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Information for Retirees Regarding 2013 Annuity Adjustments

	Core	Variable
2012 SWIB Investment Return	13.7%	16.9%
2012 Effective Rate (applied to employees' account balances)	2.2%	17%
2013 Annuity Adjustment (for retirees)	-9.6%	9.0%

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 year. Shared risk is a key design feature of the WRS. As such, retirement annuities may be either increased or decreased (adjusted) based on WRS investment returns. The adjustments are applied to annuities on May 1, 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. Once reviewed by the Board, ETF implements the changes to monthly annuity payments. View this year's actuarial report.

3. How does an annuity adjustment differ from a cost-of-living increase (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 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. Therefore, in some years – those with high investment returns – the Core annuity adjustments may be more than the State of Wisconsin Investment Board's (SWIB) actual investment returns for the year. However, in years with poor returns, the adjustments may be lower than that year's actual returns. This smoothing process provides stability in post-retirement income (the "highs" aren't so high and the "lows" aren't so low) and creates more stable Core effective interest rates and contribution rates for active employees.

This year's Core annuity adjustment marks the fifth and **final** year of annuity reductions based on the smoothing of market losses in 2008. Core Fund assets experienced a $21 billion investment decline in 2008. **Without smoothing, Core annuities would have been reduced by approximately 32% to 35% in 2009.** Instead, annuities that were not at the original guaranteed amounts reduced 2.1% in 2009, 1.3% in 2010, 1.2% in 2011, and 7% in 2012.

We are hoping that Core annuity increases return in 2014, barring another substantial downturn.

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 calendar year investment returns for the Core and Variable Trust Funds**.

b) **Using finalized SWIB returns, ETF calculates the Core and Variable effective rates of interest (for active employees).**

c) **ETF calculates the Core and Variable annuity adjustments (for retirees), using the effective rates as a starting point for the calculations**. The annuity adjustments are always lower than the effective rates – approximately 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 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. Why won't projected negative Core annuity adjustment affect all WRS retirees equally?

By law, Core annuities cannot be reduced to an amount below the original, guaranteed amount (the "floor") set at retirement. Some retirees will receive a reduction at the lower end of the range (or none at all) because their Core annuities are already either near, or at the guaranteed Core floor set at retirement, respectively. Others will experience a Core annuity reduction at the higher end of the range because their Core annuities have grown that much over time with dividends.

In general, members who retired in or before 2004 will receive Core annuity reduction, if they have any past increases to repeal, and members who retired **after 2004** will not receive a reduction because they are already at their Core floor.

This is the last year in which the Core effective rate and Core annuity adjustment reflect 2008 investment declines. The Core Fund has exceeded its investment earnings goal in the last four years. Therefore, we anticipate Core annuity increases in 2014, barring another substantial downturn.

7. 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.

8. Is there a way for ETF to a negative Core annuity adjustment?
This year's rate-setting process is the last to recognize the losses from 2008. While the WRS is working as designed by adjusting annuities based on both positive and negative investment performance, ETF nevertheless re-examined the process to determine what options, if any, may be available to avoid further reductions or years of consecutive reductions. The results of this review were presented at the September 20, 2012 retirement board meetings. The primary concepts discussed included:

- Allowing the WRS to run a deficit or build up an unfunded liability;

- Adding money to the system via increased employer contributions or asking the legislature and governor for general purpose tax revenue;

- Paying future positive annuity adjustments first to those who have received the greatest reductions. Many retirees who are currently at their guaranteed Core floor, though, would view this approach as requiring them to give up investment gains so that those who experienced investment returns in the 1980s and 1990s could continue receiving those past gains, even though those gains disappeared in 2008.

- Removing the guaranteed Core annuity floor (the minimum Core annuity amount).

The Boards acknowledged the real pain some individual retirees are experiencing, but concluded that any "fix" would need to balance the interests of all WRS participants and would require law changes that would not be implemented until after the 2008 effects are felt. Accordingly, the only viable option for the system as a whole was to continue to administer the WRS as it was designed and get the losses from 2008 behind us.

For more information, see the Annuity Adjustment Update Correspondence Memo from the September 20, 2012 retirement board meeting. The memo explains in detail the laws governing the WRS and annuity adjustments. You may also find the memo and other board materials in the Governing Boards section of the ETF website.

9. Does the WRS have a plan document that would explain how negative annuity adjustments are made?

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

As a governmental plan, the Wisconsin Retirement System (WRS) "plan document" is Chapter 40 of the Wisconsin Statutes and various chapters of the

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.

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

The key difference between the Core and Variable 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.

11. 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 year, beginning May 1.

- **Variable portion:** All retirees participating in the Variable Fund will see an increase of 9% to that portion of their monthly annuities.

- **Core portion:** In general, if you retired *after* 2004 you will not receive a Core annuity reduction because your Core annuity is already at the Core floor.
  - If you still have previously-granted Core dividends, your Core annuity will be reduced anywhere between 0% and -9.6%, depending on how long you have been retired.
  - In general, those who retired between 2000 and 2004 will now be reduced to their original starting amount (Core floor).

12. 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. If you do not know what your Core annuity floor is, then locate the most recent annuity payment 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)

Online Video: Annuity Payment Statements

Online Video: WRS—Interest vs. Annuity Adjustments

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

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