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Information for Retirees Regarding Annuity Adjustments

	Core	Variable
2013 SWIB Investment Return	13.6%	29.0%
2013 effective rate (applied to employees' account balances)	10.9%	31%
2013 annuity adjustment (for retirees)	4.7%	25.0%

This document is intended to answer the most frequently asked questions asked of ETF about the Wisconsin Retirement System (WRS) Core and Variable annuity adjustments.

It is important to point out that ETF administers benefits the same way for every WRS member. Each member's account is based on benefit levels determined by law during employment, the contributions the employee and employer have made for that employee, the investment performance of the WRS, and actuarial factors. WRS assets are managed and invested by the State of Wisconsin Investment Board (SWIB).

1. **What are annuity adjustments?**

Annuity adjustments are annual changes in the amount of a retiree's monthly pension payment (annuity) for the coming 12 months. Shared risk is a key design feature of the WRS. As such, retirement annuities may be either increased or decreased (adjusted) based on Core and Variable Trust Fund investment returns. The adjustments are applied to annuities on the May 1 payment, after year-end investment performance is finalized and an actuarial analysis is completed.

Investment returns prior to 2008 generated many years of positive Core annuity adjustments for retirees. Therefore, Core annuities in general grew to amounts above retirees' original guaranteed amounts ("floor") set at retirement. However, because of the substantial market losses of 2008, ETF has had to apply consecutive years of negative Core annuity adjustments, taking back previously-granted Core annuity increases from individual retirees not already at their Core floor.

2. Who determines the annuity adjustments?

The rates are recommended by the Department's independent consulting actuary and approved by the ETF Board chair and ETF Secretary. Each year, the actuary recommends annuity adjustments after conducting a review, which takes into account investment returns, the laws governing the WRS, and other actuarial factors, such as mortality. The actuary's recommendations are typically presented to the ETF Board, typically at its March meeting.

3. How does an annuity adjustment differ from a cost-of-living adjustment (COLA)?

The WRS does not provide guaranteed COLAs to retirees. Some retirement systems automatically pay annual increases of a set amount. However, many are beginning to revisit their COLA policies because of funding problems caused by such guarantees, as they tend to be unfunded liabilities.

After a WRS member retires, any annuity adjustments are based primarily on the investment returns of the trust funds. Actuarial factors, such as mortality rates, also affect annuity adjustments. Annuity adjustment rates are determined annually after the effective rates of interest are credited to the annuity reserve (the fund from which WRS annuities are paid).

Under state law, if after interest crediting there is **more** money in the annuity reserve than will be needed to pay the annuity reserve's future benefit liabilities, an increase (in the form of a positive adjustment) may be granted. However, if there is **less** money than will be needed to pay the future benefit liabilities, the annuity adjustment must be a decrease to make up for the shortfall.

4. How does the five-year smoothing in the Core Fund affect my annuity?

In accordance with state law, Core Fund investment performance is smoothed over five years to mitigate the effects of market volatility. This smoothing process provides stability in post-retirement income – annual adjustments are more stable, compared to what they would be if investment returns were fully recognized each year (as they are with the Variable Fund).

Smoothing also keeps changes in required employer and employee contribution rates stable from year to year.

The 2013 Core annuity adjustment, to be reflected on May 1 annuity payments, marked the fifth and **final** year of annuity reductions based on the smoothing of a $21 billion Core Fund decline in 2008. **Without smoothing, Core annuities would have been reduced by approximately 32% to 35% on May 1, 2009.** Instead, annuities that were not at the original guaranteed amounts were reduced 2.1% in 2009, 1.3% in 2010, 1.2% in 2011, 7.0% in 2012, and 9.6% in 2013.

Variable annuity adjustments do not include a five-year smoothing process.

5. Why are the annuity adjustments – both Core and Variable – always lower than the effective rate of interest that applies to active employees?

Annuity adjustments will **always** be lower than the effective rates because the adjustments are **based on** the effective rates. Here are the steps in the rate-setting process:

a) **SWIB announces preliminary calendar year investment returns for the Core and Variable Trust Funds**.

b) **The Core and Variable effective rates of interest are calculated, using finalized SWIB returns**. These rates are applied to the retirement account balances of active employees.

c) **The Core and Variable annuity adjustments are calculated, using the effective rates as a starting point**. The annuity adjustments are always lower than the effective rates – usually 5% to 8% lower – because there is already a 5% earnings assumption built into the initial benefit amount paid to retirees. In addition, actuarial factors – which vary from year to year – such as mortality, carryover, etc., are factors in the adjustment calculation process.

The purpose of the WRS is to provide a lifetime benefit to its annuitants. In order to fulfill the guarantee of a lifetime benefit in a manner that is actuarially sound, a 5% return on investments is needed. That 5% is needed to fulfill lifetime benefits for retirees above and beyond what may have been paid by the employee and the employer in WRS contributions during the employee's working career. Any surplus to an investment return of 5%, which would result in a 0.5% increase to existing Core annuities, is by state law to be distributed equitably by the ETF Board among retirees.

6. Isn't a WRS retirement benefit guaranteed never to decrease by state law?
Wis. Stat. §40.19 provides that benefits accrued to an employee under Chapter 40 of the Wisconsin Statutes, the chapter governing the WRS, shall not be taken away by any subsequent legislative act. But this provision does not relate to positive investment increases that have been accrued by retirees since retirement. The Wisconsin Supreme Court has noted that WRS annuitants have a contractual right to have dividends distributed consistent with Wis. Stat. §40.27(2),[1] the statute providing for Core annuity reserve surplus distributions. Those surplus distributions do not become a part of a retiree's base annuity, which is guaranteed. Rather, under §40.27(2), the ETF Board revokes annuity increases above a retiree's guaranteed floor amount when necessary to preserve the financial integrity of the Core annuity reserve.

7. Does the WRS have a plan document that would explain how negative annuity adjustments are made?
As a governmental plan, the WRS "plan document" is Chapter 40 of the Wisconsin Statutes and various chapters of the

[1] *See Wis. Retired Teachers Ass'n, Inc. v. Employee Trust Funds Bd.*, 207 Wis.2d 1, 3, 558 N.W.2d 83 (1997)

Wisconsin Administrative Code. You may also find these documents on the State of Wisconsin Legislative Reference Bureau website at http://legis.wisconsin.gov/lrb/index.htm.

8. **How will my annuity be affected if I elected to participate in the Variable Fund?**

The key difference between the Core and Variable Trust Funds is that the investment returns of the Core Fund are smoothed (recognized) over a five-year period, while Variable Fund investment returns are fully recognized each year. Core annuity adjustments are applied to the Core annuities of all WRS retirees because everyone participates in that fund. For those who participate in the optional Variable Fund, the Variable portion of their annuities is subject to the Variable annuity adjustment.

Variable participants are exposed to a higher degree of risk because of possible losses from unfavorable stock market performance, in exchange for the possibility of greater long-run returns. It is possible for the Variable Fund portion of your annuity to decrease to an amount below the base amount you received at retirement – there is no guaranteed "floor" for Variable annuities.

9. **How much is my check going to change in May?**

In late April ETF will send you a personalized annuity mailer statement. It will show exactly how much your monthly payment will change for the coming 12 months, beginning May 1.

10. **What is My Minimum Core Annuity Amount (Core "Floor")?**

Your Core annuity is guaranteed for your lifetime and, by law, will never be reduced to an amount below the original Core "floor" amount established at retirement (once a final calculation has been completed). If you do not know what your Core annuity floor is, then locate the most recent annuity mailer statement you have received from ETF. Look in the "Required Contributions" section of the statement and find the phrase, "Regular Core" —that dollar figure is your Core floor, your minimum guaranteed amount. If you participate in the Variable, that portion of your payment will be shown, too, but is not included in your minimum guaranteed amount.

For More Information:

Monitor ETF's website for frequent updates to this document. You may also call 1-877-533-5020 or send an e-mail. We also recommend the following ETF resources:

How Participation in the Variable Trust Fund Affects Your WRS Benefits (ET-4930)

Canceling Variable Participation (ET-2313)

Things to Consider Before Canceling Variable Participation (for Annuitants and Non-Annuitants)

ETF Webinar: WRS Effective Rates and Annuity Adjustments

WRS Core and Variable Trust Funds: Returns, Rates and Adjustments