DRAFT

MINUTES

December 15, 2016

Employee Trust Funds Board

State of Wisconsin

Location:

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

ETF BOARD MEMBERS PRESENT:

Wayne Koessl, Chair
John David, Vice Chair
Robert Niendorf, Secretary
William Ford
Michael Langyel
Paul Ostrowski
Leilani Paul
Roberta Rasmus
Victor Shier
Mary Von Ruden
David Wiltgen
Bob Ziegelbauer

PARTICIPATING EMPLOYEE TRUST FUNDS STAFF:

Office of the Secretary:
Bob Conlin, Secretary
John Voelker, Deputy Secretary
Tarna Hunter, Legislative Liaison
Cheryllynn Wilkins, Board Liaison

Bureau of Information Technology Services: Steve Mueller, Chief Information Officer

Division of Retirement Services:
Deb Roemer, Trust Funds Director
Matt Stohr, Administrator

Office of Legal Services (OLS):
Diana Felsmann, Attorney
David Nispel, General Counsel

Office of Policy, Privacy & Compliance:
Steve Hurley, Director

Office of Strategic Health Policy (OSHP):
Sara Brockman, Health Policy Advisor
Jessica Rossner, Program Manager

OTHERS PRESENT:

ETF Division of Management Services: Ryan Perkins, Dana Perry

ETF Division of Retirement Services: Anne Boudreau, Jim Guidry, Roger Fletcher

ETF Office of Internal Audit (OIA): Amelia Slaney, Yikchau Sze

ETF Office of the Secretary: Pam Henning

ETF Division of Trust Finance: Cindy Klimke, Bob Willett

Gabriel Roeder Smith & Company (GRS): Jim Anderson, Mark Buis, Brian Murphy

Legislative Audit Bureau (LAB): Lisa Kasel

Board	Mtg Date	Item #
ETF	3.23.17	1

Wayne Koessl, Chair, called the meeting of the Employee Trust Funds Board (Board) to order at 11:57 a.m.

CONSIDERATION OF MEETING MINUTES

> ***MOTION: Mr. David moved to approve the open session minutes of the September 29 2016, meeting of the Employee Trust Funds Board, as submitted by the Board Liaison. Ms. Von Ruden seconded the motion, which passed unanimously on a voice vote.***

COMMITTEE REPORTS

<u>Executive Committee</u>
Mr. Koessl noted the Executive Committee met on December 14, 2016. The Committee approved the September 28, 2016, minutes. In addition, the Committee reviewed and discussed:

- today's Joint Meeting of the Retirement Boards and ETF Board meeting agendas, highlighting:
    - the new building and IT security overview;
    - an open meetings law case update by legal counsel;
    - an ERA program update on vendor operations and compliance efforts;
    - information on next steps for the disability program redesign;
    - a discussion by GRS on WRS funding options;
    - a review of dividend reserve options, and
    - an overview of recent information security initiatives and resource request.
- some of ETF's objectives and accomplishments from the past quarter, highlighting:
    - status on several key benefit RFPs from the Office of Strategic Health Policy;
    - new customer engagement initiatives and outreach efforts underway; and
- ETF's quarterly Human Resources Report, including current key vacancies and recruitment efforts.

<u>Audit Committee</u>
Mr. Ford indicated the Audit Committee approved the September 29, 2016, minutes. In addition, the Committee:

- received the annual independence affirmation conducted for the OIA director and staff;
- discussed the third party administrator audit of Wisconsin Physicians Service Insurance Corporation (WPS). The audit was reviewed by the Group Insurance Board and shows proficient administration by the vendor but provided recommended improvements;
- discussed the Office of Foreign Assets Control (OFAC) compliance audit which prohibits ETF from paying benefits to persons on a list (terrorist, narcotics

trafficking or live in certain countries). Of the 205,000 annuitants ETF currently pays, there about 300 people that could be affected ; and
- discussed the progress of the 2015-2017 Audit Plan.

Budget and Operations Committee
Ms. Von Ruden reported the Budget and Operations Committee approved the September 29, 2016 minutes. The committee also:
- reviewed the operations update on the number of retirements and requests for retirement estimates in the third quarter of 2016;
- talked about changes to the Department's customer outreach efforts;
- discussed the Department's 2017-2019 state budget request and a recent request for additional resources for IT security; and
- discussed an update on the status of the Benefit Administration System (BAS) project and an overview of the next steps in the project. Rollout 2 of the project is scheduled to launch January 1, 2018.

DISCUSSION AND CONSIDERATION

Employee Reimbursement Accounts (ERA) / Commuter Benefits Program / Health Savings Accounts (HSA) Update
Ms. Rossner and Ms. Brockman updated the Board on benefit programs provided by Total Administrative Services Corporation (TASC) and TASC's performance. TASC is the third party administrator (TPA) for ERA, medical and dependent care, parking and commuter benefits and HSA. On March 24, 2016, the Board approved a one-year contract extension through December 31, 2017. The contract was linked to performance standards and guarantees TASC was required to meet during the one-year extension period. Participants in these benefit programs save money because contributions are exempt from federal, state and FICA taxes. In 2016, the State of Wisconsin will save more than $2.5 million on the employer portion of the FICA taxes from participant contributions in these benefits programs. Ms. Rossner discussed the participant education and communications developed specifically for state participants on the benefit program. To ensure the educational materials are available, TASC created a website landing page specifically for WRS participants.

Disability Program Redesign Proposal
Ms. Roemer updated the Board (Ref. ETF | 12.15.16 | 4B) on the proposed closing of LTDI to new enrollees and reopening 40.63 disability retirement program and the action taken since the last Board meeting.
- Scope statement was sent to the governor's office for administrative rule changes six weeks ago. ETF has not yet received a response.
- Disability program staff and application developers have been working together on the changes needed to ETF's systems to facilitate the LTDI program in-house for the grandfathered participants in the program.
- Preparing a communication plan proposal.

- The Group Insurance Board (GIB) will be notified of the proposed change to the disability program at the February 2017 GIB meeting. To streamline the oversight of all the ETF disability programs, ETF will propose the GIB no longer oversee the Income Continuation Insurance (ICI) program. This would mean that all disability programs, including the ICI program would be overseen by the ETF Board.

Wisconsin Retirement System Funding Transition to Entry Age Normal from Frozen Initial Liability

Mr. Conlin provided a synopsis of why this discussion topic is on the agenda. When the WRS was created the legislature selected a frozen initial liability (FIL) cost method to value its liabilities. This method was most likely selected because of the different systems that were coming together, and instead of sharing prior service liabilities with all employers, each employer kept track of its own separately.

Mr. Buis explained there are several different cost methods. Each cost method provides actuaries a guide on how to project a single contribution rate for all active, retired and terminated vested members, over a 100-year period. Entry Age Normal (EAN) cost method is the most widely used method, especially with the Governmental Accounting Standards Board (GASB) 67/68 standards. GASB requires the use of EAN cost method. Current WRS cost method is FIL.

Mr. Buis provided actuarial valuation terminology to help with the explanation of future benefits, actuarial accrued liability, normal cost and future normal costs and an example of how a pension is funded for one person. He compared the FIN cost with the EAN cost, showing how the cost method change will impact the total contribution rates.

The original purpose of selecting FIL may have had to do with allowing a simple path for new employers to join the WRS. However, there are fewer employers joining today than in the past. Conversion to EAN cost method would have minimal impact on WRS contribution rates. With GASB requiring EAN, changing cost methods would simplify ETF's accounting but a statutory change would be necessary. This would be a good time to make that change because the difference between the FIL and EAN Cost Method is minimal.

Wisconsin Retirement System Dividend Reserve Continued Discussion

Mr. Hurley (Ref. ETF | 12.15.16 | 4D) discussed dividend options as a way to advance the WRS funding policy. Mr. Hurley explained the importance of stable annuity adjustments in preserving purchasing power. He demonstrated the effects of inflation on the annuity benefit. For example, if you retire at age 65, on average you could live another 20 years. At 3% inflation, the purchasing power of a $2,000 annuity would be down to $1,107 in just 20 years.

Mr. Hurley provided a brief history on WRS post-retirement annuity adjustments, or dividends. The use of dividends dates from the 1982 merger of retirement systems and creation of the WRS. At that time the legislature had considered an automatic annuity adjustment, based on changes in the Consumer Price Index, with an annual cap ranging from 2-4%, but ultimately decided on the dividend system due to cost concerns.

Mr. Hurley explained the benefits and drawbacks of several projections of hypothetical dividend options, which had been provided by GRS. The approaches examined by GRS were: Status quo, Cap-and-Reserve, Dividend Delay and Dividend Lock. GRS looked at two aspects of each approach: the probability the dividend reserve would be depleted; and the probability that dividends will be negative in a given year. All proposed options are long-term concepts and would require statutory changes.

Under Cap-and-Reserve, positive dividend payouts are limited to annual inflation, but no more than 3%. When dividends exceed the capped amount, the remainder is reserved and used to offset negative dividends back to zero, but not to create positive dividends. Concerns over the reserved amount accumulating too much could be addressed by statutorily limiting the growth of the reserve to an amount that would offset the desired negative dividend level (no more than -2% or -3%). Once a sufficient amount is reserved, the dividend process would operate normally and dividends higher than the Cap-and-Reserve limit of 3% could then occur. GRS projections showed that Cap-and-Reserve would reduce the probability of dividend reserve depletion by about 3% compared to Status quo, and that after 10 years, Cap-and-Reserve significantly reduces risk of negative dividends.

As modeled, Dividend Delay works in addition to Cap-and-Reserve. Under the Dividend Delay option, dividends for new annuitants begin only after five years of retirement. Funds not paid in the first five years are reserved in the same account used for Cap-and-Reserve offset funds. Adding Dividend Delay reduces the likelihood of dividend reserve depletion by an additional 3%. In regard to the risk of negative dividends, the overall impact of adding Dividend Delay to Cap-and-Reserve is slight, with additional reductions (over Cap-and-Reserve alone) ranging from 0 to 3.2% (Year 20).

The last approach discussed was Dividend Lock. Dividend Lock does not reduce the risk of hitting dividend reserve floor or of negative dividends. Dividend Lock is an equity measure that would allow retirees that achieve a certain age to “lock in” all dividends accumulated to that age. Under Dividend Lock, members can earn additional dividends after the target age, but dividends could not be reduced in the future below the level accumulated to the target age. The idea is to protect the most fragile part of the retiree population from being reduced to their benefit floor. People who are above 80 usually have the least ability to do anything about annuity reductions. Dividend Lock slightly increased the probabilities of dividend reserve depletion and of negative dividends.

Overall, the modeled approaches do not significantly affect the probability of dividend depletion. The clearest impact is Cap-and-Reserve's significant reductions in the likelihood of negative dividends, especially after 10 years. Dividend delay, as modeled, seems to not be an effective choice, although it has incremental effects in addition to Cap-and-Reserve.

The Board commented on the need to continue educating members about the necessity of personal savings beyond the WRS pension. No further action was taken.

Information Security Initiatives
Ms. Hunter and Mr. Mueller updated the Board on several initiatives related to ETF's cyber security. Ms. Hunter discussed a passive review request, sent to the Governor's Office, asking for additional resources for the cyber security initiative. ETF has taken steps to strengthen its IT security but additional resources are necessary to properly manage the increasing risk. ETF requested funding for three FTE IT security positions, an annual security audit and security insurance. ETF recognizes that because of the nature of the data ETF holds, ETF and the Board have a fiduciary responsibility to protect members' data.

OPERATIONAL UPDATES

Secretary's Report
Mr. Conlin highlighted the following as part of his report.

- The Core Trust Fund is currently at approximately 8% for the year;
- The GIB has met several times on the state's group health insurance program and will meet again in January. The GIB is trying to decide if it will move from being fully insured to a self-insured model or some combination. GIB is focusing on a few options. If the GIB selects any self-insurance health program, ETF will need to go the Joint Committee on Finance.
- The Comprehensive Annual Financial Report (CAFR) continues to be delayed, due to issues with the LAB, the STAR system and the state controller's office.
- The Discretionary Merit Compensation program, which allows ETF to give merit based increases for staff has been suspended since July 2016, for Department of Administration, Division of Personnel Management to develop a plan. ETF has still not seen a plan.

Appeals Update
Mr. Nispel commented about efforts OLS has made to keep the number of formal appeals low. As an agency, these efforts have been successful by making timely contact with persons who have grievances and focusing on resolving formal complaints at the earliest possible stage. While appeal numbers have been low, in two categories, there were a large number of appeals: City of Madison Stagehands and County Jailers. Ms. Felsmann updated the Board (Ref. ETF | 12.15.16 | 5B) on both categories of appeals and the actions ETF has taken to resolve the open appeals.
City of Madison Stagehands (77):

- The Board previously issued decisions in two groups of cases;
- In both of those decisions, the Board concluded the appellants should have been reported to the WRS, with the exception of one appellant who had previously been reported;
- ETF negotiated with the City of Madison related to the payment of contributions for WRS-eligible stagehands who had not yet been reported to ETF; and
- ETF entered into a Settlement Agreement with the City of Madison related to payment of WRS contributions for WRS-eligible stagehands.

Jailers Appeals (335):

- The Board decided that the five jailers did not meet the definition of WRS protective occupation employees;
- Communications have been sent about the Board's decision; and
- ETF posted a frequently asked questions document on ETF's website for the jailers.

ADJOURNMENT

> ***Motion: Ms. Von Ruden moved to adjourn the meeting. Mr. Niendorf seconded the motion, which passed unanimously on a voice vote.***

The Board adjourned at 2:13 p.m.

Date Approved: ________________________

Signed: ______________________________
Robert Niendorf, Secretary
Employee Trust Funds Board