

DRAFT

MINUTES

December 10, 2015

JOINT MEETING OF THE
Employee Trust Funds (ETF),
Teachers Retirement (TR),
and Wisconsin Retirement (WR) Boards
State of Wisconsin



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

ETF BOARD MEMBERS PRESENT:

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

TR BOARD MEMBERS PRESENT:

Robin Starck, Chair	Craig Hubbell
Tom Pedersen, Vice Chair	Jon Joslin
Brent Grochowski, Secretary	Dennis Murphy
Sandra Claflin-Chalton	Patrick Phair
Gary Epping	Kim Schroeder
Susan Harrison	David Wiltgen

WR BOARD MEMBERS PRESENT:

Wayne Koessler, Chair	Ted Nickel
John David, Vice Chair	Herb Stinski
Mary Von Ruden, Secretary	Steven Wilding
Jamie Aulik	

Board	Mtg Date	Item #
JM	3.24.16	1

PARTICIPATING EMPLOYEE TRUST FUNDS (ETF) STAFF:

Bob Conlin, Secretary
John Voelker, Deputy Secretary
Division of Retirement Services: Matt
Stohr, Administrator
Office of Policy, Privacy & Compliance:
Steve Hurley, Director

Office of Strategic Health Policy:
Jessica Rossner, Employee Benefit
Plan Policy Advisor
Office of the Secretary: Pam Henning,
Assistant Deputy Secretary
Tarna Hunter, Legislative Liaison
Cherylynn Wilkins, Board Liaison

OTHERS PRESENT:

ETF Division of Management Services:
Ryan Perkins
ETF Division of Retirement Services:
Anne Boudreau, Roger Fletcher, Gene
Janke, Julie Keal, Deb Roemer
ETF Division of Trust Finance: Michelle
Mattox, Stefanie Pauls
ETF Office of Communications:
Nancy Ketterhagen, Mark Lamkins
ETF Office of Internal Audit: Yikchau Sze
ETF Office of Legal Services:
Dan Hayes, David Nispel
ETF Office of the Secretary:
Sara Brockman

Department of Administration:
Chelsea Daley
Gabriel Roeder Smith & Company
(GRS): Jim Anderson, Mark Buis,
Brian Murphy
Legislative Audit Bureau (LAB):
Lisa Kasel
Maclver Institute: Ola Lisowski, Chris
Rochester
State Engineering Association:
Bob Schaefer
State of Wisconsin Investment Board
(SWIB): Chris Preisler, David Villa,
Michael Williamson

Robin Starck, Chair, TR Board, called the Joint Meeting of the ETF Board, TR Board and WR Board to order at 9:00 a.m.

CONSIDERATION OF MINUTES OF PREVIOUS MEETING

MOTION: Mr. Wiltgen moved to approve the September 24, 2015, minutes of the Joint Meeting of the ETF, WR and TR Boards, as submitted by the Board Liaison. Mr. Pedersen seconded the motion, which passed unanimously on a voice vote.

ANNOUNCEMENTS

Mr. Stohr made the following announcements:

- There will not be separate TR Board and WR Board meetings today.
- There will be an election for three public school teacher seats on the Teachers Retirement Board in 2016. The open seats are those currently held by Patrick

Phair, Robin Starck and Jeff Zore. Four candidates have submitted nomination forms.

- The voting for this election will be throughout February 2016. The voting format will be online or via telephone.
- Two volunteers are needed from the TR Board for the Election Certification Committee. Mr. Pedersen and Ms. Claflin-Chalton volunteered to serve on the committee.
- There are several appeals that may be ready for review at the March board meetings. There is a handout that explains the Boards role in the appeals process and provides a refresher on appeals for the Boards' review. In addition, there will be a training on appeals at the March 2016 Joint Board Meeting.
- Mr. Jamie Aulik has accepted another position and no longer meets the requirements of the seat which he holds on the WR Board. Mr. Aulik submitted his resignation to the board chair. Mr. Stohr thanked Mr. Aulik for his service.

EDUCATIONAL/DISCUSSION TOPICS

Mr. Conlin noted that since the onset of the global financial crisis in 2008, pension funds and other institutional investors around the country have talked about ways to lower the level of risk in portfolios while still trying to generate sufficient returns. GRS, the ETF Board's independent consulting actuary, was asked by SWIB and ETF to help them better understand the critical role that investment performance plays in the Wisconsin Retirement System (WRS). The Boards need to be aware of the risks and advise SWIB and ETF as to what the Board feels would be an acceptable tolerance for risk regarding the investment of WRS assets.

Dividends and Downside Investment Risk

Mr. Murphy shared the GRS study objectives, which included emerging demographic trends, various deterministic and stochastic projections, evaluating the worst case scenarios and the probability of depleting the dividend reserve. He shared the projected contributions and expected benefit payments as a percent of payroll. The benefits are greater than the contribution rate and the two-thirds gap is made up by the investment return. Currently, the WRS has an estimated 7.2% investment return with 4% of this allocated to pay benefits and the remaining 3.2% to provide for wage growth. Based on simulations, there is a wide range of probable outcomes. Maturing plans such as the WRS are increasingly exposed to the effects of market volatility. The unique benefit structure of the WRS enables it to deal with volatility to an extent not feasible in most public sector retirement systems.

Mr. Buis continued the dividend/risk comparison looking at the expected rate of return with a standard deviation, comparing the potential of a negative dividend and the percentage possibility that dividends will be depleted within 1, 5, 10, 20 and 50 years. The low risk scenarios are riskier in the sense that a 5% expected return has a much higher chance of dividend depletion in later years than higher risk scenarios.

Prior to the 2008 market loss, there was approximately 25% cushion in the dividend reserve. The annuitant reserve as of December 31, 2014, is \$47.1 billion with about \$4.6 billion (or 11%) attributable to dividends with the remaining \$42.5 billion attributable to the current floor benefit. While retirees cannot fall below the floor benefit, it is possible the asset pool could fall below this level. Investment returns above 5% will help increase the 11% dividend pool and returns below 5% will erode the pool. Dividend erosion is not uniform – people who retired a long time ago lose a larger share of their current benefits than more recent retirees. The dividend reserve for retirees has declined. While the 2013 and 2014 results have helped rebuild dividends reserve somewhat, the 2015 investment results might reduce some of the cushion, depending on the return at December 31, 2015. GRS provided a few dividend reserve depletion approaches reviewing the potential impact on dividends and the intergenerational equity.

State of Wisconsin Investment Board (SWIB) Investment Risk Mitigation for the Wisconsin Retirement System

Mr. Williamson explained SWIB's role with regard to WRS trust fund investment management. Of the more than \$90 billion in the WRS, approximately 40% is managed passively and 60% is activity managed.

Mr. Williamson discussed investment risk, how it can impact investments and the risk vs. reward in current market conditions. He also reviewed SWIB's 30 year performance. The unique design and strong investment returns helped the WRS sustain full funding through the great recession. But Williamson said SWIB needs to adapt to the new global financial markets, consider risk differently and implement initiatives to position the WRS for future success.

Diversification is the primary tool SWIB uses to manage risk. Most risk exposure comes from the stock market. The Core Fund is fully diversified with stocks, real estate, fixed income, etc. The goal is to stabilize the effects of returns on the WRS, accepting slight reductions in performance during strong stock markets and better protection against extreme downturns.

Mr. Villa shared how the Core Fund performed over the last 30 years in relation to historical events of each decade. He explained the financial returns of SWIB for the Core Fund compared to cash and treasury returns from each decade. SWIB has built a robust policy portfolio that gives the best compensation for the risk taken for the different environments. SWIB's goal is to create a return greater than the policy portfolio.

Mr. Williamson and Mr. Villa summarized SWIB's performance, the changes in the market and the challenges faced. There will be more challenges and in turn, more risk. In today's environment it will be difficult to hit the targeted 7.2% over the next five to seven years. However, over the long-term SWIB's performance average will probably exceed the 7.2%. The target average around the country is 7.8%. The dynamics of the WRS are unique, and put it in a stronger position than other plans around the country.

Wisconsin Retirement System Three-Year Experience Study: January 1, 2012 – December 31, 2014

Mr. Murphy referred board members to the WRS Three-Year Experience Study (Ref. JM | 12.10.15 | 3C) and explained the study methodology, which included:

- The assumptions must be reasonable individually and in the aggregate.
- Understated liabilities/costs can lead to inability to pay benefits when due or sharp increases in required contributions in the future.
- Trends are compared with those observed in prior studies.
- It is better to make a series of small changes in the right direction rather than a single large change that in hindsight would be very wrong.

Mr. Buis discussed mortality experience. People are living longer and it is important to not let mortality improvements have an undue effect on dividends payable. Through a fully generational phase-in method to ensure adequate funding, avoiding persistent liability losses and shifting costs to future generations, the extended mortality is recognized.

Mr. Anderson shared the economic assumptions used in the study and proposed no changes. In 2010, the assumptions were reset based on SWIB input, and confirmed in the 2012 experience study. GRS also discussed historical price and wage inflation. The three-year experience study changes will be used in the 2015 valuation and will first affect contribution rates in 2017. Applying these new assumptions, based on the 2014 valuation, contribution rates would increase primarily due to changes in mortality, but would be partially offset by decreases from other changes.

Resignation Procedure for Board Members

Steve Hurley referred board members to the memo (Ref. JM | 12.10.15 | 3D). This process will be added to the *Board Governance Manual*. The Board Member Qualification Policy and the Conflict of Interest Policy provide board members guidance for circumstances in which a board member should consider resignation. This memo provides board members who intend to resign the process to follow, based on how the member gained their board seat.

OPERATIONAL UPDATES

Legislative Update

Ms. Hunter referred board members to the memo (Ref. JM | 12.10.15 | 4A). Ms. Hunter highlighted Senate Bill 45 that creates the Wisconsin Private Retirement Security Board and establishes a private retirement security plan. This bill would require the board, with the assistance of ETF, to conduct a study on the feasibility of establishing a retirement plan for private employers. This bill is scheduled for a public hearing today.

Mr. Stohr referred the Board to the remaining operational update items (Ref. JM | 12.10.15 | 4B, 4C, 4D, 4E, 4F, 4G, 4H).

ADJOURNMENT

MOTION: Mr. David moved to adjourn the meeting. Ms. Rasmus seconded the motion, which passed unanimously on a voice vote.

The meeting adjourned at 11:42 a.m.

Date Approved: _____

Signed: _____
Robert Niendorf, Secretary
Employee Trust Funds Board