DRAFT

MINUTES

March 8, 2012

Joint Informational Meeting

(Teachers Retirement, Wisconsin Retirement and Employee Trust Funds Boards)
State of Wisconsin

Location:

State Revenue Building – Events Room
2135 Rimrock Road, Madison, WI

BOARD MEMBERS PRESENT:

John David, ETF & WR Boards
William Ford, ETF Board
Kimberly Hall, ETF Board
Susan Harrison, TR Board
Wayne Koessl, Chair, ETF & WR Boards
Michael Langyel, ETF & TR Boards
Jon Litscher, ETF
Mary Jo Meier, TR Board
Lon Mishler, Chair, TR Board
Dan Nerad, ETF & TR Boards
Daniel Schwartzer for Ted Nickel, WR Board
Robert Niendorf, ETF Board
Jessica O'Donnell, ETF Board
Tom Peterson, TR Board
Patrick Phair, TR Board
Roberta Rasmus, TR Board
Robin Starck, TR Board
Herb Stinski, WR Board
Mary Von Ruden, ETF & WR Boards
Steven Wilding, WR Board
David Wiltgen, ETF & TR Boards

BOARD MEMBERS NOT PRESENT:

Jamie Aulik, WR Board
Sandra Claflin-Chalton, TR Board
Betsy Kippers, TR Board
Steve Scheible, TR Board

PARTICIPATING EMPLOYEE TRUST FUNDS (ETF) STAFF:

Bob Conlin, Secretary
Rob Marchant, Deputy Secretary
Cindy Gilles, Board Liaison
Matt Stohr, Anne Boudreau, Division of Retirement Services
Bob Willett, Office of Budget and Trust Finance
Steve Hurley, Office of Policy, Privacy and Compliance
Shawn Smith, Office of Communications and Legislation
Bill Christianson, Jack Loman, Division of Management Services

Board	Mtg Date	Item #
JI	6.21.12	1

OTHERS PRESENT:

ETF Office of the Secretary: David Nispel, Daniel Hayes, Sharon Walk, Chris Fried
ETF Division of Management Services: Pam Henning
ETF Office of Policy, Privacy and Compliance: Lucas Strelow
ETF Office of Communications and Legislation: Nancy Ketterhagen
ETF Office of Budget and Trust Finance: Jon Kranz, Jerry Dietzel
State of Wisconsin Investment Board (SWIB): Keith Bozarth, Vicki Hearing
National Institute on Retirement Security: Diane Oakley
Gabriel Roeder Smith & Company (GRS): Norm Jones, Brian Murphy
Legislative Audit Bureau: Brian Geib, Aaron Holewinski
Legislative Fiscal Bureau: Jere Bauer, Art Zimmerman
UW System: Sue Chamberlain
State Engineering Association: Bob Schaefer
Terry Rhodes, Sandy Drew, Marilyn Peplan, Rich Eggleston

Wayne Koessl, Chair, Employee Trust Funds (ETF) and Wisconsin Retirement (WR) Boards, called the meeting to order at 9:00 a.m.

CONSIDERATION OF MINUTES OF PREVIOUS MEETING

> ***MOTION: Ms. Von Ruden moved approval of the December 1, 2011, minutes of the Joint Informational meeting, as submitted by the Board Liaison. Ms. Harrison seconded the motion, which passed without objection on a voice vote.***

ANNOUNCEMENTS

Mr. Stohr reviewed a number of housekeeping items related to the new meeting location and agenda format.

He then shared the following announcements:

- The Teachers Retirement (TR) Board will not convene today.
- Mr. Wiltgen has been re-elected and certified as a member of the TR Board.
- Three nomination packets were received for the remaining vacant position on the TR Board. An election will be conducted in the spring. Ms. Rasmus and Mr. Wiltgen volunteered to assist with certifying the results of the election.
- Mr. Marchant began his role as ETF’s Deputy Secretary on January 3, 2012. Prior to joining ETF, he was the Chief Clerk and Director of Operations of the state Senate.
- Mr. Hayes is a new attorney in the ETF Legal Services office. Among other things, he will be overseeing the Ombuds function.

- Rhonda Dunn, Executive Assistant, retired from ETF in December 2011 with over 35 years of employment at ETF.
- Ms. Smith has resigned her role as Director, ETF Office of Communications and Legislation. She will begin employment with Department of Health Services on March 12, 2012.
- Lynda Hanold, ETF Human Resources Director, accepted a position with the Department of Workforce Development.
- Leah Herzberg has accepted the position of Human Resources Director at ETF. She will begin in her new role on March 12, 2012.

EDUCATIONAL TOPICS

Retirement Security Scorecard – The Best Choice for Employers, Retirees and the Economy

Mr. Conlin introduced Diane Oakley, Executive Director of the National Institute on Retirement Security (NIRS), which is a non-partisan organization located in Washington, D.C. NIRS is responsible for providing research and education about the role of both public and private sector pension plans in the workplace.

Ms. Oakley noted NIRS is entering its fifth year as an organization and has become a “think tank” on pension and retirement issues, with a specific focus on defined benefit plans. NIRS continues to publish many reports including “Pensionomics 2012,” in addition to sponsoring conferences, conducting media interviews, and providing testimony on retirement security in both the public and private sector.

One of the key messages communicated by NIRS is “pensions get retirement right”. Ms. Oakley discussed in detail various areas of research conducted by NIRS showing, among other things, that:

- Pensions are extremely cost efficient.
- Pensions help recruit and retain quality employees.
- Pensions drive public assistance savings.
- Pensions help create jobs and fuel the economy.
- Many Americans want pensions.
    - Research shows 8 out of 10 Americans believe everyone should have access to a pension plan.

State of Wisconsin Investment Board (SWIB) Update

Mr. Bozarth provided a summary of the investment performance of the Core Fund and Variable Fund during 2011. The actual return for 2011 for the Core Fund was 1.4% and the benchmark return was 0.9%. He noted that 50% of the fund’s allocation is in equities or stocks. The benchmark return last year was -5.8%. Proportionately, this is a significant part of the total Core Fund benchmark. SWIB has been reducing the stock allocation, but it is still a significant part of the portfolio. In reviewing all of the asset classes, he noted that in each case, with the exception of fixed income, SWIB was able to add value during 2011. Fixed income has had a very good run in relative terms for many years, so it is not surprising to see a year where it trails the benchmark. Real estate and private equity both performed very strongly in 2011. This is a good indication of the value of being diversified and having exposure to those asset classes.

The Variable Fund had a -3.0% actual return and a -3.6% benchmark return. In the Variable Fund, there is slightly less exposure to international stocks than in the Core Fund. The reason for this is that people who are in the Variable Fund also have Core Fund exposure, and SWIB is trying not to over-emphasize the exposure for members in the Variable Fund.

Mr. Bozarth reviewed the returns for select periods starting in 1973. He noted investment returns do not come in a steady, predictable pattern. They don't happen in five-year periods, and this has an impact on how the smoothing mechanism works.

As of February 29, 2012, the Core Fund was up 6.8% while the Variable Fund was up 10.7%, both ahead of their benchmarks.

Mr. Bozarth reminded the Boards that he is retiring. His successor, Michael Williamson, will be starting at SWIB in June. Mr. Williamson was the director of the North Carolina pension plan for nine years and is currently the assistant director at the District of Columbia pension plan. He thanked the Boards for the courtesies they have extended to him over the years.

Wisconsin Retirement System (WRS) 29th Annual Valuation of Retired Lives-December 31, 2011

Mr. Murphy explained that the purpose of the *Retired Lives Valuation* is to look at each individual retiree and determine the liability for the benefits to be paid. Based on this review, a determination is made regarding whether dividends may be granted or if dividends must be reduced. Increases or decreases are effective in April following the December 31 valuation. This is the fourth year of negative dividends, but he noted that it would have been much worse without the smoothing mechanisms.

There are over 167,600 WRS annuitants. Approximately 38,900 are in the Variable Fund. As of December 31, 2011, there is $40 billion assigned to retirees. The liability for the annuities currently being paid is $42 billion. In order to bring the reserve back into balance, a negative annuity adjustment is required. He reminded Board members that annuities cannot be reduced below the initial starting value (floor). This is an important protection for retirees. Some people have no dividends to reduce. The first group of people that will be affected by the decrease are those who retired in 2007.

Therefore, while the computed divided rate is -4.0%, due to the class of people not eligible to have their annuities reduced, the actual decrease that most of the population will see is close to 7%.

There will be more people at the statutory “floor” next year, and there is still a large loss from 2008 to be recognized so there is the potential for another large negative adjustment next year. In 2011, there were double the number of new retirees that would normally have been expected, and this group comprises 12% of the total liabilities.

Mr. Jones discussed the Variable annuities being paid to retirees. The SWIB actual rate was -3.0%, and the actual decrease for annuitants is -7.0%.

Over a long period of time, the Core Fund has achieved its long-term investment objectives.

Effective Rate and Annuity Adjustment Projections

Mr. Willett reviewed the assumptions used to calculate annuity dividend increases and decreases. Negative adjustments can only reduce increases granted in prior years. Next year, less than half of all annuities will be subject to a negative dividend, so there will be a significant leveraging effect.

The Market Recognition Account (MRA) is the mechanism used to smooth gains and losses through the system. The MRA is intended to give recognition to long-term changes in asset values while minimizing the impact of short-term fluctuations in the capital markets. Investment gains equal to the assumed rate of 7.2% are recognized. The difference between actual gains or losses and the assumed rate is spread equally over five years.

At the end of 2011, there was $5.3 billion in losses from 2008 to be recognized. Of this, $4.6 billion will be recognized in 2012. This means that in 2012 the year will start out with a loss of $4.6 billion. If the returns for 2012 are exactly 7.2% (the assumed rate of return), then the entire $4.6 billion will need to be recognized. The good news is that 2012 will be the last year in which any of the 2008 losses will need to be recognized.

Mr. Willett provided a number of examples showing how annuitants are affected by the negative annuity adjustments. He explained the difference between the effect on a Core annuity and a Variable annuity. He noted that in each example, the Core Fund outperformed the Variable Fund.

In 1987, the average beginning annuity was $8,680. Over time, this has increased to approximately $23,000. Inflation over the same period of time has increased the cost of living to $18,000. This group, over the most recent declines, has been well-protected against inflation. There are 2,400 annuitants who retired in 1987. He also pointed out that while beginning annuities have increased significantly over the years, the current average annuities are very similar, all in the $23,000-$25,000 range. In other words, no matter when a person retired, the current average income is very similar. Mr. Willett reviewed similar statistics for 1992 and 1997.

The biggest change occurred for members who retired in 2002. There are 7,145 annuitants. There have been some small increases over the years but most of these annuitants are at or close to their “floor”. Most have been trailing behind inflation. The same is true for members who retired in 2007.

Mr. Willett discussed the declining portion of annuitants affected by the negative dividends. In 2008, the first year of negative adjustments, there was a small portion of the annuitant population who were not affected (those who retired in 2008) by the adjustment. In 2009, there were two years of annuitants who were not affected. By 2011, twice as many annuitants were not subject to the full negative annuity adjustment, which meant more of the negative adjustment had to be absorbed by a smaller population of annuitants.

Looking forward to the end of 2012, there will be a group of new annuitants who will not be subject to a negative adjustment. It is expected that 2002 and 2001 annuitants will most likely lose all of the dividends that they have received. It is likely that all gains from 2000 will be lost and that gains will be affected back to 1999. This means that two-thirds, possibly more, are not subject to the full adjustment. This will be a highly leveraged situation in which one-third or less of the population will be subject to annuity reductions to pay for the losses.

Mr. Willett discussed projections and made special mention of the fact that these are not <u>predictions</u>. This information is useful for anticipating the magnitude of future adjustments.

A 7.2% investment gain may result in a maximum annuity adjustment between -12% and -16%.

A 0% return may result in a negative effective rate. The effective rate is the interest rate that is credited to the active member accounts. This would be the first time that there would be negative interest crediting for active members. This would also create the possibility of negative adjustments in future years.

In order to avoid a negative dividend in 2012, there will need to be a 30% investment return. To pay out a positive dividend, there will need to be a 35% investment return.

Mr. Conlin advised that ETF would be reviewing potential options for the future.

Board Training Initiative and Update

Mr. Conlin discussed training for Board members. He referred them to the memo in their binders (ref. JI | 3.8.12 | 3E) which outlined the training that has been provided over the years. In addition, ETF is working with the International Foundation of Employee Benefit Plans to provide an on-site retirement-related certification program for staff and interested Board members. This training will be primarily geared toward staff, due to the increase in turnover and may be more time-intensive than previous training that has been available to Board members.

OPERATIONAL UPDATES

Legislation and Communications Update

Ms. Smith provided a legislative and communications update. She referred the Board members to the memo in their binders (ref. JI | 3.8.12 | 4A). The following legislation was discussed: AB 318/SB 239 (rehired annuitants); SB 153 (local government health insurance plan offered by the Group Insurance Board); AB 503/SB 314 (HEART Act); AB 550 (employee contributions of WRS members who are called to active duty military service); and AB 539 (optional defined contribution plan).

Ms. Smith noted questions about *The WRS Study* continue to be received by ETF. Department of Administration Secretary Huebsch issued a statement in February 2012 outlining his understanding of the scope of the study.

She also described ETF's efforts to provide WRS annuitants with information about the Core and Variable Fund annuity adjustments.

WRS Benefit Program Statistics and Trends

Ms. Boudreau provided an update on WRS benefit program statistics and trends. She referred the Board members to the memo and slide show printout in their binders (ref. JI | 3.8.12 | 4B). She noted the volume of both retirement estimates and new annuities in 2011 broke records. Retirement estimates increased by 33.6% over 2010. Retirement benefit applications increased by 59.8%.

Outreach Program

Ms. Boudreau highlighted the Outreach Program, which was introduced in January 2011 (ref. JI | 3.8.12 | 4C). ETF divided the state into nine service districts and assigned a Trust Funds Specialist to each district. Members who have a retirement estimate can make a “reservation” at a group session. These sessions have been very well received and very successful. Mr. Stohr noted the Outreach Program is one of ETF's 2010-2015 strategic priorities.

WRS Act 32 Study Update

Mr. Hurley reminded the Boards that Act 32 requires ETF, the Department of Administration (DOA), and the Office of State Employment Relations (OSER) to conduct a study of the structure and the benefits of the WRS. Specifically, the focus of the study centers on the creation of an optional defined contribution program and allowing employees to opt-out of employee required contributions. The findings of the study must be reported to the Governor and the Joint Committee on Finance no later than June 30, 2012. The work is proceeding according to schedule. GRS has been hired to perform an actuarial analysis related to the above issues. The first draft of the analysis is due April 2, 2012. This is a critical part of the study and will form the basis for many of the key findings of the study. SWIB has provided funding and investment impact information. ETF's outside tax counsel, Ice Miller, has provided information on potential tax issues. Great West Retirement Services, the administrator of the Deferred Compensation Program, has provided information on cost and efficiency data. DOA and OSER have reviewed the drafts and are providing input.

Administrative Rules Update

Mr. Stohr referred the Board members to the other operational update memos in their binders (ref. JI | 3.8.12 | 4E, 4F, 4G).

Future Items for Discussion

Mr. Niendorf asked that the policy statement on communications be reviewed so Board members who are asked for an interview are aware of proper procedure.

ADJOURNMENT

> ***MOTION: Ms. Von Ruden moved to adjourn the meeting. Mr. Nerad seconded the motion, which passed without objection on a voice vote.***

The meeting adjourned at 12:55 p.m.

Date Approved: ____________________________

Signed: ___________________________________
Robert Niendorf, Secretary
Employee Trust Funds Board