## Major Expansions and Reductions

Budget Item	Governor's Recommendation	
	Other Funds	FTE
Two New Research Analysts	147,454	2.0
Part Time Staff Attorney	32,456	0.3
Base Salary and Promotional Increases	291,943	-
Contractual Services	41,855	-
Capital Outlay	4,192	-
Perfomanced Based Compensation	796,804	-
<b>Total</b>	<b>1,314,704</b>	<b>2.3</b>

## Narrative – Provided by Investment Council

### **Personal Services:**

This FY 2016 budget request was approved by the Investment Council on June 17, 2014 and the LRC Executive Board on September 9, 2014.

For investment position salaries, total compensation consists of base pay and investment performance 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 early 2013 indicated total compensation was at 55% rather than the 70% cost of living adjusted industry median. To get back to target level, the Investment Council expanded the incentive compensation plan as opposed to adjusting base compensations (see Performance Based Compensation). Base pay increases for FY16 are in line with the Council's long-term plan.

**NEW FTEs:** Two entry level investment positions-Research Analysts-at base salary of \$57,210 after successful six-month probation, plus related full-time benefits. This request is the second step in the plan initiated in 2012 to add six new FTEs over several years to expand the areas of small/midcap equity, high yield/distressed, and private equity/real estate limited partnerships.

**NEW ¼ FTE:** Staff Attorney at \$30,108 for ¼ time with no benefits. The current attorney with the Attorney General's office that provides legal services to the Investment Council is expected to retire next year. This part-time position will allow the Council to consider hiring this or another very experienced attorney to continue to meet the Council's needs for legal services and to work with replacement Attorney General staff to transition these responsibilities over the next few years.

**BASE SALARIES:** The base salaries budget (not including state salary policy) increases 8.65% (5.3% without new FTEs being requested). This includes a 1.8% increase for the 24 investment positions according to our long-term plan, plus promotional increases of between 1.2% and 15.5% 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 1% on top of salary policy to move toward compensation levels for years of experience and CPA designations.

**LONGEVITY:** It is anticipated that 24 employees will be eligible for longevity pay in FY16.

**BOARD & COMMISSION MEMBERS:** 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:**

**NEW FTE OPERATING EXPENSES:** To cover the expected increases due to the new 2.25 FTEs, BIT services increasing by \$2,402, Central Services by \$1,031, telecommunication services by \$2,000, and insurance premiums by \$390.

**RENT:** Increase in rent of \$5,406 to take down additional space available on our floor for a small conference room. The current small conference room will be remodeled as part of our expansion for the new FTEs. This results in an additional 340 sq. ft. to our current 7,242 sq. ft. The current square footage cost is based on a gross rate of \$15.90 per sq. ft., or a net rate of \$9.65 per sq. ft. before operating expenses of utilities, maintenance and cleaning.

**LEGISLATIVE AUDIT FEES:** Increase of \$1,500 in Legislative Audit fees to estimated amount.

**OTHER CONTRACTUAL:** Other Contractual Services for all investment research services netted to an increase of \$29,162. Included is a decrease of \$10,000 for BNY/Mellon Performance & Risk Analysis due to canceling a portion of that service; an increase of Bloomberg by \$9,511 and Factset by \$10,285 for access by new FTEs; increase of \$16,780 for expanded use of Reuters; increases of \$2,325 for Credit Sights and \$225 for Value Line to expected levels. 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.

**CAPITAL OUTLAY:** Purchases projected for FY 2016 include:

- Two desktop computers at \$1,100 each for new FTEs
- Five desktop computers at \$1,100 each to upgrade existing computers
- Five replacement monitors at \$229 each
- Five mobile computer devices and docking stations at \$1,130 each
- Software & CAL's for 2 new FTEs computers at \$460 each
- Two phones for new FTEs at \$300 each
- Three phone headsets at \$282 each
- Furniture for remodeled and new space \$27,831. This includes a portion of the amount budgeted for furniture in FY 2015 which is being deferred to FY 2016.
- In addition to the miscellaneous books purchased during the year (approximately \$300), it is expected that four staff will be involved in the Chartered Financial Analyst program requiring approximately \$550 each for 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 increased 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 2015 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**

**State Investment Council**

Company and Fund Name	Blue Book Page	Ending Cash and Investment Balance June 30		60-Month Average	Lowest Monthly Cash Balance in Past Five Years	
		FY2013	FY2014	Cash Balance	Amount	Month
Company 3017 - Investment Council Expense Fund	311	1,043,941	1,247,180	3,400,124	(115,382)	August 2013
Company 8000 - Agency Fund	312	11,736,137	8,621,677	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, 90% of the estimated proration due to the general fund from the cash flow fund is credited in the current year and the remaining 10% is credited in the succeeding fiscal year after the actual proration amount is determined. For FY2015, the Governor is recommending this law be amended and to continue with the original practice of prorating 100% of interest earnings in the succeeding fiscal year after the actual proration amount has been determined. Under this recommendation, the general fund will receive the 10% proration in FY2015 from the prior year earnings. Then, in FY2016, it will begin to receive 100% of the proration from the prior year.

**Governor's Recommended Employee Compensation and Billings Pool – (from page 01-23 of the Governor's FY16 budget book)**

For FY16, the Governor recommended the 1) state employee compensation plan, 2) bureau billings, and 3) captive insurance be placed in a pool in BFM to be distributed to each agency. *Therefore, individual agency personal services and contractual services budgets do not reflect budget increases for the compensation plan, bureau billings, or captive insurance.*

- Below are the estimated distributions for employee compensation for FY16. BFM will distribute dollars from the Pool after employees are placed in the new General Pay Structure and career band pay-for-performance scores and percentages are calculated. The distributed amount to the agency will be in addition to the agency's appropriated personal services budget.

Est. FY16 Expenditures	General Funds	Federal Funds	Other Funds	Total Funds
Market Adjustments	0	0	113,307	113,307
Movement Toward Market Value	0	0	0	-
<i>Total Comp Pkg</i>	-	-	113,307	113,307

- ✓ Recommended FY16 – 2% market adjustment for all permanent employees (except Career Bands); 0%-6.6% market adjustments for Career Bands; 2.5% movement toward market value for General Pay Structure and PACE; 0% to 4.5% pay for performance for Career Bands; 0% health insurance.
  - ✓ FY15 – 3% across-the-board/market adjustment for all permanent employees (including Career Bands); 3% adjustment toward job worth for PACE; 0%-4.5% pay for performance for Career Bands; targeted compensation adjustments for a small number of hard-to-fill, below market vocational jobs; 18.6% health insurance.
  - ✓ FY14 – 3% across-the-board for all permanent employees (except Career Bands); 3.5% to 4% market adjustment for Career Bands; 3.5% adjustment toward job worth for PACE; 0%-4.5% pay for performance for Career Bands; 14.7% health insurance.
  - ✓ FY13 – 3% across-the-board for all permanent employees (including Career Bands); 2.5% adjustment toward job worth for PACE; 0%-7% adjustment toward market value for Career Bands; 3.3% health insurance.
2. Below are the estimated distributions for bureau billings for FY16. The amount distributed to the agency will be in addition to the agency’s appropriated contractual services budget.

<b>Est. FY16 Expenditures</b>	<b>General Funds</b>	<b>Federal Funds</b>	<b>Other Funds</b>	<b>Total Funds</b>
Bureau Billings for Expansion	0	0	4,676	4,676
Bureau Billings for Comp Pkg	0	0	1,126	1,126
<i>Total</i>	-	-	5,802	5,802

3. The estimated distribution to each agency for Captive Insurance is not available at this time.

**Cash & Investment Balances in State Reserve & Trust Funds as of December 31, 2014**

**State of South Dakota  
Cash and Investment Balances in State Reserve  
and Trust Funds as of December 31, 2014**

**Estimates - Unaudited**

**Total Balance \$1,085,713,953**

