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Correspondence Memorandum

Date: June 17, 2015
To: Employee Trust Funds Board
From: Steve Hurley, Director, Office of Policy, Privacy and Compliance
Subject: WRS Dividends and Annuity Reserve Options: Effect of Investment Performance

Staff recommends the Employee Trust Funds Board (Board) direct the Department of Employee Trust Funds (ETF) to conduct additional analysis of the effect of investment performance on the WRS, including the annuity reserve and contribution rates.

BACKGROUND

This memorandum is a follow-up to the Board's brief discussion of risks and Wisconsin Retirement System (WRS) dividend reserves at the Board meetings on April 2, 2015. Annual investment performance dictates whether there are funds available to provide retirees with annuity dividends beyond their initial annuity amounts. Investment return also affects WRS contribution rates. The WRS Funding Policy outlines general measures regarding risks that affect investment performance.

The WRS has a long-term assumed investment rate of return of 7.2%. While it would be nice to achieve exactly 7.2% each year, experience tells us that such an outcome is unlikely, as investment returns from various investments tend to fluctuate from year-to-year. These normal fluctuations in investment return are expected and the WRS has mechanisms in place to level out the fluctuations. The primary example of this is smoothing. Sometimes, however, the actual returns deviate substantially from what is expected. Understanding how these substantial deviations affect the various components of the WRS is important to understanding and accepting the investment risk associated any long-term rate of investment return.

As part of the continued development of the WRS funding policy we propose to work with the State of Wisconsin Investment Board (SWIB) and the WRS consulting actuary, GRS, to develop some models that demonstrate the effects of various investment return simulations outside of the normal expected range of returns. We believe this will assist

Reviewed and approved by Pamela Henning, Assistant Deputy Secretary

Electronically Signed 6/23/15

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the Board in understanding the risks associated with its investment return assumption and help SWIB in analyzing the various potential asset allocation models and portfolio structures available to it. In addition, through this work we hope to identify opportunities to mitigate the effects of investment returns that fall substantially outside the normal expected range.

Staff will be at the Board meeting to answer any questions.