Wisconsin Coalition of Annuitants

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Minutes of Meeting December 17, 2012

The meeting was held at the Wisconsin Professional Police Association Building, 660 John Nolen Drive, 2nd Floor Conference Room, Madison, and was called to order by Vice Chair Jerald Vreeland at 9:32 a.m.

DIRECTORS & ALTERNATES PRESENT: R. Beglinger, WFT-R; O. Berge, WARSDA; J. Craig, UWRA; V. Cutler, UWMRA; S. Drew, SWIB; B. Fendel, AFSCME; E. Frank, DNR; J. Grosklaus, West Allis; R. Hoessel, DOT; C. Howard, WEAC-R; A. Knop, WEAC-R; D. Kratz, CORR; J. Maydak, West Allis; J. Miller, DNR; J. Munro, WARSDA; D. Rohweder, ESP; B. Schaefer, SEA; T. Speranza, RPFFW; J. Vreeland, Wauwatosa; A. Wallace, UWRA.
GUESTS: A. Fendel, C. Preisler, M. Stohr, M. Susman, S. Sweet, R. Willett, R. Wojciak .
EXCUSED: B. Davis, J. Egan, J. Skiles, J. Palmer.

MINUTES of the November meeting were approved as mailed.

GUEST: Chris Preisler, Communications, SWIB

Mr. Preisler began with the preliminary numbers for the end of November, Core 12.1% with a benchmark of 11.4% and the Variable 14.7% with a benchmark of 14.5%. Assets under management for the end of November were $78 billion Core and $6 billion Variable.

The Board of Trustees received a report from CEM Benchmarking and Callan Associates both indicating SWIB is a low-cost manager of trust funds. CEM reported SWIB savings of $20.2 million in 2011 by using in-house management. Callan reported that SWIB compared to a peer group of 35 public funds, with assets in excess of $10 billion, has similar asset allocations with good risk management and performance above the peer group. The reports will be posted online.

Mr. Williamson has nine goals for SWIB in the coming year. The goals were shared with the Board at the November meeting: 1) Create a three-year strategic plan for SWIB, 2) Standardize SWIB's process management framework, 3) Create and deploy a comprehensive data management plan, 4) Enhance service level agreement and create performance metrics for BNY Mellon services, 5) Develop a process to ensure compliance with SWIB's contracts and with domestic and foreign laws, 6) Continue to enhance internal and external investment strategy within a framework of separating active returns from market returns to improve the overall fund sharpe ratio, 7) Enterprise investment management system study, 8) Continue increasing employee engagement, satisfaction and commitment, and 9) Create an organizational process for managing IT priorities.

Eric Buchholtz, SWIB Investment and Management Services Director, has been accepted into the Wisconsin Enterprise Leadership Academy.

At the board meeting last week a new video was introduced on the Wisconsin Private Debt portfolio which was set up in the 1970's and is managed by Chris Prestigiacomo. The video highlights the portfolio and the work that is being done with Wisconsin headquartered companies, using the SWIB loan to Organic Valley of La Farge as an example. This is not for venture capital or start up companies, but for established companies. The video will be available online.

GUEST: Bob Willett, Director, Office of Trust Finance and Data Analysis, ETF

Mr. Willett was asked to attend our meeting and share information on the new accounting standards from GASB.

GASB's own definition is "The Governmental Accounting Standards Board or GASB is an independent, private-sector, not-for-profit organization that through an open and thorough due process--establishes and improves standards of financial accounting and reporting for US state and local governments. Governments and the accounting industry recognize the GASB as the official source of Generally Accepted Accounting Principles (GAAP) for state and local governments."

GASB is not a government entity, but a private organization created by government for government and by people interested in good financial reporting from government. Mr. Willett stated that GASB was created by ourselves and as much as entities may express concerns about a GASB rule and what they do, they are here because we need them, we want them, and they exist only because we accept them. If government stopped believing in the legitimacy of the GASB, they would cease to exist because they can exist only if they are generally accepted as independent, impartial and in the best interest of government.

Funding is from various private and professional organizations with no government funding involved. The GASB intent is to obtain permanent funding to increase independence.

The GASB project began in 2009 with an "invitation to comment" which is the first step in a long due process. Using received comments, in June 2010 preliminary views were presented. A year later in June 2011 an Exposure Draft was presented which is the first effort to put forth an actual standard. Following additional hearings and comments, in July 2012, two statements were issued: statement number 67 - Accounting and Financial reporting for Pensions by Governmental Entities and statement number 68 -Financial Reporting for Pension Plans.

GASB has a long thought-out process for comments and anyone with an opinion has had several opportunities to be heard.

GASB's pension philosophy is this:

1) The employer incurs a pension obligation as a result of the exchange of employee services for compensation. This simply means that an employee puts in a week's work and is paid at the end of the week along with health insurance and pension contributions. The pension is part of the compensation so that at retirement the pension is not a taxpayer's obligation.

2) The pension plan is primarily responsible for paying benefits, to the extent it has sufficient assets.

3) The employer is primarily responsible for paying benefits to the extent the plan does not have assets. If the employer has made promises to the employee, it is not the pension plan responsibility. The pension plan is a tool for the employer. If the employer does not put sufficient funds in the pension plan, it is not the responsibility of the pension plan, but the responsibility of the employer. An underfunded pension plan needs to be reflected by the employer and not the plan.

4) The unfunded pension liability meets the definition of liability and is measurable with sufficient reliability to be included in the basic financial statements. For accountants a liability has to be very explicit and measurable. Pension liabilities are obtained through an actuary and vary among actuaries. Accountants have never considered the unfunded liability definitive enough to include it in a financial statement. GASB now says that an unfunded liability by an actuary is certain enough to be included in the employer's financial statement. This is a major change in financial reporting. In response to a question it is the individual school district making a promise to their employees and they will have to list any unfunded liability on their financial statements.

GASB statements 67 and 68, what they do is establish standards for accounting and financial reporting for public pension plans and governmental employers to measure and report on pension expense and liabilities. What they don't do is establish standards for funding pension benefits or expenses or require governments to change how they fund pension expenses. There is no mention on how the plan is to be funded or require governments to change the way the plans are funded. GASB has no authority to tell a plan what to do; however, if the plan accountants follow the standards, any deviation will be reported as the employer not following generally accepted accounting standards, meaning that you cannot rely on the employer's financial statements.

The first major change is that accounting and funding of pensions have been decoupled. Historically accounting standards have followed funding standards. An actuarial funding plan could use one of five actuarial cost methods and with the funding assumptions falling within standards, those same calculations could be used for accounting standards. GASB now has two independent questions. In the accounting and financial reporting it is a point-in-time measurement and in funding it is long term and smoothing of peaks and valleys. The goals of accounting and funding are so different that they cannot be tied together. In the past GASB had the ARC (Annual Required Contribution) and accountants felt the funding obligation was fulfilled, as accounting and funding were tied to each other.

Once the above decoupling is accomplished, then calculation of the pension liabilities and annual expense will follow more traditional accounting rules. Peaks and valleys are no longer considered and the market value on December 31 is used. Without smoothing there will be market volatility from year to year.

Employers must present the net pension liability on their balance sheet. In the past the pension liability was not measurable to put on the balance sheet. A single employer pension plan will list the calculated liability on their balance sheet. Multiple employer pension plans such as the WRS will have the WRS calculate the plan liability and allocate the unfunded liability to the 1500 employers for their balance sheet.

A second major change is GASB specific and technical change in calculating the pension liability. The discount rate, asset valuation, amortization, and actuarial cost method will have new standards.

The discount rate simply is how much money is needed today to grow with interest until needed. If the plan needs $100 million 30 years from now, using the 7.2% discount rate, about $12.5 million is needed today. A lower discount rate of 5% earnings will require about $20 million today. Traditionally, the discount rate has been the expected long term-rate of return. Historically this has always been an issue of concern. The academic world has stated that if a pension plan guarantees the risk free benefit, then the discount rate should also be risk-free or closer to the bond rates. GASB rejected the idea but went with a hybrid. Assets used to pay benefits may be liability discounted using the long rate of return as long as you are a fully funded plan. If the plan does not have fully funded assets the liabilities are discounted at a bond rate. For plans partially funded a combination or hybrid of the long rate and bond rate are to be used. Therefore, a plan not fully funded will have a lower discount rate and a need for additional assets resulting in higher annual expenses as well as reporting higher liabilities. GASB encourages plans to be fully funded to take advantage of the liability calculations. Mr. Willett indicated under GASB the WRS will be fully funded and will use the current long-term discount rate but will need additional actuarial studies to project liabilities many years beyond what is currently done. In response to a question: The approximately $100 million WRS employers owe the system is amortized over 20 years and does not impact the funding ratio.

Asset valuation will be based on fair market value rather than the five-year market recognition account smoothing. At present the WRS has about $5 billion in losses from 2008 and based on GASB it would be a $5 billion shortfall. Based on this standard, the 2008 loss would have dropped the WRS to the 70% funding level because of market recognition rather than smoothing. This standard will reflect the annual market volatility. Well-funded systems will continue to be analyzed as well funded.

Amortization will be smoothed over fewer years. With the decoupling accounting will use short terms adding market volatility. Actuarial gains and losses will be spread over a shorter time using the estimated work life of all participants; actives, inactives and annuitants. Presently actives have estimated thirteen years of work life to smooth gains and losses. When inactives and annuitants, who have no work life, are added to the pool, the average drops to around five years.

Actuaries look at future benefit payouts and then allocate to annual periods. Actuarial cost for accounting purposes will now have one method, the entry age normal. In the past plans could use one of five methods. The entry age normal method is the most common and is used by almost all major systems. The WRS uses a combination of entry age normal with frozen initial liabilities. The frozen initial liability addresses gains and losses. This will result in a slight change in calculations for the WRS.

The above are the major changes that will be used in the pension liability calculations as a result of GASB.

Mr. Willett provided an update on the WRS 7.2% discount rate used for calculating active employees. There also is a 5% discount rate used for annuitants when calculating dividends. The actuaries blended the rates and concluded that a single 5.5% discount rate would have the same results as the present two rates. In reality the WRS discount rate is 5.5%. By statute the 5% used for annuitant dividends and the 7.2% targeted investment returns will not change. When 5.5% is mentioned, it is a blend of the two rates and does not change anything.

What do the new standards mean? There will be two pension liabilities -- one for funding and one for accounting -- and people will get to pick and choose which one to utilize. This will be a major communications issue. Both numbers are correct but they will be confusing to the public. For funding we want a smooth liability calculation and for accounting a point-in-time liability which will be volatile. We need to emphasize the two numbers are for two different purposes.

Implementation of the standards is scheduled for June 15, 2013. For the WRS it will begin calendar year January 1, 2014. Employers of the WRS will begin June 15, 2014 for school districts and January 1, 2015 for state and local governments. The WRS will be providing information, guidelines and wording for employers' balance sheets. The WRS will begin early implementation, and presently the actuaries are doing a calculation for 2011 and working forward. GASB is also working on an implementation guide and answers to questions.

Question from November: Voluntary contributions made to your individual WRS account are considered a separate annuity and have their own floor. It is a money purchase calculation with a guaranteed annuity resulting in two annuity floors.

The IRS Highly Compensated Act has pension plan limits for public employees. There is a annual earnings limit of $250,000 to be considered annually toward pension consideration and also a $50,000 maximum additional annual voluntary contribution. The maximum for an annual annuity is about $200,000. The Wisconsin State Statutes also have limits.

GUEST: Matt Stohr, Administrator, Division of Retirement Services, ETF

The Legislative Audit Bureau report on rehired annuitants, which was required by the Legislature's Audit Committee, was released last Friday. Several bills were introduced last session without passage. The LAB met with the ETF, surveyed employers, compared ETF and employer payroll systems, and questioned employers who rehired annuitants. The 70-page report is available on ETF and LAB websites. The first 50 pages address employer issues and then 15 pages on ETF's function of tracking and investigating the 30-day break in service and dealing with violations. The remaining pages are suggestions for the Legislature, included doing nothing, extending the break in service, limiting the duration of working as a rehired annuitant, and considering an actuarial analysis of the financial impact of rehired annuitants. Any analysis will be funded through the Legislature. There was considerable discussion on the pros and cons of rehires' break in service, as well as the unique needs of rehires by employers. The simplest fix is to extend the break in service, considering Wisconsin has the most lenient break in service in the nation. We can anticipate introduced legislation in the next session.

LEGISLATIVE REPORT: None

CORRESPONDENCE: Communication received from ACE regarding the following.
The newly formed Wisconsin Coalition for Retirement Security has been holding meetings throughout the state. Their statement indicates they believe that legislation affecting the Wisconsin

Retirement System (WRS) will be introduced and debated in the next legislative session. For many in the community, this organization is being confused with our WCOA. Contact was made with our leadership regarding a proposed referendum in Dane County that was initiated by this organization. The ACE newsletter has indicated that this organization is in contact with the long-standing Coalition of Annuitants. The WCOA is not affiliated with this organization.

OLD BUSINESS: Annual conference evaluations were sent to the committee and will be sent to the membership.

NEW BUSINESS: Next month we will be addressing the 2013 annual conference.

TREASURER'S REPORT: Dues statements were distributed and the remaining will be mailed. Checkbook balance $6719.33.

NEXT MEETING: January 28, 2013 9:30 a.m., WI Professional Police Association Building.
The meeting adjourned at 11:28 a.m.
Respectfully submitted – Dick Kratz