

DRAFT

# MINUTES

December 10, 2020

## Employee Trust Funds Board

State of Wisconsin

### Location:

Department of Employee Trust Funds  
This meeting was held via teleconference.



### ETF BOARD MEMBERS PRESENT:

Wayne Koessler, Chair  
John David, Vice Chair  
Robert Niendorf, Secretary  
Malika Evanco  
William Ford

Michael Langyel  
Katy Lounsbury  
Leilani Paul  
Roberta Rasmus  
Steve Wilding

### ETF BOARD MEMBERS ABSENT:

Stephen Arnold  
Chris Heller

### PARTICIPATING ETF STAFF:

Office of the Secretary:

Bob Conlin, Secretary  
John Voelker, Deputy Secretary  
Cheryllynn Wilkins, Board Liaison

Division of Retirement Services:

Matt Stohr, Administrator  
Anne Boudreau, Deputy Administrator

Division of Trust Finance:

Amelia Slaney, Director, Financial  
Compliance Bureau

Office of Policy, Privacy & Compliance:

Steve Hurley, Director

### OTHERS PRESENT:

ETF Division of Management Services:

Greg Beach, Patrick Hughes, Kadi  
Mbanefo, Tim Steiner

ETF Division of Retirement Services:

Elisabeth Davis, Roger Fletcher, Jim  
Guidry

ETF Division of Trust Finance: Cindy

Klimke, Ramona Yee

ETF Office of Communications: Nancy

Ketterhagen, Mark Lamkins

ETF Office of Internal Audit (OIA):

Michelle Hoehne, Kimberly  
Richmond, Yikchau Sze, Amanda  
Williams

ETF Office of Legal Services (OLS):

Monica Anderson, Diana Felsmann,  
Dan Hayes, David Nispel

ETF Office of the Secretary: Lisa

Gurley, Pam Henning, Tarna Hunter,  
Kathryn Young

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ETF	3.25.21	2A

Gabriel, Roeder, Smith & Company (GRS):

Jim Anderson, Mark Buis, Brian Murphy

Legislative Audit Bureau (LAB):

Lisa Kasel

Sherry Haakenson

Other Guests: 1 person connected via  
telephone

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Mr. Koessler, Chair, called the meeting of the Employee Trust Funds Board (Board) to order at 9:15 a.m.

## ANNOUNCEMENTS

Mr. Stohr reviewed the schedule of this quarter's retirement board meetings: The committees and the Teachers Retirement (TR) Board met on December 9, 2020, and the Wisconsin Retirement (WR) Board met on December 10.

Mr. Stohr thanked the Board for its input on the actuarial services. He stated that the survey results help ETF determine if the agency should continue to contract with GRS and Milliman. Both ETF staff and the Board members gave GRS and Milliman high marks.

Mr. Stohr provided an update about the governing board redesign proposal, which was approved by the retirement boards and included in ETF's state budget request. A letter from the chairs of the three retirement boards in support of the changes was included in that request. The Governor is set to deliver his budget address on February 16, 2021.

## CONSIDERATION OF MEETING MINUTES

***MOTION: Mr. David moved to approve the open and closed session minutes of the September 17, 2020, meeting of the Employee Trust Funds Board, as submitted by the Board Liaison. Ms. Paul seconded the motion, which passed unanimously on a voice vote.***

***MOTION: Mr. Ford moved to approve the open and closed session minutes of the October 7, 2020, meeting of the Employee Trust Funds Board, as submitted by the Board Liaison. Ms. Rasmus seconded the motion, which passed unanimously on a voice vote.***

## COMMITTEE REPORTS

### Executive Committee

Mr. Koessler noted the Executive Committee met via teleconference on December 9, 2020. The committee discussed the ETF Board agenda, the GRS presentation on the Wisconsin Retirement System (WRS) stress testing, a financial reporting update, the

appointment scheduling demonstration, and other operational updates. The committee also reviewed some of ETF's accomplishments from the past quarter and highlighted recruitment efforts and Human Resource projects that are underway.

#### Secretary Search and Screen Committee

Mr. Koessl noted the ETF Secretary Search and Screen Committee met via teleconference on October 28, 2020 and finalized the recruitment timeline, position announcement, and screening criteria. The position announcement was published on November 10, 2020 with a deadline of December 1, 2020. There were 15 applicants. The committee will meet on December 16, 2020 to screen and assess qualifications of the applicants, determine applicants for initial interviews, and discuss potential interview and reference questions.

#### Audit Committee

Mr. Ford indicated the Audit Committee met via teleconference on December 9, 2020. The committee approved the minutes. In addition, the committee:

- Reviewed the 2019 annual financial reports for the WRS and other benefit programs ETF administers. The Legislative Audit Bureau (LAB) audited the financial reports, found no internal control deficiencies, and provided unmodified opinions. LAB noted that the WRS continues to be well funded and ETF staff are to be congratulated.
- Reviewed the results of Segal Consulting's audit of StayWell, a third-party administrator for the State's wellness program.
- Discussed internal audit results of the Disability Annuity Benefits and how the claims process shows the internal controls were effective.
- Discussed the Employer Reporting Audit. There are approximately 1500 state and local employers in the Wisconsin Retirement System. The internal audit stated controls are adequate but could be stronger. Additionally, ETF could increase employer training and compliance reviews.
- Conducted its annual review of the Internal Audit Charter, including adding that the Director of the OIA should annually confirm the organizational independence of the internal audit function.
- Reviewed the independence and affirmations disclosure memo, which includes that ETF's internal auditors are free from impairments.
- Reviewed the complete FY2020 - FY2021 Audit Plan.
- In closed session, discussed the member bank account setup and change audit and ETF's Information Technology Network Security Audit.

#### Budget and Operations Committee

Ms. Rasmus stated the Budget and Operations Committee met on December 9, 2020 via teleconference. The committee discussed the following matters:

- Mr. Stohr provided an operations update. Staff working from home continues to go well for both staff and customers. The new service that allows members to schedule a retirement appointment online has been successful. About half of the members who scheduled an appointment have used the online tool and even more used the service

after ETF promoted it in the active employee newsletter, *WRS News Online*. Ms. Boudreau will provide a demonstration of the service at today's ETF Board meeting.

- Ms. Baxter provided an update on the modernization projects ETF is working on, including:
  - The Electronic Content Management system, which is scheduled to go live in late August 2021;
  - The Insurance Administration System. A Request for Proposal (RFP) has been prepared and ETF has scheduled proof-of-concept presentations with the two finalist vendors. The proof of concept will show staff how the vendors would handle ETF's requirements and will help staff decide the best vendor for ETF. This review is scheduled for late January.
- Mr. Voelker went through the new organizational metrics report, which aligns to ETF's strategic plan and tracks progress towards each initiative in the plan. The metrics and targets are called North Star because these measures show the progress towards organizational long-term goals.

## DISCUSSION/CONSIDERATION

### Review of Committee Charters

Mr. Stohr referred to the memo (Ref. ETF | 12.10.20 | 4A). Each committee had the opportunity to review the charter and make changes.

***Motion: Ms. Evanco moved to approve the charters for the Executive Committee, the Audit Committee, and the Budget and Operations Committee. Ms. Rasmus seconded the motion, which passed unanimously on a voice vote.***

### WRS Stress Testing

Mr. Conlin reminded the Board about the State of Wisconsin Investment Board (SWIB) presentation from March 2020. At that time, SWIB expressed concerns about the effects of the pandemic on the markets and the WRS. The market has since recovered and Core Fund investment performance is currently in the low double digits.

Mr. Murphy, Mr. Buis, and Mr. Anderson from Gabriel, Roeder, Smith & Company (GRS) presented on the recent stress test performed on the WRS (Ref. ETF | 12.10.20 | 4B).

GRS performed two different types of stress testing on the WRS -- Deterministic and Stochastic. Deterministic stress testing investigates extreme market scenarios that are in the realm of possibility, such as a negative 20% or 30% return. Stochastic stress testing provides insight into how the WRS would respond to severe unfavorable markets. This includes looking at how contribution rates would be impacted, the probability of depleting the past dividend liability, and the probability of a negative dividend in any given year.

The annuity dividend process is based on a 5% benchmark with a 7% return assumption, which implies expected dividends of 1.9%

The WRS currently is very well funded. They stated that due to the built-in cost sharing methods, the range of funding in the stochastic testing drops the funding status, but not as much as other pension systems that are not as strong as the WRS.

The projections in the stress tests incorporate 2019 data. WRS cost sharing mechanisms result in more narrow contribution and fund status impacts at the tails (5<sup>th</sup> and 95<sup>th</sup> percentiles).

GRS discussed the probability of a negative dividends. For an example, increasing the dividend threshold to 2% from 0.5%, which means the system would not pay dividends or take away dividends until after +/-2%. The difference does eventually get paid to annuitants; it gets carried over to the next year.

GRS presented a scenario where the system would cap the positive dividends at 3% and reserve them. Under this scenario, it would decrease the probability of negative dividend returns. Scenario 3 may help retirees weather a significant downturn in the market by not taking the hit all at once.

Mr. Ford asked about the possibility of extending the smoothing period from the current five years to perhaps seven or more years. GRS responded that this was an option that they studied. They found in their testing that lengthening the smoothing period to seven or more years did reduce the likelihood of negative dividends and dividend liability depletion. However, they emphasized that five-year smoothing is the recommended best practice under actuarial standards and that longer smoothing periods tend to cause intergenerational equity issues by shifting gains and losses to future generations. Additionally, a period longer than five years would require an asset corridor to limit the extent to which smoothed values can differ from market values. The asset corridor would reduce the effectiveness of the strategy of lengthening the smoothing period when in times of volatile investment markets.

#### Wisconsin Retirement System (WRS) Stress Testing Policy Discussion

Mr. Hurley's presentation (Ref. ETF | 12.10.20 | 4C) addressed pros and cons of the three stochastic dividend scenarios that GRS mentioned in its presentation on stress testing. The scenarios address modifying the dividend thresholds, capping a negative dividend, or capping positive dividends and reserving surplus. He spoke about documentation of dividend risk in the WRS Funding Policy and asked the Board whether ETF should work with the actuary to further develop the concept of dividend risk in the Funding Policy.

Mr. Hurley emphasized the importance of the role that annuity adjustments (dividends) play as a risk-sharing feature of the WRS, and the clear distinction between dividends and cost of living adjustments (COLA). The WRS was created as a shared-risk plan and does not have a COLA. Mr. Hurley explained that inflation, over time, can erode the spending power of an annuity. However, for WRS dividends, inflation-protection is not the central point. A positive dividend due to investment surpluses can counter inflation, but it is a side-effect of the shared-risk system. Dividends play a broader role of maintaining stability, and in times of good investment returns, can also help against inflation.

Mr. Hurley quoted a 2018 article by the National Association of State Retirement Administrators (NASRA) that highlighted shared risk public retirement systems:

“Wisconsin’s risk-sharing post-retirement benefit feature is credited as a key factor contributing to the plan’s solid funding level and relatively low and stable costs over the years. This feature works as a relief valve reducing pressure on plan benefit payments following periods of relatively poor investment performance and rewarding retirees only after periods of strong investment experience.” [Risk Sharing in Public Retirement Plans](#), NASRA, Keith Brainard, December 2018, p. 13.

Mr. Hurley asked the Board to consider whether dividend risk is a matter to be controlled in a risk-sharing plan such as the WRS. He noted that deflecting what would otherwise be a shared risk is possibly incompatible with continuing to describe the WRS as a shared-risk plan.

Mr. Hurley discussed the pros and cons of scenarios from the GRS stress testing presentation.

Regarding the scenario of modifying dividend thresholds, he explained that adjusting the dividend threshold to +/-2% would likely not work well for a single-year response. For example, in 2011 and 2012, negative dividends were -7% and -9.6%. If in those years, the threshold was modified to -2%, it would have made no difference. If used over many years, +/-2% threshold would likely make payable dividends less frequent.

Capping a negative dividend could mitigate the impact of a large negative dividend as a single-year response, but would carry significant risk. It is essentially a bet that a market recovery would quickly remove the deficit created by withholding the negative dividend.

The Board has previously discussed the final scenario, “Cap and Reserve,” (CAR). Mr. Hurley explained that CAR would require an administrative rule. For CAR to be effective, there would need to be sustained higher dividends (possibly 4% and higher) over many years to accumulate funds that could be used to offset negative experience. This approach has significant downside with equity issues between generations of annuitants.

Mr. Hurley concluded with a discussion of the WRS Funding Policy. He pointed out that the Funding Policy addresses several types of risk but does not mention dividend risk. He added that even with the shared-risk aspect of the WRS, it may be beneficial for the Board to consider whether to amend the Funding Policy to add more about risks to dividends, such as a “Dividend Liability Health Measure” in the Risk Measures section of the policy.

Mr. Ford commented that the Cap and Reserve option will not avoid dividend depletion. Additionally, he would not like the Board to be required to decide year-to-year whether a dividend should be distributed or not. If the Board is worried about the annuity reserve, Mr. Ford thinks lengthening the current five-year smoothing period might be an option.

The five-year smoothing is statutory and would require legislation to change. The Board does not need legislation to update the WRS Funding Policy.

Mr. Conlin described how SWIB has been working to address risk as it relates to controlling dividend depletion. Since the 2008-09 market crash, ETF has increased communication to members on how the WRS works. This informs retirees and upcoming retirees know they cannot count on guaranteed increases.

***MOTION: Mr. Ford moved for ETF to work with the Board's actuary, GRS, to specifically address dividend risk in the WRS Funding Policy. Mr. Wilding seconded the motion, which passed unanimously on a voice vote.***

#### CY2019 Financial Reporting Update

Ms. Slaney (Ref. ETF | 12.10.20 | 4D) provided an update regarding ETF's 2019 financial reporting. There were a few delays in ETF's Comprehensive Annual Financial Report (CAFR) related to implementation of Governmental Accounting Standards Board (GASB) statement no. 84, "Fiduciary Activities." ETF issued a separate financial statement report for calendar year ending December 31, 2019. Overall, ETF has received positive WRS audit results. LAB issued unmodified opinions, which means the financial statements are clean, representing the financial position of the WRS in accordance with accounting principles. The LAB audit had no audit findings or recommendations. The WRS is financially strong and funding has been in the expected range over the last three years.

The LAB audit of the 2019 CAFR is in progress. ETF reviewed other programs, reviewed the changes, and the programs will now show a more traditional financial statement. Several significant changes were needed for the sick leave programs. Ms. Slaney detailed the sick leave program changes for both the Accumulated Sick Leave Conversion Credit (ASLCC) and the Supplemental Health Insurance Conversion Credit (SHICC) programs. ETF worked directly with GASB on SHICC and ASLCC reporting because these programs are very complex.

Mr. Voelker recognized the efforts of ETF staff and commended them on an outstanding job to get things done right.

#### Appointment Scheduling Demonstration

Ms. Boudreau gave a demonstration of the new appointment scheduling software. ETF has advertised this new program to members and employers on ETF's website and in member newsletters and social media. The system starts with the first available appointment, but the member can select any other date or time currently available. The system automatically confirms the appointment by email and via text message, if the member enters a mobile phone number. Ms. Boudreau also demonstrated how members can use the system to cancel or reschedule appointments.

## **OPERATIONAL UPDATES**

### Secretary's Report

Mr. Conlin reminded the Board of what a challenging year 2020 was, but ETF had the ability to pivot to a virtual world easily. He thanked the Board for its support throughout all the changes.

Preliminary investment returns from SWIB through the end of November indicate the Core Fund is seeing low double-digit positive returns. Mr. Conlin also indicated that he is resigning his position on SWIB after SWIB's December meeting. The Wisconsin Retirement (WR) Board may schedule a meeting in late February to possibly make a new SWIB appointment.

The Board will hear more about ETF's IT security in closed session. Having these discussions in closed session allows the Board to explore ETF's IT security at a deeper level.

### ETF Organizational North Star Metrics

Mr. Voelker (Ref. ETF | 12.10.e20 | 5B) discussed the new ETF Operational North Star Metrics report. The report may appear smaller than the previous report, but it holds additional metrics.

The new North Star metrics report helps the Board know if ETF is fulfilling its mission to develop quality services for members. This report provides additional support to Board members to assist them in fulfilling their fiduciary responsibility.

The Board already has many tools to evaluate the integrity of the trust. Previously, CEM Benchmarking Inc. was one of the few ways the Board and ETF could measure the overall service to members. The North Star metrics report is a more efficient way to track and measure ETF's service to members. The Board can clearly see the target and progress. This journey will take years, but with strategic direction, the Board will know if ETF is making progress toward the goal.

The North Star targets are aggressive and were set weighing the cost versus business value. Mr. Voelker walked the Board through the modernization goal. The North Star report better supports the boards' fiduciary duty of prudence. Board members know the ultimate goal, see the direction and the progress, and will have the ability to ask questions along the way.

Mr. Stohr referred the Board to the additional operational update memos (Ref. ETF | 12.10.20| 5C through 5M) included in the Board packets.

## **FUTURE ITEMS FOR DISCUSSION**

Mr. Stohr referred the Board to the March 25, 2021 Agenda Topics memo (Ref. ETF | 12.10.20 | 6A).



**CLOSED SESSION**

Mr. Koessler announced that the Board is going into closed session to discuss ETF's Information and Security Management program and will be getting an update on security measures in place to protect information at ETF.

Unless there is an objection, Mr. Koessler, as the board chair, will be the sole Board member to return to open session and announce the action taken on these items and adjourn the meeting. No objections were made.

**MOTION: Mr. David moved to convene in closed session pursuant to the exemptions contained in Wis. Stats. § 19.85 (1) (d) to consider strategy for crime detection or prevention. Mr. Niendorf seconded the motion, which passed on the following roll call vote:**

**Members Voting Aye: David, Evanco, Ford, Koessler, Lounsbury, Niendorf, Paul, Rasmus, and Wilding**

**Members Absent: Arnold, Heller, Langyel**

The Board convened in closed session from 12:11 p.m. until 12:49 p.m. Mr. Koessler returned to open session.

**ANNOUNCEMENT OF ACTION TAKEN ON BUSINESS DELIBERATED DURING CLOSED SESSION**

Mr. Koessler announced the Board took the following action during closed session:

The Board discussed with ETF's Chief Information Security Officer the agency's IT security program and various initiatives to protect information. No action was taken.

**ADJOURNMENT**

The meeting adjourned at 12:54 p.m.

Date Approved: \_\_\_\_\_

Signed: \_\_\_\_\_

Robert Niendorf, Secretary  
Employee Trust Funds Board