STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

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CORRESPONDENCE MEMORANDUM

DATE: June 3, 2010

TO: Employee Trust Funds Board

FROM: Matt Stohr, Director, Office of Legislative Affairs, Communications, and Quality Assurance

SUBJECT: Member Correspondence

This memo is for informational purposes only. No Board action is required.

Please find enclosed a sampling of member correspondence (letters and e-mails) that the Department has received from Wisconsin Retirement System (WRS) members since the March Board meeting. The Department's response precedes the member's letter in the enclosed packet.

The most common correspondence themes were the 2010 Core Fund negative annuity adjustment and the difference between the 2010 Variable Fund effective rate and the Variable Fund annuity adjustment.

As you will see, many WRS members contact their state representative or senator, the Governor, and/or their United States representative or senator about WRS issues. Since the March meeting, the Department has received 30 member contacts through the Governor's office and legislators. All of these contacts have been responded to and addressed. Again, the common themes in these contacts were similar to the member contacts made directly to the Department.

I will be available at the June meeting to answer any questions you may have.

Enclosures

Reviewed and approved by Robert Conlin, Deputy Secretary

Signature ______________________ Date ______________

Board	Mtg Date	Item #
ETF	6.24.10	5B

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March 29, 2010

Governor James Doyle
Wisconsin State Capitol, P.O. Box 7863
Madison, WI 53707

Lieutenant Governor Barbara Lawton
19 East, State Capitol, P.O. Box 2043
Madison, WI 53702

Representative Brett Davis, Assembly District 80
Room 11 West, State Capitol, P.O. Box 8952,
Madison, WI 53708

Senator Jon Erpenbach, Senate District 27
8 South, State Capitol, P.O. Box 7882
Madison, WI 53707-7882

SUBJECT: Appeal on Behalf of Retired Wisconsin Public Employees Regarding Department of Employee Trust Funds 2009 Variable Annuity Adjustment

The purpose of this letter is to request your assistance in obtaining a change in the Department of Employee Trust Funds (ETF) 2009 variable annuity adjustment awarded to Wisconsin public employees. I am writing on behalf of many other Variable Fund participants who shared the same experience and have similar concerns.

Early in 2010, ETF surprised everyone by announcing that after the Variable Fund lost -42.7% in 2008, participants in the fund would only be allowed to make up +22% of that loss even though the fund effective rate gained +33%. This 11% spread between the Variable Fund effective rate and the actual annuity adjustment is unprecedented in the history of the WRS. And it occurred after ETF provided advice to public employees that the 2009 variable fund annuity adjustment would be somewhere between 25% and 30%.

ETF failed to provide the risk information we needed about this year's annuity adjustment to make informed financial decisions. Therefore, in the absence of that information, the 2009 22% annuity adjustment should be revised to restore it to within the 25-29% range of the estimates provided to us by ETF.

Absent such a revision, the 2009 adjustment is based on a contract between ETF and retirees that was not properly executed. Information was not provided about concerns ETF had regarding the potential for a large spread between the Variable effective rate and the actual annuity adjustment that substantially affected the understandings in the contract. It was ETF's fiduciary obligation to provide that information so WRS employees could make informed financial plans and decisions. ETF failed to carry out this fiduciary obligation.

Well before the end of 2009, ETF was discussing concerns about the potential for a large spread between the Variable effective rate and the annuity adjustment rate with its actuaries and others. But ETF did not warn public employees about this potential. It failed to carry out its fiduciary responsibility to public employees to provide them with the information they needed for personal financial planning and decision-making. As a result, many participants in the WRS made financial decisions based upon incomplete information, anticipating one level of annuity adjustment while receiving another quite lower one. And they made irrevocable decisions about their participation in the state pension fund that they may not have otherwise made had this information been provided to them.

ETF should have sent out a warning to Variable Fund participants, its counselors, and the news media before the end of 2009 advising of its concerns regarding the potential for a large spread between the effective rate and the actual annuity adjustment. Instead, it sent out an explanation afterwards in 2010 when it was already too late for public employees to make informed decisions. The warning should have advised:

"Because of the steep plunge in 2008, and the fact that ETF knew it continued to pay higher amounts for part of 2009, there is a situation where the spread between the Variable Fund effective rate and the annuity adjustment could be significantly wider than any other year in the history of the retirement fund and the final number may be substantially outside the range of the estimate."

In summary: I am writing on behalf of many other Variable Fund participants who shared the same experience and have similar concerns. ETF failed to provide us with the risk information we needed about this year's annuity adjustment to make informed financial decisions. Under such circumstances, the annuity adjustment should be revised to restore it to within the 25-29% range of the estimates provided to us by ETF.

I fully appreciate that this suggestion may be unprecedented. However, the 2009 variable annuity adjustment is unprecedented. And the failed manner in which the risks leading up to the 2009 variable annuity adjustment were communicated by ETF is unprecedented.

Attached to this letter you will find a letter to the Wisconsin Department of Employee Trust Funds illustrating my own experience with ETF's 2009 variable annuity adjustment. It explains in substantially more detail why the annuity adjustment awarded to public employees this year violates the spirit of state contracts, the fiduciary responsibility of ETF to public employees, and the terms of the retirement fund agreements signed by public employees.

Thank you for your consideration of this suggestion and for any assistance you may chose to be in obtaining a revision of the 2009 annuity adjustment.

Best wishes,

Douglas King

Cc: *(see next page)*

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Marty Bell, Executive Director
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Lon Mishler, Chair
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Marilyn Wigdahl
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Selected Media Representatives

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EMPLOYEE TRUST FUNDS

2010 MAR 31 PM 12: 22

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March 29, 2010

Bob Conlin, Deputy Secretary
Wisconsin Department of Employee Trust Funds
Department of Employee Trust Funds
PO Box 7931
Madison, WI 53707-7931

RE: Reconsideration of 2009 Variable Fund Annuity Adjustment

Dear Bob,

As you know, during 2009, you and I corresponded and spoke on the phone on many occasions regarding letters that I sent to the Employee Trust Funds Board urging the Board to implement changes to ETF policies, procedures and rules. The changes would have made it possible for Variable Fund participants to make fully informed decisions about their participation in the Variable Fund rather than gambling with guesses at year's end.

Our dialogue was constructive and cordial and I very much appreciate the time you took to look into the issue. You presented several of my letters to the Board, but it took no action on them.

Like many other retirees, I was concerned about the historic 42.7% loss that the Variable fund experienced 2008. I hoped to "break even" with the Core Fund in 2009 so I could cancel my participation in the Variable Fund and achieve stability and security in retirement going forward. My goal was to avoid future losses and volatility even if that meant not participating in future gains as long as I was "even" with Core. Especially since SWIB's chart comparing the 20-year average returns of the two funds showed them as having the same average return over time.

You graciously requested ETF staff to estimate my Variable-at-Core balance and project how close I was to breaking even at the end of the year to help me make an informed decision. I appreciate that very much.

As December 31, 2009 approached, I worked with SWIB staff who provided me with new end-of-year SWIB returns for the Core and Variable Funds based on the Russell 3000 and MSCI-EAFE indexes. I also worked with several ETF counselors who provided me with oral and written estimates of the anticipated 2009 annuity adjustment based upon those revised numbers. The process involved a dozen emails and phone calls.

The estimates all concluded that due to the unusual +33% gain in the Variable Fund: a "reasonable and conservative estimate of the 2009 annuity adjustment would be in the range of 25-29%." The calculation was that even at the low end of the range (25%) my Variable annuity would be within just a few dollars short of "being even" with the Core Fund. Unfortunately, it was not even close. Which leads me to the subject of this letter.

Before going further, I would like to say that *the ETF counselors I worked with did their best to provide the estimates in good faith using the best information available to them at the time. No fault is intended or implied with respect to the conduct of their duties. They did their best with what they had to work with and I very much appreciate their efforts. The issue is not with what they did, but rather what they had to work with.*

When the Variable fund began rebounding at an unprecedented rate in 2009, I was pleased to learn that at the end of 2009, the calculations showed that I was within a few dollars of breaking even with the Core Fund.

Therefore, I filed a "Conditional Cancellation" of participation in the Variable Fund, which would cancel my participation if I was one cent or more "ahead" at the end of the year. But I had to rescind it and resubmit an "Unconditional Cancellation" instead.

I had to resubmit an "Unconditional Cancellation" instead because at year's end, ETF counselors updated my annuity projection to be only "$2.75 behind." Under a "Conditional Cancellation" if I was as little as only one cent "behind" then I would have remained in the Variable Fund and been exposed to the risk of a "double dip" recession that would reduce my annuity below an acceptable level. My goal was to avoid the possibility of being exposed to another loss in the Variable Fund. I simply wanted to be close to "break even" and move to the Core Fund. Therefore, by ETF rule, I had no option other than to file an "Unconditional Cancellation" that allowed me to cancel my participation if I was just one cent "behind."

Being forced by rule to blindly submit an "Unconditional Cancellation" under such circumstances instead of waiting for the information needed to make an intelligent decision is precisely the issue that I wrote to the ETF Board about five times urging them to develop a mechanism to avoid such situations.

I noted on my Unconditional Cancellation, quote: "I do not want to irrevocably cancel Variable Fund participation if ETF thinks there is a flaw in the method we have used to make this decision that would result in my annuity being behind by a significantly larger amount than the updated projection." Counselors confirmed that: "the method was correct but the accuracy depends upon the accuracy of the assumed core and variable adjustment rates." However, the counselors also offered: "We do not have an official annuity adjustment for the variable fund yet, but our projection is for it to be somewhere between 25% and 30%." Unfortunately, as I said, the final number of 22% was not even close.

A key basis for the estimates was the Chart of Variable Fund Effective Rates vs. Annuity Adjustments from 1983-2008 published by SWIB. I was referred to the chart, which showed that only once in the past 25 years has ETF's spread between the Variable Fund effective rate and the annuity adjustment been greater than a single digit. The chart also showed that during those 25 years, the average difference between the Variable Fund effective rate and the annuity adjustment was only 6.5%. This was roughly the percentage difference that ETF counselors used to illustrate that Variable Fund participants could "reasonably and conservatively expect an annuity adjustment in the range of 25%-29%" in 2009, suggesting: "An effective rate of 5% less than actual performance is typical in the history of the Trust Fund and the few very large differences may be anomalies, so it (5%) is a safe assumption."

Early in 2010, ETF surprised me and the counselors working with me by announcing that after the Variable Fund lost -42% in 2008, participants in the fund would only be allowed to make up +22% of that loss even though the fund effective rate gained +33%. The 11% spread between the Variable Fund effective rate and the actual annuity adjustment is unprecedented in the history of the WRS.

Unfortunately, the announcement was made early in 2010, but December 31, 2009 was the date by which Variable Fund participants were required to make irrevocable decisions about whether to continue their participation in the fund. I filed an "Unconditional Cancellation" of participation in the Variable Fund because I and my ETF counselors calculated that my annuity was just a few dollars short of "breaking even" with the Core Fund based upon "a reasonable and conservative annuity adjustment somewhere in the range of 25-29%."

I may not have made a decision to "Unconditionally Cancel" participation in the Variable Fund if ETF had warned me or the ETF counselors working with me that ETF was contemplating the possibility of a large spread between the Variable effective rate and the annuity adjustment rate prior to December 31, 2009. Other participants in the WRS also made financial decisions based upon incomplete information anticipating one level of annuity adjustment while receiving another quite lower one. And they too made irrevocable decisions about their participation in the state pension fund that they may not have otherwise made had this information been provided to them.

Internal documents brought to my attention reveal that well before the end of 2009, ETF was discussing concerns about the potential for a large spread between the Variable effective rate and the annuity adjustment rate with its actuaries and others. Yet ETF did not warn me or the counselors of its concerns about this potential.

The language in ETF's January, 2010 announcement explaining the unprecedented 11% spread between the Variable effective rate and the annuity adjustment rate illustrates the point. For example, to quote from the announcement (*inserts mine*), ETF knew:

- "Last year, the -42% Variable annuity adjustment was actually -42.7%. However, by law, the WRS actuary [***will be***] is required to truncate the adjustment to the lower whole percentage; hence, the -42% rate. The negative amount carried over was magnified because there were substantially lower assets in the Variable Fund, due to the investment losses in 2008."

- "The -0.7% was carried over to this year's calculation and this [***may have***] had a large impact on this year's adjustment. The negative amount carried over [***may be***] was magnified because there were substantially lower assets in the Variable Fund, due to the investment losses in 2008."

- "ETF has to make the annuity adjustments effective with May 1 benefit payments. Therefore, there is a four-month lag time that is factored into the calculation of the annuity adjustments. *Because of the lag time, ETF was not adjusting annuities by -42% in the first four months of 2009, even though there was roughly a 40% loss in the annuity reserve.* This lag time and the truncation described above [***may amount***] amounted to a (***large***) -3.9% carryover loss from 2009 into this year's Variable annuity adjustment calculation."

ETF should have sent out a warning to Variable Fund participants, its counselors, and the news media before the end of 2009. It should have been written in the future tense as shown above by the inserts in **bold** italics. It should have been sent out before December 31, 2009 as a warning, not afterwards in January 2010 as an explanation. The warning should have advised:

" Because of the steep plunge in 2008, and the fact that <u>ETF knew it continued to pay higher amounts for part of 2009</u>, there is a situation where the spread between the Variable Fund effective rate and the annuity adjustment could be significantly wider than any other year in the history of the retirement fund and the final number may be substantially outside the range of the estimate."

By failing to provide such advice, ETF did not carry out its fiduciary responsibility to provide Variable Fund participants with "informed" risk.

To reiterate: The above paragraphs quoted from the announcement ETF sent out in January, 2010 should have been sent out <u>*before*</u> December 31, 2009 as a warning written in the future tense rather than an announcement written in the past tense. ***(See example in bold italic inserts above.)***

ETF should also have put a warning on its web site prior to the end of 2009 regarding its published chart of 1983-2008 effective rates vs. annuity adjustments. Such an advisory would have alerted ETF counselors and Variable Fund participants that the chart published on the ETF web site could no longer serve as a reliable guide for making irrevocable decisions about participation in the Variable Fund because of concerns about the potential for a large spread between the Variable effective rate and the annuity adjustment rate in 2009.

I previously wrote to ETF Board Chair Marilyn Wigdahl in five letters over the last 14 months urging the Board to discuss the possibility that participants in the Variable Fund would encounter this situation by the end of 2009. In those letters I predicted that if the Board failed to provide participants in the Variable Fund with a mechanism for making fully informed, intelligent decisions instead of gambling with guesses, it could cost retirees needless losses in their pensions because of decisions they would not have made had they been fully informed. Regrettably, this has come true.

You distributed all of the letters to the entire Board and presented several of the letters to them. But the Board never took any action on the issue. Nor did it have any substantive discussion of it even though it had over one year of advance notice. Nor was any presentation of the issue by participants allowed even though such presentation was formally requested. Nor were any public comments about the issue allowed because there is no provision for public comments at its meetings. The Board's inaction is regrettable at best and appalling at worst.

In summary:

ETF failed to fulfill its fiduciary responsibility to provide me and the ETF counselors working with me with "informed risk" because it did not fully disclose, communicate or warn of its concerns about the potential for a large spread between the Variable Fund effective rate and the annuity adjustment rate prior to the end the December 31, 2009 deadline for making irrevocable decisions about cancelling participation in the Variable Fund. The ETF Board failed to fulfill its fiduciary responsibility to the Department (ETF) because it never deliberated on the approaching issue of how to provide annuitants with informed risk prior to the end of 2009 even though the issue was brought to its attention on five occasions with over 14 months of lead-time.

For these reasons and under these circumstances, I respectfully object to an irrevocable 22% adjustment to my annuity. An acceptable number would be 25%. I fully appreciate that this suggestion may be unprecedented. However, the 2009 variable annuity adjustment is unprecedented. And the failed manner in which the risks leading up to the 2009 variable annuity adjustment were communicated by ETF is unprecedented.

As previously described, my decision to cancel participation in the Variable Fund was made based upon a Variable-at-Core calculation that projected I was within $2.75 of "breaking even." That calculation was based upon advice including: "We do not have an official annuity adjustment for the variable fund yet, but our projection is for it to be somewhere between 25% and 30%;" and, "a reasonable and conservative range would be 25-29%;" and, "an effective rate of 5% less than actual performance is typical in the 1983-2008 history of the Trust Fund and the few very large differences may be anomalies, so it (5%) is a safe assumption." Unfortunately, the counselors were not aware of ETF concerns that were not communicated to them or me about the potential of a large spread between the Variable effective rate and the annuity adjustment rate in 2009.

When an estimate is given to a WRS participant by multiple counselors on multiple occasions that is characterized as "within the range of 25%" it could reasonably be interpreted to mean a number between 24.5% to 25.5%. Or a more generous interpretation of the phrase "within the range of 25%" could reasonably be interpreted to mean 24.0% to 26%. *But there is no possible, reasonable interpretation of the phrase "in the range of 25%" that could mean 22.0%.*

As I said at the beginning of this letter, the ETF counselors I worked with did their best to provide the estimates in good faith using the best information available to them at the time. No fault is intended or implied with respect to the conduct of their duties. They did their best with what they had to work with and I very much appreciate their efforts. This issue is not with what they did, but rather what they had to work with.

I am anticipating that your response to this letter might be to offer sympathy for the situation but then remind me that the terms of the Unconditional Cancellation I filed cannot be modified and it is irrevocable.

Given the circumstances described above, I consider the terms of the Unconditional Cancellation to be subject to modification because it is a contract between ETF and myself and it is my belief that the contract was not properly executed. Information was not provided to me or the counselors working with me by ETF by the time of contract execution about concerns ETF had regarding the potential for a large spread between the Variable effective rate and the actual annuity adjustment that substantially affected the understandings in the contract. It was ETF's fiduciary obligation to provide that information.

I also imagine that you will remind me that the counselors who worked with me clearly stated the limitations of any estimate they provided to me, such as: "it is only an estimate and may not provide a very precise projection of the final core and variable annuity adjustment rates;" and, "it is a ballpark projection based upon the information currently available;" and, "it depends on a number of assumptions including the final year end dollar amount of investment earnings (or losses) credited to the annuity reserve, the balances to which they are credited, changes in mortality rates, gains or losses carried over from the previous year, etc."

I agree that I was advised that the estimate I was given might not be the final number due to other factors unknown at the time the estimate was made. That has always been true of all estimates that I have been given in previous years so that was nothing new. It is standard boilerplate advice given as risk information to ensure full disclosure.

But this year, ETF knew there was a potential for a large spread between the Variable effective rate and the annuity adjustment based on information that it had at its disposal and concerns that it was discussing with its actuaries and others before the end of 2009. Therefore, advising me "the estimate may not be the final number" was necessary but not sufficient. Had the counselors working with me known about the potential for a large spread, the advice I received would have included a warning. The warning would have been and should have been: *"the estimate may not be the final number, but this year, because of other circumstances that we are concerned about,* ***the final number may be substantially outside the range of the estimate."***

While I am writing to you about my own situation, I am writing on behalf of many other Variable Fund participants who shared the same experience and have similar concerns. ETF failed to provide us with the risk information we needed about this year's annuity adjustment to make informed financial decisions. Therefore, in the absence of that information, the annuity adjustment should be revised to restore it to within the range of the estimate provided to us.

In the past, I was able to provide you with a preview of correspondence to get your thoughts about it and revise it if needed prior to distribution to others. Unfortunately, there is only one month left in the legislative session. And the final May, 2010 annuity adjustments are only a month away. For that reason I was unable to afford you the courtesy of preview prior to sending this letter. I apologize for not being able to hold to our previous protocol.

Thank you for your consideration of this suggestion and for any assistance you may chose to be in obtaining a revision of the 2009 annuity adjustment. I appreciate our previous collegial conversations and correspondence and I look forward to your consideration of this letter.

Best wishes,

Doug King

Cc:

Office of the Governor
Selected Legislators
Selected State Board Chairs
Selected Employee Unions
Selected Media Representatives

CC 10-008

STATE OF WISCONSIN
Department of Employee Trust Funds
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SECRETARY

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April 16, 2010

DOUGLAS B KING
991 PERRY CENTER ROAD
MOUNT HOREB WI 53572

Re: Variable Fund Annuity Adjustment

Dear Mr. King:

I have received your letter dated March 29 in which you request that a higher Variable Fund adjustment be applied to your account than the one recommended by the independent consulting actuary and approved by the Employee Trust Funds (ETF) Board. Your request is based on your assertion that the Department's preliminary projections of the possible Variable Fund annuity adjustments resulting from 2009 investment performance were not accurate and that the Department should have warned Variable Fund participants in 2009 that the actual adjustments could be significantly different than the projections. You allege that, as a consequence, the Department breached its fiduciary duty to all Variable Fund participants and therefore the Variable annuity adjustment should be increased to 25%.

As I'm sure you know, we are not able to provide you with a higher annuity adjustment than the 22% increase you and all other Variable Fund participants received. The Department takes its fiduciary duty very seriously. Furthermore, communication with our participants is one of our top priorities, especially when it comes to providing timely information about significant retirement issues such as annuity adjustment rates. However, our fiduciary duty does not extend to informing individual participants that the Variable Fund adjustment may not be as big as they hoped it would be. Consistent with our past practices, the Department did not publicly disseminate any Variable Fund projections before the end of 2009. We did use Variable Fund projections internally. When we do provide the projections to participants, we always inform them of the limitations of those projections. We did that in your case, as you have acknowledged. We gave you the best projections that we had available and our benefit specialists informed you of the limitations of those projections.

We did not know that the projections we gave you in December, which included an eight point differential between the Investment Board's then-current returns, were going to fall short of the actual differential we announced in March. However, if you have information that shows otherwise, as you suggest you do, please forward it to me.

The Department prepares projections concerning possible annuity adjustments as a service to our members so that they have a sense of the magnitude of the potential adjustments to help them better prepare for the financial impact. Typically, we don't publicly disseminate projections on the Variable Fund before the close of the year because of its extreme variability, other than to note that Variable returns are not smoothed and that Variable adjustments tend to be closer to actual returns than the Core Fund adjustments are because of the five-year smoothing mechanism associated with the Core Fund. Instead, we use Variable projections internally to assist in preparing retirement and other estimates as we get closer to the end of the year. For example, we used these projections to assist you in your decision as to whether to cancel your participation in the Variable Fund.

Core Fund projections, on the other hand, are often made available to the public each spring. These very broad projections are easier to do because of the smoothing that takes place in that fund. These projections took on greater importance in 2008 as we tried to prepare members for the possibility of the first-ever reduction in Core Fund annuities as 2008's financial markets sunk ever lower.

Whether the projections are publicly disseminated or disseminated for internal use, they still come with plenty of cautions about them being preliminary, being dependent on final investment performance and on number-crunching from the consulting actuaries. They are not intended as a tool for precise planning of the final outcome of a particular year's investment returns. Looking over the voluminous email exchanges you had with our benefit specialists, I'm more than satisfied that they made sure you were aware of the limitations of the projections before you cancelled your Variable participation.

In fact, those exchanges make clear that your primary concern was not wanting to stay in the Variable Fund and suffering another loss in 2010, and that you wanted to get out of the Variable Fund as close to your "break even" point as you could because being "about even" was a satisfactory outcome for your future retirement needs. By the looks of it, the benefit specialists worked very closely with you to give you the information we had available so that you could make the decision that fit your needs. They also went to great lengths to explain to you why the spread between the Variable effective rate and annuity adjustment was so great once we knew what the actual spread was. In fact, it appears from those exchanges that even with the difference between the projections and the actual adjustments you felt the outcome was satisfactory because you were out of the Variable Fund and your future retirement income would be more predictable. I would suggest that our projections actually served their intended purpose by giving you a sense of the magnitude of the Variable annuity adjustment and allowed you to better determine where your "about even" point was. I understand that you hoped to be closer to your break even point than the $60 difference you ended up with. Everyone, I think, wished for a higher Variable adjustment but we can't pay you (or others) more simply because you hoped for more. An action like that would be inconsistent with our fiduciary responsibilities.

You apparently believe that the Department had a duty to inform participants of the actuarial adjustments made to the 2008 and 2009 Variable Fund returns. In support of that position, you indicate that in January 2010, the Department explained the 11% differential between the Variable effective rate and annuity adjustment in a certain manner and should have provided that explanation in December 2009.

However, that is not how events occurred or how the process works. First, the language you cite was developed in March, not January, **after** we received the actuary's calculation of the annuity adjustments. Second, those actuarial adjustments are regular occurrences. There is usually carryover from truncation. There are always adjustments that need to be made because benefits paid in the first few months of the year are higher or lower than they should be because of the timing of the annual adjustments. And there are usually other actuarial adjustments that need to be made due to changes in mortality rates and the like. (These are always identified in the actuarial reports which are available on our Internet site.) We simply didn't and don't know what cumulative effect all these moving pieces have on the final adjustment calculation until the independent actuaries crunch the numbers. And, as we've discussed before, the actuaries don't start that process until final Investment Board returns are in, usually around the end of January.

Finally, you raise again the issue of changing the operation of the Variable Fund so that participants can decide retroactively to cancel their participation after they see the previous year's returns and, presumably, get a glimpse of the current year's trajectory. You note that the ETF Board took no action on your demands that the rules be changed to accommodate your desire. We've corresponded on this matter a number of times and you know why the Department believes such a change is not feasible. I won't reiterate those reasons here. Your letters were shared with the Board. Board members were aware of your concerns. It is simply wrong and unfair to suggest that the ETF Board acted in an "appalling" manner because the Board didn't do what you wanted it to do.

If you need additional information or would like to discuss this matter further, please feel free to contact me.

Sincerely,

Robert J. Conlin
Deputy Secretary

cc: Employee Trust Funds Board

CC 10-008

THE MADISON GROUP™
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April 30, 2010

Robert Conlin, Deputy Secretary
Wisconsin Department of Employee Trust Funds
Department of Employee Trust Funds
PO Box 7931
Madison, WI 53707-7931

RE: Repair the Unintended Consequences of the 2010 Variable Annuity Adjustments on Participants in the State of Wisconsin Retirement System

Dear Bob,

Thank you for your letter dated April 16, 2009 in reply to my letter of March 29, 2010.

You accurately described why I believe that the Department of Employee Trust Funds and the ETF Board breached their fiduciary duty to participants in the Variable fund this year when ETF announced the 2010 variable annuity adjustments that resulted from 2009 investment performance. I propose that the Department and the Board have a responsibility to seek financial relief for a class of participants in the Variable Fund. That class is made up of people who irrevocably cancelled their participation based upon projections of annuity adjustments that were made in good faith by ETF after informing participants of the limitations of the projections, but which turned out to be exceptionally wrong this year.

I found your letter careful and thoughtful. It thoroughly explains the actions of the Department and the Board. But the explanations do not excuse what I believe is a failure of the Department and the Board to exercise due diligence, which caused financial harm to this class of participants. I propose there is a solid rationale for the Department to work with the Board and its actuaries to develop a mechanism that would repair the unintended, unacceptable and irrevocable losses experienced by this class of participants. One mechanism might be to apply a fraction of future investment gains to offset and restore the shortfalls in their accounts until they are "even" (not more than even). There are others. I will outline the rationale in this letter.

Your explanations are stated below ***in bold italics*** for convenient reference. I offer the following responses to them for your consideration:

"Our fiduciary duty does not extend to informing individual participants that the Variable Fund adjustment may not be as big as they hoped it would be."

I do not assert that ETF had a fiduciary duty to warn individual participants that the Variable Fund adjustment "may not be as big as they "hoped it would be." I assert that ETF had a fiduciary duty to warn individual participants that this year, because of the unprecedented fiscal uncertainty and financial risk, *there was a much greater chance that the Variable Fund adjustment may be substantially outside of* *the range of the more reliable projections ETF provided to participants in the past.*

There was an unprecedented plunge in 2008. ETF already knew in 2009 that it continued to pay higher amounts for part of 2009. As a result of that combination, there was greater fiscal uncertainty and financial risk that the spread between the Variable Fund effective rate and the annuity adjustment might be significantly wider by an amount unprecedented in any year in the history of the retirement fund. This is the same history that is tracked by SWIB on the chart of fund returns from 1983-2008 that ETF benefits specialists offered Variable Fund participants to assure them that the final annuity adjustment would likely be within the range of the projections as it had been in the past.

The increased potential for a wider spread is a critical piece of information that should have been communicated by ETF to its benefit specialists. That piece of information should have been taken into account by benefits specialists by widening the range of their projections of the spread for 2009 instead of assuming that it would be approximately the same as the 1983-2008 historical average shown on the SWIB chart of investment returns. That piece of information should have been called to the attention of participants in the Variable Fund by benefit specialists when participants were making irrevocable decisions. It was not.

In additional to the fiduciary duty to warn of the potential for increased risk, ETF had an institutional duty to its clients in the Wisconsin Retirement System. The unique 11% spread that was applied by the actuaries this year is a number that does not even exist on the 26 year history of the SWIB chart of spreads that was given to participants. Such a surprise violates institutional trust. An institution has an obligation not to harm a class of employees who are retiring after 30 years by firing them one week before they retire in order to reduce a payroll. Similarly, an institution has an obligation not to harm a class of employees making irrevocable Variable Fund cancellation decisions by surprising them after the fact with a number that has been applied to their annuities that no one has ever seen before in the history of WRS as an accounting measure. In both cases, the institution has an obligation to mitigate the harm.

"We did not know that the projections we gave you in December, which included an eight point differential between the Investment Board's then-current returns, were going to fall short of the actual differential we announced in March. However, if you have information that shows otherwise, as you suggest you do, please forward it to me."

I do not assert that ETF "knew" the projections given to me December "were going to fall short of the actual differential that ETF announced in March." I assert that information brought to my attention shows well before the end of 2009, ETF, its actuaries and others *had discussions about concerns* that the projections might fall short of the differential ETF was assuming it would be when making projections. I think we both know that is the case. Regrettably, it cannot be illustrated herein without embarrassing the sources, none of whom are benefits specialists.

Absent that documentation, let us assume for the moment that I accept your argument that in spite of the historic financial circumstances of 2008-2009, ETF had no concerns about the potential for a larger than normal spread between the Variable effective rate and the annuity adjustment. And let us assume that I accept your argument that ETF was not discussing such concerns with its actuaries. Really? That would be a remarkable admission. It would mean that in spite of the unprecedented financial circumstances of 2008-2009, ETF was not even seeking advice from its own actuaries about whether its benefits specialists could still remain confident in telling Variable Fund participants that it was safe to assume the final annuity adjustments would fall within the 25%-30% range of their projections. That would be a remarkable admission of failure to exercise due diligence.

"You raise again the issue of changing the operation of the Variable Fund so that participants can decide retroactively to cancel their participation after they see the previous year's returns and, presumably, get a glimpse of the current year's trajectory."

I do not suggest that participants in the Variable Fund should be able to "retroactively" cancel participation. I suggest that *participants should have access to a mechanism assuring them that they would not be forced to accept a permanent, unexpected and unacceptable loss if their final annuity adjustment was not reasonably close to the estimate given to them by ETF before cancelling their participation.* To describe them as making "retroactive" decisions is like describing a person who wants to know what a new job will pay before deciding to accept the job as wanting to make a "retroactive" decision. There is nothing retroactive about wanting to know that your paycheck will be close to what it was estimated to be by your employer before you accept the job. There is nothing retroactive about wanting to know that your annuity will be within the range of the estimate given to you by ETF before you irrevocably commit to it. These are forward looking, not backwards looking decisions.

Regarding the notion that participants "presumably want to wait in order to get a glimpse of the current year's trajectory" before making their decision, no reasonable person would dare use the unreliable trend from the first month or two of a year to predict the arc of that entire year as a reason to wait before making a decision.

"We've corresponded on this matter a number of times and you know why the Department believes such a change is not feasible. I won't reiterate those reasons here."

I agree that in our previous correspondence you outlined the reasons why the Department believes such as change is not feasible. I agree we need not revisit them here. That said, there are other opportunities that the Board could have and should have entertained to provide the relief I and other participants in the Variable Fund seek.

The Board could have operated under a temporary emergency rule that allowed ETF to advise Variable Fund participants that anyone cancelling participation would be assured they would be within at least X% of "breaking even" if they cancelled. A single, across-the-board percentage applying to all participants would have avoided the administrative burden of responding to an array of percentages selected by participants that ETF deemed infeasible.

We agreed that some participants would still miss the cut-off percentage no matter what number ETF picked. However, we also agreed that at least participants who cancelled their participation would be assured of knowing that if they cancelled based upon an ETF estimate made in good faith that later proved to be wrong, the participants would not be locked into an annuity that had a loss that was any greater than a known percentage they had already accepted. Ideas such as this one, as well as others should have been discussed by the ETF Board. They were not.

"You note that the ETF Board took no action on your demands that the rules be changed to accommodate your desire. Your letters were shared with the Board. Board members were aware of your concerns. It is simply wrong and unfair to suggest that the ETF Board acted in an "appalling" manner because the Board didn't do what you wanted it to do."

I do not suggest that the Board acted in an appalling manner "because the Board didn't do what I wanted it to do." Nor is an urgent plea for action a "demand." I suggest and continue to affirm that the Board acted in an "appalling" manner because even though my letters were distributed to the Board, *it never had the curiosity to discuss them in even as they dramatically illustrated how financial harm was coming to retirees.* Unfolding events have proven that forecast to be correct. Nor was any presentation of the issues by participants in the Variable Fund allowed even though such presentation was formally requested by letter. Nor were any public comments about the issues even allowed by participants in the Variable Fund because the Board has no provision for public comments at its meetings.

What is appalling is not that "they didn't do what I wanted them to do." What is appalling is that in spite of being urgently informed of the foreseeable and irrevocable financial harm that was fast approaching participants, *they did nothing at all. That* is appalling. I say this as a former member of the State Budget Office in the Wisconsin Department of Administration and Executive Director of a legislatively appointed State Board under Governor Tommy Thompson. Just because the Department advised the Board that it thought a change was infeasible does not relieve the Board from the duty of pursuing alternatives. The Board's first duty is not to the convenience of the Department. The Board's first duty is to the oversight of the Department. Its fiduciary duty is to be proactive, not passive.

"Looking over the voluminous email exchanges you had with our benefit specialists, I'm more than satisfied that they made sure you were aware of the limitations of the projections before you cancelled your Variable participation."..."When we do provide the projections to participants, we always inform them of the limitations of those projections. We did that in your case, as you have acknowledged. We gave you the best projections that we had available and our benefit specialists informed you of the limitations of those projections."

You correctly point out that I acknowledged the many ways ETF benefits specialists informed me and others of the limitations of the projections. In my letter I quoted some of the caveats expressed by a half dozen different benefits specialists. No fault is implied with respect to their conduct. My experience with them was excellent. The issue is not with what they did. The issue is with what they had to work with.

One of the key things they had to work with was the Chart of Variable Fund Effective Rates vs. Annuity Adjustments from 1983-2008 published by SWIB. The spread in the chart was described to me and others as: "An effective rate of 5% less than actual performance is typical in the history of the Trust Fund and the few very large differences may be anomalies, so it (5%) is a safe assumption." The benefits specialists were not given any other cautionary information by ETF or its actuaries to the contrary in spite of the unprecedented fiscal circumstances of 2008-2009. Therefore, while I acknowledge being informed of the limitations, in the absence of other more urgent caveats, the phrase "5% is a safe assumption" can reasonably be interpreted to mean that the final spread might be 6%, or 7% or perhaps even as high as 8%. *But there is no possible, reasonable interpretation of the phrase "5% is a safe assumption" that could possibly mean 11%* regardless of having been informed that the projections had limitations.

When multiple estimates are given to Variable Fund participants by multiple specialists on multiple occasions that consistently describe the limitations of projections as being "within the range of 25%-30%" most reasonable observers would conclude that advice to mean that while the final number cannot be predicted because of the limitations of the projections, it is safe to assume the final number would be between 25% and 30%. Absent any other more cautionary advice about the limitations of the projections, in the English language, that is what "in the range of" means. Some might allow for a more generous interpretation that could even fall *outside* the boundaries of the range, perhaps between 24% and 26%. *But there is no possible, reasonable interpretation of the phrase "in the range of 25%-30%" that can mean 22.0%* regardless of having been informed that the projections had limitations.

"Exchanges [with benefits specialists] make clear that your primary concern was not wanting to stay in the Variable Fund and suffering another loss in 2010, and that you wanted to get out of the Variable Fund as close to your "break even" point as you could because being "about even" was a satisfactory outcome for your future retirement needs."

We agree on this one. :-)

"It appears from those exchanges that even with the difference between the projections and the actual adjustments you felt the outcome was satisfactory because you were out of the Variable Fund and your future retirement income would be more predictable."

My expressions of satisfaction to the benefits specialists were deliberately restrained and cheerful because I did not want them to feel badly about providing me with their best advice that turned out to be unusually wrong. It would have been pointless to get into these issues with them because these issues are at the policy level.

While I agree the outcome is satisfactory in terms of being out of the Variable Fund in order to exchange potentially higher but volatile returns for retirement income predictability, the outcome is not satisfactory in terms of being "about even." The benefits specialists calculated "about even" to mean a difference of $2.75/mo. not $60/mo. Over 15 years at 2% that is nearly $13,000. Multiply that by the losses of other retirees with the same experience or worse and the cumulative impact on retirees is certainly worthy of ETF's attention in terms of seeking relief on their behalf.

"I would suggest that our projections actually served their intended purpose by giving you a sense of the magnitude of the Variable annuity adjustment and allowed you to better determine where your "about even" point was."

I agree that ETF's projections helped me "get a sense of the magnitude of the Variable annuity adjustment." But they did not serve their intended purpose of helping me come anywhere near close to being "about even."

You apparently believe that the Department had a duty to inform participants of the actuarial adjustments made to the 2008 and 2009 Variable Fund returns. In support of that position, you indicate that in January 2010, the Department explained the 11 % differential between the Variable effective rate and annuity adjustment in a certain manner and should have provided that explanation in December 2009. However, that is not how events occurred or how the process works. First, the language you cite was developed in March, not January, after we received the actuary's calculation of the annuity adjustments. Second, those actuarial adjustments are regular occurrences.

I do not believe that the Department's duty was to inform participants of the actuarial adjustments made to the 2009 Variable Fund returns before ETF published its March, 2010 explanation of the 11% differential between the Variable effective rate and the annuity adjustment. What I do believe is that the Department's duty was to *exercise due diligence by proactively consulting with its actuaries* ***prior*** *to the end of December, 2009 and then publishing a warning* advising both participants and benefits specialists that because of the unprecedented market circumstances of 2008-2009, this year there was greater financial risk and uncertainty that there might be a larger than average spread between the Variable Fund effective rate and the annuity adjustment than what was experienced over the 1983-2008 period of investment returns shown on the SWIB chart that benefits specialists were offering to Variable Fund participants as assurance for decision making.

"There is usually carryover from truncation. There are always adjustments that need to be made because benefits paid in the first few months of the year are higher or lower than they should be because of the timing of the annual adjustments. And there are usually other actuarial adjustments that need to be made due to changes in mortality rates and the like. (These are always identified in the actuarial reports, which are available on our Internet site.)
We simply didn't and don't know what cumulative effect all these moving pieces have on the final adjustment calculation until the independent actuaries crunch the numbers."

Simply "not knowing what cumulative effect all the moving pieces have on the final adjustment calculation until the independent actuaries crunch the numbers" does not excuse ETF from the fiduciary duty to anticipate and warn Variable Fund participants of the potential for increased risk and uncertainty in its projections compared to previous years. The range of projections made by benefits specialists should have been widened to accommodate the increased risk and uncertainty. Had that been done, the final annuity adjustments would not have fallen so wildly beyond the boundaries of the range of the projections.

To use an analogy, suppose an airline pilot had been flying an intercontinental route from 1983-2009 during the same 26 years that SWIB tracked investment returns. And suppose at the end of 2009, the pilot encountered an unprecedented set of atmospheric circumstances he never before encountered that affected his flight path, altitude and fuel consumption. Much like the unprecedented financial circumstances that ETF encountered. The pilot has a responsibility to exercise due diligence by proactively consulting with his navigators to see if he still has sufficient fuel to cross the ocean. Much like ETF had a fiduciary responsibility to exercise due diligence to consult with its actuaries to see if its projection methodology would be as reliable as it had been in the past. If the pilot were so uncurious that he would not even ask the question of his navigators, then he would have failed to discharge his duty to exercise due diligence on behalf of his passengers. And if ETF was so uncurious that it did not even consult with its actuaries, then it too failed to discharge its fiduciary duty to Variable Fund participants.

Now suppose the pilot did in fact consult with his navigators and they gave the pilot the same answer that you gave me: *"We simply didn't and don't know what cumulative effect all these moving pieces have on the final adjustment calculation until the independent actuaries (read independent navigators) crunch the numbers."* Fine. Then under such circumstances, what do you think is the pilot's duty at that point? Is it just simply to inform his passengers that he thinks that his fuel load will be "within the range of his projection" based upon his previous experience from 1983 to 2009 while making sure that he covers himself by saying "he fully informed his passengers of the limitations of his projection?" Much like ETF benefits specialists advised participants in the Variable Fund while informing them of the limitations to their projections. No. Why? Because it is the pilot's duty is to tell his passengers that under such unprecedented circumstances, *this time he has concerns that there might be a greater chance* that his fuel load may be *"outside* the range of his projection" and therefore they should turn back before the aircraft passes the point of no return. Just like it was ETF's duty to warn participants in the Variable Fund that this time its projections were not just subject to the same limitations as they had been in the past, *but also that this time they might be subject to a greater level of risk and uncertainty because of the unprecedented circumstances known to its actuaries.* By not doing so, ETF failed to meet its duty to exercise due diligence and its fiduciary duty to warn.

I believe the Department and Board should have been exercised greater due diligence and been more proactive. We can differ on whether or not that is a reasonable expectation. However, where there is shared responsibility for negative outcomes, there is a shared duty to repair the damages. There are clearly unintended outcomes and unintended damages. It is unfair to ask the class of Variable Fund participants who cancelled their participation under such circumstances to bear the cost of the unintended, unacceptable and irrevocable outcomes they experienced without the partnership of the Department and the Board in seeking a remedy.

I understand that you hoped to be closer to your breakeven point than the $60 difference you ended up with. Everyone, I think, wished for a higher Variable adjustment but we can't pay you (or others) more simply because you hoped for more. An action like that would be inconsistent with our fiduciary responsibilities.

I agree that you cannot pay me or others more "simply because we hoped for more." But the request is not based on a "hope." The request is based on a self-evident rationale. That rationale is: This time the Department's good faith efforts produced projections that were wildly wrong. Variable Fund participants based cancellation decisions upon those mistaken projections and incurred irrevocable financial harm. Those cancellation decisions were based upon projections that ETF characterized as being subject to expressed limitations but "within the range of 25%-30%" and "an effective rate of 5% less than actual performance...is a safe assumption." (The final differential was 11%, not the "safely assumed" 5%). The method used by benefits specialists to make the projections did not widen that range nor qualify that "safe assumption" to account for this year's increased risk and uncertainty, an increase that ETF and its actuaries *should have known* and should have advised its benefits specialists about so that they could have taken that into account by widening the boundaries of the range of their projections. For that reason, putting aside our differences about whether or not the Department and the Board failed to exercise due diligence, the Department and the Board have a fiduciary duty to seek some form of financial relief on behalf of that class of participants.

In my own case, if the benefits specialists had not been confident that the final annuity adjustment would be within the range of their projections, then working together we would not have elected unconditional cancellation as a prudent course. Had the benefits specialists had any serious reservations that the limitations of the projections that they explained to me would not cause the final number to vary wildly beyond the boundaries of the range of their projections, then a conditional cancellation may have been more appropriate. They did their best, but it turned out to be wildly wrong because they had insufficient risk and uncertainty advice from actuaries to work with. What then is ETF's fiduciary duty to other participants in the Variable Fund who find themselves in similar circumstances?

I offer the previous example of the employee who accepted a job only to discover that this year's paycheck would actually be significantly less than what was initially projected by the employer. In spite of the employer's good faith effort to estimate the pay rate correctly and despite the employer's explanation of the limitations of the method used to estimate the rate of pay, it turned out to be wrong.

The employer could correct that problem by making plans to use a fraction of the gains from the first profitable business year to bring the paycheck back into line with what was intended by both parties. There are other options, but this one serves the purpose of illustrating one of the many things the Department and Board could pursue as relief for this class of participants in the Variable Fund.

The Board could take the same action as the employer in the illustration above. The Department could work with the Board and its actuaries to develop a mechanism to repair the unintended shortfalls of this class of participants by applying a fraction of future investment gains to their accounts until they are "even" (not more than even). That was the intended outcome of the participants and the benefits specialists who advised them. It should be the intended outcome of the Department and the Board to achieve.

It is unfair at best and a breach of fiduciary duty at worst, to simply walk away from this class of participants in the Variable Fund and say, "oops, sorry, our bad, we informed you that we might blow it; guess you'll just have to live with it." The Department has a fiduciary duty to be a partner in finding a solution to this problem.

We can differ on whether or not the Department and Board should have exercised greater due diligence and been more proactive to prevent what happened to this class of participants in the Variable Fund. But surely we can agree on this:

This year, in spite of the best efforts of its benefits specialists, the Department's projections of the spread between the Variable Fund effective rate and the actual annuity adjustment were unusually and exceptionally wrong. This year, the projections were more inaccurate than any time in the 26-year history of the Wisconsin Retirement System. This year, a class of participants in the Variable Fund made irrevocable cancellation decisions relying on those mistaken projections, incurring unintended harm. This year, the Department and the Board faced circumstances that are unprecedented in the history of the Wisconsin Retirement System. Therefore, this year, the Department and the Board have a commensurate duty to repair that harm with equally unprecedented solutions.

Thank you for considering this issue. I look forward to the Department and the Board working together prospectively to find a way to repair the unintended consequences of the 2010 Variable Annuity adjustments on participants in the State of Wisconsin Retirement System.

Best wishes,

Douglas King

Cc: Wisconsin Employee Trust Funds Board c/o Cindy Gilles, Board Liaison
Selected Legislators, Board Chairs, Union Representatives, Media Representatives
Interested Parties

Stohr, Matthew

From: Stohr, Matthew
Sent: Wednesday, March 17, 2010 3:19 PM
To:
Cc: 'Rep.parisi@legis.wisconsin.gov'; 'Hanson, Linda'
Subject: FW: Constituent Question -- Liabilities
Importance: High

Hello

Linda from Representative Parisi's office asked me to respond to your e-mail about unfunded pension and insurance liability. Please find below a few links to documents that provide good information about unfunded pension and insurance liability.

1) The first link is to a report by the PEW Center on the States, which lists Wisconsin as one of the "national leaders" in keeping unfunded pension and insurance liability to a minimum. Here is the link to the summary of the report: http://www.pewcenteronthestates.org/report_detail.aspx?id=56695

In addition, here is specific portion of the report that centers on Wisconsin:
http://www.pewcenteronthestates.org/uploadedFiles/wwwpewcenteronthestatesorg/Initiatives/R_and_D/Trillion_Dc

2) Another document that I think is helpful is the annual report on the programs administered by the WI Department of Employee Trust Funds. In short, we are the state agency that administers the Wisconsin Retirement System (WRS) and the state health insurance program. The state and many of the larger local units of government participate in the WRS, except Milwaukee County and the City of Milwaukee-which have separate systems.

Here is a direct link to our 2007 annual report: http://www.etf.wi.gov/about/2007_cafr.pdf. Page 104 shows the assets and liabilities. We hope to have the 2008 report done soon.

3) If you are looking for the WRS unfunded liability of a particular local unit of government, please visit this database on our website:

http://etfonline.wi.gov/ETFCalculatorWeb/etf/internet/employer/ETFemployerrates.jsp

In summary, the WRS is 99.7% funded using the actuarial funding measure.

I hope you find this information helpful.

Matt Stohr, Director
Legislation, Communications & Quality Assurance
Wisconsin Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931
608.266.3641 (phone)
etf.wi.gov

Learn more about our benefit programs by viewing an educational video today! Go to http://etf.wi.gov/webcasts.htm to check out the latest presentations in our video library.

From:
Sent: Sunday, March 14, 2010 7:13 PM
To: Rep.Parisi
Subject: Dollar amount of unfunded State of Wis. obligations

Hi Joe,

I would be interested in knowing if the State of Wis. has any unfunded pension liabilities or insurance liabilities or perhaps any other unfunded liabilities? If so, what is the dollar amount of these liabilities?

Thank you.

Stohr, Matthew

From: Stohr, Matthew
Sent: Wednesday, March 17, 2010 10:06 AM
To:
Cc: Meier, Jaymee; Hearing, Vicki L - SWIB
Subject: FW: WRS ranks as national leader
Attachments: 2010_Variable.pdf; Item 3A - GRS 2009 Retired Lives.pdf

Mr. :

In addition to the Variable Fund explanation document that Ms. Hearing sent you, please find attached the independent actuary's report that highlights the calculations used to determine this year's Core and Variable annuity adjustments. Specifically, page 15 of the report shows each calculation used to determine the Variable Fund annuity adjustments. The methodology used by the independent WRS actuary has been reviewed and approved by other independent actuaries in the past.

Typically, there is a 5% or 6% difference between the effective rate (the rate applied to active employee accounts) and the annuity adjustment (the rate applied to retiree accounts). The 5% or 6%, which is consistent with pension systems across the nation, is needed to pay benefits for the retiree's projected lifetime. This year there is an 11% difference between the Variable effective rate and annuity adjustment due to the many factors explained in the document that Ms. Hearing sent you. The document is also available on the ETF Internet site (www.etf.wi.gov). In addition, it is important to point out that last year there was a 2% difference between the effective rate and the annuity adjustment and that had a lot to do with this year's 11% difference.

Finally, in regard to your comment about how the WRS is "making money" because of the Variable adjustment, it is important to note that WRS assets are only used to pay benefits and to cover the administrative expenses and services needed to pay the benefits. ETF's administrative costs are so low in relation to the value of WRS assets that if the ETF administrative budget was more than doubled, it **wouldn't** have an impact on WRS annuity adjustments or contribution rates.

Matt Stohr, Director
Legislation, Communications & Quality Assurance
Wisconsin Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931
608.266.3641 (phone)
etf.wi.gov

P.S. Jaymee-please include these e-mails in file for future reference.

From: Vicki.Hearing [mailto:vicki.hearing@swib.state.wi.us] **On Behalf Of** INFO
Sent: Tuesday, March 16, 2010 4:43 PM
To:
Cc: Stohr, Matthew
Subject: RE: WRS ranks as national leader

Mr.
The State of Wisconsin Investment Board is responsible for investing the funds and is not involved in the determination of the amount of increase or decrease to participants. The investment returns are reported to Department of Employee Trust Funds (ETF), the agency that calculates the impact on retirees based on several factors. I have attached a statement from ETF regarding the Variable Fund and am forwarding your comments to Matt Stohr, Director of Legislation, Communications & Quality Assurance at the Department of Employee Trust Funds.

Vicki Hearing - Public Information Officer - State of Wisconsin Investment Board - vicki.hearing@swib.state.wi.us

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From:
Sent: Sunday, March 14, 2010 5:28 PM
To: INFO
Subject: WRS ranks as national leader

It's no wonder WRS is in good shape with the way they screw the variable annuitants every year. Bigger losses and smaller gains passed on. With that setup, WRS should be making money no matter what. Although, they did reached a new low this year for sticking it to us. Congratulations!

Texas

RECEIVED

MAR 29 2010

EMPLOYEE TRUST FUNDS
OFFICE OF THE SECRETARY

Select Members of the ETF Board
c/o Cindy Gilles, Board Liaison
Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707-7931

Dear ETF Board Members:

Last year at this time, the retired Wisconsin employees were being informed about the poor performance of the invested funds of the retirement system. For the 35,000+ in the variable program, we were told to expect a 42% reduction in the variable portion of our retirement.

The primary justification for the devastating amount of the reduction was that "by law, the amount of reduction/increase in the variable must be very close to actual." Personally, that meant a $600 monthly decrease in retirement. I think most of us on the variable program have accepted the risks and enjoyed the benefits of the program.

Most disturbing about the announcement this year from WETF, is that we aren't realizing anything close to the 33% (probably closer to 37%) increase. Justification for the discrepancy for not being close to "actual" revolved around the fact that an actuarial party had reviewed the calculation and said it was OK. Another major point being made was the "Timing." Clarification was reported in WETF documents stating that the first four months of 2009 did not reflect the reduction, and that amount has to be accounted for beginning in May of 2010. The same argument should be made about the fact that the INCREASE isn't realized for four months in 2010. In other words, the adjustments run for 12 months regardless of when the cutoff dates for calculation occur.

I believe the Board has let down a significant number of retired Wisconsin employees. You are encouraged to review and correct the policies of the Board, and help protect all sectors of the retirement community. I am encouraging other variable members to question the action of the Board.

Sincerely,

STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

1-877-533-5020 (toll free)
Fax (608) 267-4549
http://etf.wi.gov

April 15, 2010

DR

Dear Dr.

Thank you for your March 23, 2010, letter to Employee Trust Funds (ETF) Board Chair, Marilyn Wigdahl, and ETF Board members, Michael Langyel and Theron Fisher. You wrote to express disappointment about the Variable annuity adjustment calculation process, in general, especially in the wake of last year's -42% annuity adjustment and this year's +22% adjustment. The Board members asked me to respond to your letter on their behalf.

In your letter, you asked the Board members to "review and correct" the policies of the Board with respect to Wisconsin Retirement System (WRS) annuity adjustments. The methodology used by the Board's independent consulting actuary, who determines all WRS annuity adjustments and contribution rates, is professionally reviewed by other independent actuaries. In fact, in accordance with Wis. Stat. § 13.94(1)(dc), the State of Wisconsin's Legislative Audit Bureau works with another independent actuary to review the entire WRS annuity adjustment process at least once every five years. The methodology used by the WRS independent consulting actuary to determine annuity adjustments has been approved by the other independent actuaries each time.

In addition, you referenced the "timing" issue inherent to the Variable annuity adjustment process. You correctly pointed out that regardless of whether the adjustment-to-be is an increase or a decrease, the fact remains that there are four months at the beginning of the year that annuities are unchanged. In other words, just as the calculation process for 2009 factored in the four months that annuities were not negatively adjusted (even though there was a -39% investment decline in the Variable Fund in 2008), the process this year reflected the first four months of 2010 in which they were negatively adjusted (even though there was a 33.7% investment increase in the Variable Fund in 2009). This calculation process has been used for many years, therefore the calculation process and the "timing" issue equals out over time.

In closing, you might find the following information useful. Each year the WRS consulting actuary presents the annuity adjustments to the ETF Board at its March meeting. On the following page is a link to the Internet site where the actuary's report for the March 2010 Board meeting can be viewed. Specifically, page 15 shows the exact calculations for this year's Variable annuity adjustment: http://etf.wi.gov/boards/agenda_items_2010/etf20100318_items/ji-item3a.pdf.

Thank you for taking the time to write. I hope this information has been helpful to you. If you have further questions or comments, please contact me at (608) 266-3641.

Sincerely,

Matt Stohr

Matt Stohr, Director
Office of Legislative Affairs, Communications
and Quality Assurance

cc: Marilyn Wigdahl, ETF Board Chair
Theron Fisher, ETF Board
Michael Langyel, ETF Board
CC 10-009

CC 10-012

David A Stella

Secretary, Employee Trust Funds

PO Box 7931

Madison, WI 53707-7931

RECEIVED
APR - 8 2010
EMPLOYEE TRUST FUNDS
OFFICE OF THE SECRETARY

Dear Mr. Stella:

After having lost forty percent of my variable retirement account last year, it was just about the last straw when I read the fixed account was about to lose one percent this coming year, while the variable (which I am no longer in), will increase twenty-five percent.

In the very least, I believe my account should be re-examined. I elected to change to all fixed in May of 2008. For some archaic reason, I was held in the 50-50 arrangement until May 2009 when all the damage had been done. I see no reason to hold anyone in such an arrangement for an entire year. When you sell any stock, it is accomplished now, not sometime in the future.

Furthermore, I feel the decision to award brokers millions of dollars in bonuses to be extremely inappropriate. Those of us who have made our contributions to the system over the years have been cut while the system brokers enjoy bonuses. It just doesn't make any sense. Haven't we learned anything from the investment and banking problems of the past year and a half? In our present economy, our leaders should show a little more restraint

I will be looking forward to your response.

Sincerely,

STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

1-877-533-5020 (toll free)
Fax (608) 267-4549
http://etf.wi.gov

April 16, 2010

Dear Mr.

Thank you for your letter to Secretary David Stella regarding your Wisconsin Retirement System (WRS) annuity. Secretary Stella has asked me to reply on his behalf.

In your letter you requested that that the Department of Employee Trust Funds (ETF) re-examine your WRS annuity to determine whether the Core and Variable portions of your annuity were correctly adjusted. I have reviewed your WRS annuity, and it was adjusted correctly as required under the laws governing WRS benefits.

ETF received your completed *Canceling Variable Participation* form on May 19, 2008, on which you elected to unconditionally cancel your Variable Fund participation. The informational portions of the cancellation form explained that your Variable Fund cancellation would become effective on December 31 of the year in which ETF received your completed form, and that in the following year your Variable annuity would be adjusted based on the Variable investment experience for the year in which ETF received your cancellation form.

You elected to cancel your Variable Fund participation unconditionally; this meant that once the final Variable adjustment was applied to your annuity, it would be transferred to the Core Fund. In subsequent years the Core Fund annuity adjustments would be applied to your entire annuity. This information was also provided to you on the *Canceling Variable Participation* form, as well as on the acknowledgement notice sent to you on May 20, 2008.

In your letter you stated that you "see no reason to hold anyone in such an arrangement for an entire year. When you sell any stock, it is accomplished now, not sometime in the future." I would like to clarify that participating in the Variable Fund is very different from owning stocks that an individual can sell at will. In a defined benefit plan such as the WRS, for investment purposes the funds are comingled; participants' accounts are not invested individually. Furthermore, once a participant begins a retirement annuity the participant's account is closed, and the monies necessary to fund the annuity for the participant's projected lifetime are transferred to the Annuity Reserve. This is the pooled fund from which all annuities in force are paid; there are no individual participant accounts in the Annuity Reserve.

Once the annual Core and Variable effective rates for all WRS funds have been determined based on the previous year's investment experience, effective rate interest is credited respectively to the Core and Variable portions of the Annuity Reserve. At that point the Core and Variable annuity adjustment rates can be calculated, and on the May 1 payment those adjustments are applied to Core and Variable annuities. By law, only then can the annuities for which Variable cancellations have been submitted be transferred to the Core Fund.

I can understand your frustration that you are not eligible for the 22% Variable annuity increase because you cancelled your Variable Fund participation, and that a small decrease must now be applied to your entire annuity. Unfortunately, because of the smoothing mechanism that distributes Core Fund gains and losses over a five-year period, the investment losses from 2008 will continue to be reflected in the Core interest and annuity adjustment rates for another three years. ETF has no alternative but to apply the annuity adjustments based on the investment experience of the fund as required by law.

While I recognize that this explanation does not help your personal situation, I hope that this information clarifies why the annuity decrease is necessary. If you have any questions you are welcome to contact me at the number below.

Sincerely,

Linda Owen

Linda Owen, Policy Analyst
Office of Policy, Privacy and Compliance
(608) 261-8164
linda.owen@etf.state.wi.us

Enclosure

CC 10-010

Mr. David A Stella, Secretary
Department of Employee Trust Funds
State of Wisconsin
801 W Badger Road
Madison, WI 53707-7931

April 9, 2010

RECEIVED
EMPLOYEE TRUST FUNDS
2010 APR 13 AM 11:10

SUBJECT: Excessive Amount Deducted from the Variable Fund Dec 09 "Opt Out Pensioners"
Dear Mr. Stella

We are very concerned with the unexpected change this year to an 11% deduction rather than the customary 5-6%..

We phoned the State several times from October through December to get input on what the percentage would be while we were considering Opting Out of the Variable in Dec 2009. During all of the phone calls there was never a mention of the unusual step of an extra percent 5%-6% being taken out. We were told time and time again that IF the market stayed where it was (and it did) we would see about 25-27% increase in our monthly benefit check; i.e we would see the 33% gain minus the customary 5-6% deduct by ETF; i.e. about 25-27% increase in pension.

We had taken the FULL LOSS of 42% the year before, with the Variable. There was no attempt by ETF to soften that amount – We knew the risk and we accepted that. Those remaining in Variable know the risk too.

We based our decision to opt out on the market performing "as expected" (and it did) and ETF taking out the USUAL, CUSTOMARY 5-6% from the 33% gain. We watched the video explanation carefully as well. We can't remember ETF doing anything like this in the past.
No warning, no telling us when we called and called and watched and watched -- JUST AN UNPLEASANT SURPRISE ON MARCH 9-10, 2010!

Now we are "stuck" with this additional, excessive, unexpected reduction <u>forever</u> because of an unprecedented decision by ETF. We had based our decision on the market ending at about +33% and our calls to ETF confirming that if that was the end-year scenario (and it was) we could expect to recover about 25-27% of the 42% lost the prior year.

Some of the reasons given for this unusual move is for the FUTURE VARIABLE FUND.-- Those of us who opted out in Dec 09 will not be in the variable in the future.
So we are being punished with a reduction in our monthly pension for the ***FUTURE*** *VARIABLE FUND!!*
It does not appear to be appropriate to deduct an additional 5-6% from those who opted out of variable in December 09 and who, therefore, will not benefit from the extra 5-6% withheld from our pension for the sake of ***<u>FUTURE PENSIONERS IN THE VARIABLE FUND</u>***.

Those of us who 'opted' out of Variable in December 2009 - should **NOT** see this excessive reduction that is based on "helping" the variable fund for which we are no longer a part!

Please check the legal basis for taking extra money away from those who are NOT a part of future years of the Variable Fund. Where would the excessive money go from those of us not longer in the Variable – not to us!

We look forward to your prompt response

CC 10-010

STATE OF WISCONSIN
Department of Employee Trust Funds

David A. Stella
SECRETARY

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April 29, 2010

Dear Mr.

Thank you for your April 9, 2010 letter to Department of Employee Trust Funds (ETF) Secretary David Stella concerning the 2010 Variable Trust Fund annuity adjustment. Secretary Stella asked me to respond to you on his behalf.

As you pointed out in your letter, the Variable Trust Fund investment return was 33.7% in 2009 and the Variable effective rate and Variable annuity adjustment for this year, set by the Wisconsin Retirement System's (WRS) independent consulting actuary, are 33% and 22%, respectively. You expressed disappointment that the difference between the Variable effective rate and the Variable annuity adjustment this year is 11% — not the "customary 5% to 6%", as you described it. You were expecting a Variable annuity adjustment in the 25% to 27% range and, given that expectation, unconditionally canceled your participation in the Variable Fund in December 2009. You based your expectations on ETF's rate projections, subsequent conversations with ETF staff, and your review of historical Variable Fund returns and dividends. You also questioned the legality of the calculations used by the independent consulting actuary to determine Variable Fund annuity adjustments. The calculations used are in full compliance with state law.

I have listed on page two a few of the major reasons for the 11% difference between the two rates this year. However, please note that while the differential is often in the range of four to six percentage points, larger gaps are not uncommon. For example, since 1986, the difference has been seven points once (1999), eight points four times (1988, 1989, 1995 and 2006), nine points once (2003) and ten points once (1991). On the other hand, the differential has been as little as two points-such as last year.

ETF prepares projections concerning possible annuity adjustments as a service, to give members a sense of the magnitude of the potential adjustments and, in theory, prepare for the general financial impact. These projections come with plenty of cautions about being preliminary figures that are dependent on final investment performance and the required analysis by the ETF Board's independent actuaries. Our projections are not predictions. Although the Variable Trust Fund investment return did come in at about 33% at the end of the calendar year, the calculation used to determine the Variable

Fund annuity adjustment depends on a number of actuarial factors. Once these factors are determined and investment returns are finalized – processes that take time to complete – only then can the work to determine **actual** effective rates and annuity adjustments begin. These factors include carryover from the previous year, rounding, and mortality rates.

In your letter you also mentioned that you "were told time and time again that IF the market stayed where it was we would see about 25-27% increase in our monthly benefit check; i.e. we would see the 33% gain minus the customary 5-6% deduct by ETF". We did provide a range of projections about Variable annuity adjustments based on possible investment returns in the January newsletter, however, I am not aware that we provided predictions as precise as you suggest.

Another thing to keep in mind: Although the Variable Fund last year experienced its largest gain since 1986, it also experienced it largest single-year loss in 2008. These dramatic swings had an unanticipated, exaggerated effect on some of the actuarial factors necessary to calculate this year's final annuity adjustments. Thus, the primary reasons behind the 11% difference between the two rates for 2009 are listed here:

- Built-in 5% assumption rate of return. A 5% percent investment return is needed each year to pay benefits for a retiree's projected lifetime.
- Carryover from last year's calculation. By law, the WRS consulting actuary calculates variable annuity adjustments to the whole percent. As a result, a negative number was carried over from last year and that number has compounded due to the reduction in Variable assets brought about by the 2008 market crisis.
- Timing (the four months that Variable annuities were NOT reduced in 2009 must be accounted for). ETF does not adjust annuities until May 1 of each year; it takes time to finalize year-end investment returns and calculate interest rates and annuity adjustments. ETF was not adjusting annuities by -42% in the first four months of 2009, *even though there was roughly a 40% loss in the annuity reserve*. This lag time and the truncation (rounding of numbers) described above amounted to a -3.9% carryover loss from 2009 into this year's Variable annuity adjustment calculation. The lag time can benefit Variable annuities in certain years, such as last year when there was only a 2% overall difference between the Variable Fund effective rate and annuity adjustment. Conversely, there are years when the lag time can have a negative impact on annuities, such as this year.

The methodology used by the independent actuaries is professionally reviewed by other independent actuaries. In fact, in accordance with Wis. Stat. S. 13.94(1), the State of Wisconsin Legislative Audit Bureau works with yet another independent actuary to review the entire WRS annuity adjustment process at least once every five years. The methodology used by the WRS actuaries to determine annuity adjustments has been approved by the other independent actuaries each time.

In your letter you wrote about the -42% annuity adjustment last year and wrote that "there was no attempt by ETF to soften that amount". As you are aware, the Variable Fund investment returns are not smoothed over the course of five years like the Core Fund. The intent of the Variable Fund, by law, is to give WRS members an all-equity investment tool where the returns are not smoothed. If members are uncomfortable with the volatility of the fund, it may not be the right choice for them and we have communicated that message to members extensively through our newsletters, website and other means. We have also developed and distributed information about cancelling Variable participation.

Although participation in the Variable Fund is a personal decision, I can understand your frustration with the Variable Fund. In fact, the ETF Board and the Department feel the design of the Variable Fund is inconsistent with the goals and purpose of a defined benefit plan such as the WRS. As a result, the ETF Board (with the help of the Department) asked the Legislature to close the Variable Fund to new enrollees. A bill to close the fund to new enrollees was introduced this legislative session, however, it did not pass. Both the Board and the Department will ask the Legislature to reintroduce this bill next legislative session.

I thank you for taking the time to write. I hope this information has been helpful to you. If you have further questions or comments, please don't hesitate to contact me at (608) 266-3641.

Sincerely,

Matt Stohr

Matt Stohr
Director of Legislation, Communications and Quality Assurance

CC 10-010

First Name
Last Name
Street Address 1
Street Address 2
City, State, Postal Code
Country UNITED STATES
Day Time Phone (229)
E-mail Address
Employer NONE

Message: What incompetent clown is responsible for yet ANOTHER decrease in my annuity payment? Don't these people know how to invest? I see MANY other entities making money yet WI ETF fails to keep abreast of changes.
Don't bother giving me the tired rhetoric about how money was made in the past.
It's bad enough having an idiot in the whitehouse without suffering the effects of the idiots on the ETF board.
I have a message for the totally incompetent, blind, moronic board members.
Quit kissing the butt of the governor and try focusing your limited attention to actually MAKING money. Wisconsin is one useless tax hell of a state and coupled with your bad investment strategy only serves to support that reality.
It's a shame that board members can't be immediately removed from their position and prosecuted for their actions. You people are part of the problem of why there is an economic crisis and if justice actually existed you should be put in jail.

Stohr, Matthew

From: Stohr, Matthew
Sent: Friday, May 07, 2010 11:09 AM
To:
Subject: FW: Annual Annuity Adjustments

Importance: High

Mr.

The Department of Employee Trust (ETF) is responsible for the administration of the Wisconsin Retirement System (WRS) and the State of Wisconsin Investment Board (SWIB) is responsible for WRS investments. If you have an investment related question, I suggest you contact SWIB directly. You may want to check their website to learn how they frequently beat investment benchmarks and to learn about SWIB's solid investment track-record.
http://www.swib.state.wi.us/

ETF has communicated extensively (through our newsletters, website, online videos, press releases, presentations, direct letters and more) with WRS members about the impact of the 2008 stock market crash on WRS accounts. In our newsletter, which is mailed to all WRS retires, we have continuously written about the state law that requires WRS Core Fund investment returns to be smoothed over a course of five years. Although, retirees experienced a -1.3% reduction in the Core Fund portion of their annuities effective May 1, 2010 (and a -2.1% reduction last year) because of the 2008 market crash, they would have experienced roughly a -30% reduction effective May 1, 2009 if the investments weren't smoothed. Both the January 2010 and May 2010 editions of the newsletters provide more detail about smoothing and the impact on Core Fund annuities. We also have an online video on our website if you want more information about smoothing and annuity adjustments.

Matt Stohr, Director
Legislation, Communications & Quality Assurance Wisconsin Department of Employee Trust Funds
P.O. Box 7931 Madison, WI 53707-7931
608.266.3641 (phone)
etf.wi.gov

-----Original Message-----
From: ETF Secure Email System [mailto:noreply@etfmailer.state.wi.us]
Sent: Sunday, May 02, 2010 1:22 PM
To: E-Mail (Call Center)
Subject: Annual Annuity Adjustments

The following feedback was submitted to ETF on 05/02/2010 at 01:22:26 PM CDT

Subject Line Annual Annuity Adjustments

SSN Last 4
Member ID
Month/Year of Birth

5-1-10

10-016

Mr. David A. Stella E.T.F.
P.O. Box 7931
Madison, WI 53702-7931

RECEIVED
EMPLOYEE TRUST FUNDS
2010 MAY -7 AM 8:28

Dear Mr. Stella,

I have a concern regarding the Variable Fund payments to annuitants.

The Variable Annuity Fund made 20-25% on their funds for several years and paid annuitants about 10% less than what the fund made. This is what you are doing in 2010 where the Variable Fund made 33% gains and you are only paying annuitants 22%. I called your department to question this and I was told the law requires this to smooth out payments for bad years.

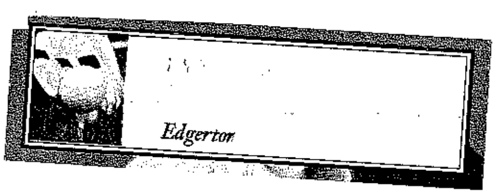
In 2008 the Variable Fund lost 36% and annuitants payments were reduced 42% for 2009.

Can you explain to me a law that requires you to withhold 10% in good years and then deduct more than the fund lost in a bad year?

The attached chart shows that the Core Fund and Variable Fund returns for a 20 year period are about the same. In fact the Variable Fund did a little better than the Core Fund. Why was my monthly annuitant payment for the Variable Fund $994.84 less than from the Core Fund for 2009 and $777.64 per month less in 2010?

There is something very wrong with your Variable Fund annuitants monthly fund payment.

Sincerely,



cc: Mike Sheridan
cc: Kim Hixon

CC 10-016

STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

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May 17, 2010

EDGERTON WI 53534-

Dear Mr.

Thank you for your May 1, 2010 letter to Department of Employee Trust Funds (ETF) Secretary David A. Stella concerning the 2010 Variable annuity adjustment. Secretary Stella has asked me to respond to you on his behalf.

In your letter, you expressed disappointment over this year's Variable annuity adjustment and wondered about the legality of the Variable annuity adjustment process itself. Please be assured that the Department of Employee Trust Funds (ETF) follows the letter of the law in determining all Wisconsin Retirement System (WRS) rates and adjustments.

As you know, the Variable Trust Fund investment return was 33.7% in 2009. Variable investment results are not "smoothed" (unlike Core Trust Fund returns). The WRS independent consulting actuary subsequently calculated a Variable effective rate (for active employees) of 33%; the effective rate is the starting point for calculating the Variable annuity adjustment (for retirees). That rate, as you know, was determined to be 22%.

How, given a 33% investment return, did the Variable annuity adjustment end up being 11% lower than the effective rate, when the difference between the two rates is usually around 5% to 7%? Simply stated, the calculation also depends on a number of key actuarial factors, including carryover from the previous year, rounding, and mortality rates. We would never arbitrarily withhold 10% from the calculation process in order to make up for significant investment losses, as you surmise in your letter.

I have listed on page two a few of the major reasons for the 11% difference between the two rates this year. However, please understand that while the differential is often in the range of four to six percentage points, larger gaps are not uncommon. For example, since 1986, the difference has been seven points once (1999), eight points four times (1988, 1989, 1995 and 2006), nine points once (2003) and 10 points once (1991).

Another thing to keep in mind: Although the Variable Fund last year experienced its largest gain since 1986, it also experienced it largest single-year loss in 2008. These dramatic swings had an unanticipated, exaggerated effect on the actuarial factors necessary to calculate this year's final annuity adjustments. Thus, the primary reasons behind the 11% difference between the two rates for 2009 are listed here:

- "Built-in" 5% assumption rate of return. A 5% percent investment return is needed each year to pay benefits for a retiree's projected lifetime.
- Carryover from last year's calculation. By law, the WRS consulting actuary calculates Variable annuity adjustments to the whole percent. As a result, a negative number was carried over from last year and that number has compounded due to the reduction in Variable assets brought about by the 2008 market crisis.
- Timing (the four months that Variable annuities were NOT reduced in 2009 must be accounted for). ETF does not adjust annuities until May 1 of each year; it takes time to finalize year-end investment returns and calculate interest rates and annuity adjustments. ETF was not adjusting annuities by -42% in the first four months of 2009, *even though there was roughly a 40% loss in the annuity reserve*. This lag time and the truncation (rounding of numbers) described above amounted to a -3.9% carryover loss from 2009 into this year's Variable annuity adjustment calculation. The lag time can benefit Variable annuities in certain years, such as last year when there was only a 2% overall difference between the Variable Fund effective rate and annuity adjustment. Conversely, there are years when the lag time can have a negative impact on annuities, such as this year.

The methodology used by the actuaries is professionally reviewed by other independent actuaries. In fact, in accordance with Wis. Stat. S. 13.94(1), the State of Wisconsin Legislative Audit Bureau works with yet another independent actuary to review the entire WRS annuity adjustment process at least once every five years. The methodology used by the WRS actuaries to determine annuity adjustments has been approved by the other independent actuaries each time.

In your letter you also wrote about the 20 year investment returns for the Core Fund as compared to the Variable Fund. I have enclosed some information that compares Core Fund annuities to Variable Fund annuities over time.

In your letter you also asked why your Variable annuity is less than your Core annuity in 2009 and 2010, since the average Variable adjustment is higher between 1988 and 2007. Whether your Core or Variable annuity is higher depends on the original amounts of the Core and Variable portions of your annuity, as well as the Core and Variable adjustment rates for the specific years that your annuity has been in force. I have enclosed a chart showing your

original Core and Variable life annuity amounts and the annuity adjustment rates that were applied to your annuity each year, which illustrate exactly how these annual adjustments resulted in your current annuity amounts.

I thank you for taking the time to write. I hope this information has been helpful to you. If you have further questions or comments, please don't hesitate to contact me at (608) 266-3641.

Sincerely,

Matt Stohr

Matt Stohr
Director of Legislation, Communications and Quality Assurance

cc: Mike Sheridan, Assembly Speaker
Kim Hixon, State Representative

CC 10-016

5/22/2010

Matt Stohr
801 W Badger Road
PO Box 7931
Madison, WI 53707-7931

Dear Matt:

Thank you for your letter responding to my May 1, 2010 letter regarding my payments from the variable annuity fund.

I still maintain that there is something very wrong with the payments from the variable fund, if the payments from the core fund are accurate.

The attached chart shows that the core fund and variable fund have returns about the same amounts roughly 8% annually for a 20-year period. To me this means both funds should have about the same funds for payments. Is my thinking wrong?

In 2009 my payments from the variable fund was almost $1000 less per month than the core fund and in 2010 it is about $800 less. Anybody with common sense can see there is a problem here.

If you have followed the law then there is a problem with the law, and this needs to be dealt with.

I am requesting that an auditor from the Legislative Audit Bureau review my case and this problem and send me an explanation.

Sincerely:

Cc: Mike Sheridan, Assembly Speaker
Kim Hixon, State Representative

Annual Investment Returns		
Year	Core Fund	Variable Fund
2009	22.4%	33.7%
2008	-26.2%	-39.0%
2007	8.7%	5.6%
2006	15.8%	17.6%
2005	8.6%	8.3%
2004	12.8%	12.7%
2003	24.2%	32.7%
2002	-8.8%	-21.9%
2001	-2.3%	-8.3%
2000	-0.8%	-7.2%
1999	15.7%	27.8%
1998	14.6%	17.5%
1997	17.2%	21.6%
1996	14.4%	19.8%
1995	23.1%	25.6%
1994	-0.6%	0.8%
1993	15.0%	16.5%
1992	9.7%	10.7%
1991	20.4%	27.1%
1990	-1.5%	-11.3%
20-year Annualized Return	8.3%	7.7%

CC 10-022

STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

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Madison WI 53707-7931

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May 25, 2010

EDGERTON WI

Dear Mr.

Thank you for your letter dated May 22, 2010, to Matt Stohr regarding the Core and Variable annuity adjustments to your Wisconsin Retirement System (WRS) annuity. Mr. Stohr has asked me to reply on his behalf.

In your letter you expressed concern that the Core and Variable annuity adjustments cannot be correct, because the average Core and Variable investment earnings have both averaged roughly 8% over the last 20 years but your Variable annuity is significantly lower than your Core annuity. I would like to assure you that the annuity adjustments have been calculated accurately, based on the laws governing WRS benefits and on sound actuarial principles.

I would like to clarify several points which may be helpful in understanding why your Variable annuity is currently significantly lower than your Core annuity. **First, you cannot use an "average" of the Core or Variable rates to evaluate the relative annuity amounts, because the variations in the rates from year to year will produce very different results.**

A simplified example is a $1,000 monthly annuity that receives a 10% increase in the first year and a 10% decrease in the second year. Using an **average** the two rates, you would assume that the annuity is back to the original $1,000 per month. However, that is not the case, as illustrated below:

- First year: $1,000 x 10% increase = $1,100 per month
- Second year: $1,100 x 10% decrease = $ 990 per month

In other words, while the *average* annuity adjustment rate is 0%, the net *result* is a 1% decrease in the total monthly annuity. The effects would be exactly the same if the decrease occurs in the first year and the increase occurs in the second year.

This effect is greatly exaggerated when the increases and decreases are larger, as is the case with the Variable annuity adjustments. For example, suppose that same $1,000 annuity receives a 40% increase in the first year and a 40% decrease in the second year:

- First year: $1,000 x 40% increase = $1,400 per month
- Second year: $1,100 x 40% decrease = $ 840 per month

Again, while the *average* annuity adjustment rate is 0%, the net *result* is a 16% decrease in the total annuity. **The sharp increases and decreases in the Variable Fund annuity adjustments are the primary reason why your Variable annuity is currently so much lower than your Core annuity, even though the "average" Core and Variable investment results may be similar.**

There are several other, though much less significant, factors that contribute to your Variable annuity being lower than your Core annuity:

- The comparison of the Core and Variable annual investment returns you provided with your letter shows the "raw" investment returns from the State of Wisconsin Investment Board (SWIB). In that chart the Core returns have not been "smoothed" over a five-year amortization period through the Market Recognition Account.

  This means that only two-fifths of the 26.2% Core Fund losses in 2008 have been recognized so far in the annual interest and annuity adjustment rates (for 2008 and 2009). **The 2008 Core Fund annuity adjustment rate for 2008 was significantly higher than it would have been had those losses been fully recognized in that year.** However, since those losses must be spread over five years (2008, 2009, 2010, 2011 and 2012), the 2008 losses will continue have a negative effect on the Core interest and annuity adjustment rates for 2010, 2011 and 2012.

- The initial amount of your Core annuity ($937.24) was over 21% higher than the original amount of your Variable annuity ($772.27). Even if the Core and Variable annuity increases and decreases had been identical (which they clearly were not), your Core annuity would still be significantly higher than your Variable annuity.

- While you cannot use an "average" of the Core and Variable returns to predict the relative results, there is still .6% difference between the average Core investment returns (8.3% after smoothing) and the Variable investment returns (7.7%). This average .6% difference alone, compounded over 20 years, would produce about a 12.7% difference in the final result.

I hope that this information will clarify how the differences between the Core and Variable annuity adjustments have resulted in your current Variable annuity being so much lower than your Core annuity. For your convenience, I enclosed a copy of the January 2010 newsletter that explained both the effects of the negative compounding of money and the effects of smoothing Core Fund investment returns over five years. If you have any questions about this information you are welcome to call me at the number below.

Sincerely,

Linda Owen

Linda Owen, Policy Analyst
Office of Policy, Privacy and Compliance
(608) 261-8164
linda.owen@etf.state.wi.us

cc: Representative Mike Sheridan
Representative Kim Hixon

CC 10-022

CC 10-020

RECEIVED
EMPLOYEE TRUST FUNDS
2010 MAY 12 AM 9:58

May 11, 2010

ETF
P O Box 7931
Madison WI 53707-7931

REF: Member ID

This is the second time or more that our Annuity Payments have been reduced. This is not acceptable to either of us. I am sure it is not acceptable to the other retirement system holders.

What is being done with the executive and staff's wages ? I am sure they are not reduced. Perhaps a way to off set the loss that you claim was generated would be to reduce the wages and bonus's paid to the executive staff.

Apparently the operation at the Wisconsin Employee Trust Fund follows the banking industry and its high paying administrators, while sticking it to the people who created the fund balance to start with.

I am not so sure that ETF is really losing money. If this is the case, perhaps along with a reduction in administrators salaries, (and a poor employee review) perhaps they should be terminated and replaced with people who are more qualified in finance.

Sincerely yours;

CC 10-020

STATE OF WISCONSIN
Department of Employee Trust Funds
David A. Stella
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

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http://etf.wi.gov

May 20, 2010

Dear Mr.

I am writing in response to your letter to the Department of Employee Trust Funds (ETF), which was received on May 12, 2010. Thank you for taking the time to write.

In your letter, you expressed concern and disappointment over having your (and your wife's) Wisconsin Retirement System (WRS) Core Fund annuity reduced for the second year in a row. I understand how difficult this may make things for you, but regret there is nothing ETF can do to mitigate this loss.

We have communicated extensively, through our newsletter, our website, presentations to various groups and other means, about the impact of the 2008 global economic crisis on the WRS. Whether noted in the *Trust Fund News* – which is published and sent to retired WRS members three times a year – or through other means, the primary message has always centered on the following points:

- Annuity increases or decreases are dependent on the investment performance of the WRS trust funds
- By law, the WRS does not guarantee "cost of living" annuity adjustments
- By law, the WRS is a "shared risk" system; the effects of the stock market are spread among employers, employees and retirees

Since the WRS Core Fund investment returns are spread out over the course of five years (in accordance with state law), the impact of the 26.2% Core Fund investment decline in 2008 will be felt for the next three years. **If the investment returns were not spread out to reduce the volatility of market swings, your Core Fund annuity would have decreased more than 31% on May 1, 2009. Instead, you experienced a -2.1% adjustment in 2009 and a -1.3% adjustment this year.**

I assure you that ETF follows the letter of the law in determining all WRS rates and adjustments. The methodology used by the independent consulting actuaries for the WRS is professionally reviewed by other independent actuaries. In fact, in accordance with Wis. Stat. S. 13.94(1), the State of Wisconsin Legislative Audit Bureau works with yet another independent actuary to review the entire WRS annuity adjustment process at least once every five years. The methodology used by the WRS actuaries to determine annuity adjustments has been approved by the other independent actuaries each time.

You also asked about ETF staff wages and accused ETF of benefitting financially at the expense of other WRS members. All ETF staff were subject to 8 furlough days this fiscal year and will be subject to 8 furlough days this coming fiscal year, which will amount to roughly a 3% pay reduction for all ETF staff each fiscal year.

Again, thank you for taking the time to write. I can be reached at 608.266.3641 if you have questions.

Sincerely,

Matt Stohr

Matt Stohr
Director of Legislation, Communications and Quality Assurance

CC 10-020