Wisconsin Coalition of Annuitants

www.wicoa.org

Minutes of Meeting July 16, 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 Chair Jim Palmer at 9:40am.

DIRECTORS & ALTERNATES PRESENT: R. Beglinger, WFT-R, D. Bennett, WREA; O. Berge, WARSDA; L. Bundy, ESP; J. Craig, UWRA; V. Cutler, UWMRA; B. Davis, WFT-R; S. Drew, SWIB; B. Fendel, AFSCME; W. Ford, ETF-B; E. Frank, DNR; R. Hoessel, DOT; C. Howard, WEAC-R; A. Knop, WEAC-R; D. Kratz, CORR; J. Maydak, West Allis; J. Munro, WARSDA; J. Palmer, WPPA; D. Rohweder, ESP; W. Rowe, ACE; J. Skiles, UW-R; J. Vreeland, Wauwatosa; A. Wallace, UWRA.

GUESTS: B. Bird, A. Fendel, S. Hurley, E. Janke, D. Lueck, C. Preisler, P. Sickel, J. Strohl, M. Williamson, R. Wojciak.

EXCUSED: J. Egan, J. Grosklaus, J. Miller, R. Schaefer, T. Speranza.

MINUTES of the June meeting were approved as mailed.

GUEST: Chris Preisler, Communications, SWIB

SWIB's preliminary returns the end of June are the core fund at 5.9% ahead of the benchmark of 5.6% and the variable fund at 7.5% ahead of the benchmark of 7.4%. At the end of May the WRS assets were core fund at $73.1 billion and variable fund $5.2 billion for a total of $78.3 billion.

Mr. Preisler provided a copy of an article in a financial publication, FundFire, which summarized a report by alternatives consultant Cliffwater identifying top ten performing public pensions in several categories over a ten-year period. SWIB was number one in private equity performance at 13.2%. Missouri was number one in overall performance at 7.1% with SWIB slightly out of the top ten at 6.4%. The same was true for real estate with Ohio at number one at 10.4% and number ten Iowa at 7.6% with SWIB at 7.5%. SWIB is among the top pension plans and because of the unique structure and investment strategies will not always be number one in every area. SWIB is not as heavily involved in alternative investments as some of the leaders in this report. The Pew Report accurately reflects the various components and strategies including alternative investments. SWIB's goal is to be in the upper 25% always balancing returns with risk.

Mr. Preisler also provided a copy of a new pamphlet “Wisconsin Retirement System - Investing For Your Retirement”, which is also available on the SWIB website home page under “What's New?”. Additional copies may be obtained by contacting Mr. Preisler.

In response to a question, 75% of the income to SWIB is from investments and the remaining 25% from active employees and employers. States are not necessarily in trouble because of investments, but because employers over time have not been making their required contributions.

Michael Williamson was asked by the Chair to introduce himself. Mr. Williamson, age 58, is from North Carolina and for a brief time was an annuitant until accepting the Executive Director position. Previously he was in Wisconsin from 1979 to 1994 attending graduate school and then employed by the state as a budget analyst. His masters’ thesis was on the merger of the retirement systems in Wisconsin into a unified system, and a major resource was Blair Testin. While employed as a budget analyst one of the five agencies he was assigned to was ETF working with Gary Gates. In 1994 he returned to North Carolina where he worked for 15 years with the last 10 years being responsible for the equivalent of ETF and managing the largest 401(k) plan and 457 plan of 220,000 participants. He then became the chief investment officer for North Carolina with a $78 billion fund. Less than two years ago he left North Carolina to work with the Washington DC retirement board as deputy to Eric Stanchfield. Mr. Williamson indicated he is happy to be back in Wisconsin.

GUESTS: Steve Hurley, Director, Policy Unit, ETF
Eugene Janke, Senior Policy Analyst, Policy Unit, ETF

A handout, "Wisconsin Act 32 Study of the WRS Overview" was provided and is available on our website, www.wicoa.org.

The WRS study has been out two weeks having been delivered to the Governor and the 16 members of the Joint Finance Committee. Reaction to the study has been positive with minimal inquiries probably due to the recommendation of no changes. Three agencies produced the report with ETF playing a major role along with the Department of Administration and the Office of State Employment Relations. Major contributions were made by SWIB, Gabriel Roeder Smith the ETF actuaries, Ice Miller outside tax counsel, and other studies conducted throughout the nation. The 2008 recession definitely had an impact on pension systems nationally and resulted in many states reviewing their systems and ways to sustain them.

Mr. Hurley began by describing the purpose and scope of the study. The focus of the study was limited to the directives outlined in Act 32. The study was not a comprehensive examination of the system but answers to the questions posed by the legislation and therefore it had a narrow focus. The three agencies were to study the structure of the WRS, feasibility of establishing a defined contribution plan and permitting employees to opt out of making required contributions. The legislation did not state a goal or objective, and as a result several assumptions were made. The basic assumption was saving money or reducing costs. However, other assumptions were considered such as workforce retention and recruitment, administrative simplification and putting more dollars in employees' hands through the opt-out provision.

All participants in the study came up with the following recommendation: "The WRS is in good health, and neither an optional DC plan nor an opt-out of employee contributions should be implemented".

A DC plan would be considerably more costly than the present WRS DB plan. The opt-out provision had legal concerns with the IRS. It would also result in an under-funded benefit at the time of retirement.

Mr. Hurley described the three basic types of retirement plans. 1) The defined benefit plans provide a benefit based on a fixed formula with the benefit usually provided for the lifetime of the retiree. The structure of the WRS DB plan has a shared risk with similar plans having the risk on the employer. 2) Defined contribution plans specify the amount to be contributed, basically a 401(k) plan. Participants bear the risk of investment loss and with losses over a period of time employers are pressured to increase contributions. The plans are portable and have what is called leakage through taking out loans, hardship withdrawals and cashing out at separation, that result in fewer dollars at retirement. Indications are that almost 50% of those who switch jobs cash out their plan. 3) Hybrid plans include both DB and DC components. Past WRS financial reports refered to the WRS as a hybrid plan but in the eyes of the IRS it is a DB plan with several DC features. A hybrid plan involves both DB and DC being brought together and not a DB plan adding DC features. Utah and recently Rhode Island have hybrid plans, which have two independent plans serving one retirement benefit.

Mr. Janke provided a two-page summary of the 68-page study. If additional information is desired, review the key findings of the study.

In reviewing retirement in the United States there is ample information indicating that approximately only 45% of Americans are saving enough money for retirement, and as a result there is a retirement crisis as we move forward. Because of this looming retirement crisis, pension plans nationally are being asked to look at their plans. Also private-sector employers have moved to DC plans from DB plans, which has been easy for them since they are not under the same federal regulations as public/governmental employee pension plans. For private employers, it is easier to project costs on a defined contribution plan as opposed to a defined benefit plan. Private versus public plans are not comparable. There are challenges in public pension plans especially those that are under funded. In addition to the Pew Report praising the WRS, they also indicated that public pensions have a $1.3 trillion gap in liabilities for health and retirement benefits which accounts for the under funding. The question was asked regarding the private employer cost of 401(k) plans. In the long run it is more costly than a DB plan. In bad economic times there is pressure for the employer to increase contributions and the individual plans do not have access to the asset classes that are present with SWIB investments. Volatility for the private employer is an added cost.

Since 2009 there have been 43 states that made changes to their pension systems with a majority making changes that resemble the WRS. They have added components such as money purchase, restructured formula multipliers, adjusted employer and employee contributions, more risk sharing among participants, changing funding discipline, and changes in COLA structure. Gabriel Roeder and Smith indicate that a 3% COLA adjustment adds 26% to the cost of a retirement benefit. Since 2000 only nine large state systems have created an optional DC plan. They did not eliminate the DB plan, but for new employees there was an option, and approximately 75% of new employees select the DB plan. It is a myth that large public pension plans are moving to defined contribution plans. Alaska switched but because of liability issues they are returning to a DB plan. West Virginia teachers in 1991 switched back to a DB plan and in 2003 Nebraska switched from a DC plan to a cash balance plan which is similar to a money purchase plan with some difference in how contributions are made and pooled.

Structure of the WRS. Findings in this study are the WRS is stable and has been funded over 90% for 20 years and 100% since 2004. Contribution rates have been steady for the last 20 years with an expected increase next year. Even with the increase the WRS is below many states' contribution rates. The WRS benefits multiplier is lower than most major public plans. The WRS multiplier for general employees is 1.6% compared to 1.95% nationally. The multiplier being approximately 20% lower does result in modest benefit levels but with income replacement levels maintained at the recommended 65% to 80%. The guarantee is lower, but the income individuals receive is above most systems. Our fully funded system is due to its structure of funding discipline through annual actuary contribution rate reviews and the risk-sharing mechanisms. Employer and employee contribution rates are usually set at the June Board meeting. Act 10 and Act 32 changed the contribution structure and had an unintended increase in individual money purchase accounts. The money purchase increase, the last year of 2008 losses, and the increase of baby boomer retirees will result in more money paid out and an increase in contribution rates projected in the area of 1% to 1.5%. The statute was changed from 5% employee and 5% employer contribution with annual adjustments through the BAC (Benefit Adjustment Contribution) to one half for each based on the ETF actuary contribution rate.

The cost to taxpayers has decreased by the employers no longer being allowed to pick up any percentage of contribution. From 2002 through 2010 SWIB investments has provided 76% of pension revenue with 11% from employer contributions and 13% from employee contributions. The BAC was considered an employee contribution. The WRS is also one of the lowest cost systems in the US. In traditional DB plans the majority of risk is to the employer. In the WRS core fund 75% of risk is with the participants, with 25% to the employers. (Study-Appendix B has additional detail.)

The second purpose of the study was to look at an optional DC plan. There are advantages and disadvantages. For the employer there is no investment risk with stable contributions and ability to lower benefits. However, in poor investment times there is pressure for the employer to increase contributions. The WRS also has low risk to employers and the legislature could lower benefit levels with structural changes. The advantages to employers in a DC plan are also available to employers in the WRS. Advantages for employees are portability and choice of investments. Portability options in the WRS include taking a separation benefit or leaving the account until retirement. Investment options in the WRS are using SWIB investors as opposed to self investing with the option of the variable fund and the independently operated deferred compensation plan. Disadvantages of a DC plan are decreased benefits with increased costs. Higher contribution rates and higher administrative costs would be needed to match the WRS. With system revenue diverted there would be a lower investment return for the WRS. Death and disability benefits would also be removed with members having to purchase their own protection or insurance.

The third purpose of the study was to look at permitting employees to opt out of making required contributions. Employees would receive their employer contributions and upon retirement have a money purchase option based on employer-only contributions. It is not a complete opt out of the system. An advantage would be more take-home pay for the employee. Disadvantages would be problematic issues with the IRS over the WRS defined benefit plan standing and decreased under funded benefits for retirees. The present law requires employee and employer to share equally in contributions. A zero contribution by the employee would also be a zero contribution by the employer. Most likely the lower-paid or new employee would opt out of contributions and by IRS rule it is an irrevocable decision. Like the DC plan there would be lower investment returns because of contributions being diverted. There is a potential for negative effects on contribution rates for remaining participants in the DB plan and a risk of destabilization of the trust fund. The loss of death and disability benefits would also occur.

It was mentioned that over the years the pickup of partial pension payment in place of a salary increase was a recruitment selling point. A component that is missing in this report is a study on workforce development looking at competitive compensation and the different types of plans and changes that would impact recruitment and retention.

As the study was being developed by ETF, it was sent to DOA and OSER for their review and sent back and forth without any real issues. It was a congenial effort of data review without political intervention.

There was a question regarding additional contributions to the WRS. Very few active employees are aware of this option. Upon retirement there are numerous options for distribution. ETF will be addressing this feature.

ETF continues to look at options for adjusting annuities, especially for those who have been retired several years and could lose all of their dividend adjustments since retirement. There are risks in changing the structure. A change in one area has impact in many areas, and any change must be cautious. In a worst case scenario and if everyone were at their annuity floor, the annuity reserve fund of approximately $40 billion would be utilized.

Mr. Hurley and Mr. Janke were thanked for their time and presentation.

LEGISLATIVE REPORT - None

CORRESPONDENCE: None

OLD BUSINESS: - AFT-W resolution <u>Understanding and Protecting the Wisconsin Retirement System.</u> No action, topic dropped.

NEW BUSINESS: - AFT-W <u>WRS for All - A Proposal to expand WRS to all Wisconsin Workers.</u>

Mr. Davis provided a 27-slide handout of his PowerPoint presentation. He previously provided to the directors a e-mail of 30 pages detailing two proposed state-managed pension systems for private workers in Wisconsin.

There has been considerable media coverage of public pension systems being under funded and little mention of the $6.6 trillion shortage in private pension savings. Mr. Davis provided numerous demographics of private employees, their retirement needs and inadequate or nonexistent pension plans. The goal is to change the focus on pension discussion from cutting or reducing public benefits to improving and increasing private benefits using a system similar to the WRS. Mr. Davis had several questions for the WCOA and draft motions which will be on the September agenda.

(Draft Motion #1: The WCOA supports the Wisconsin Legislature working to enact a state-managed pension system for Wisconsin private sector workers. Draft motion #2: The WCOA will send a representative(s) to a statewide meeting to consider building a coalition to work toward state enactment of a state managed pension system for Wisconsin's private sector workers.)

There are over 1.5 million workers in Wisconsin without a pension plan. Future retirees will be the poorest of the last 35 years due to the changes in private pension plans. In conclusion, Mr. Davis stated how we might work to bring about a pension system for all utilizing those involved at the state and national levels.

The WPPA has monthly provided a conference room and coffee for the WCOA meetings. Following a brief word of thanks the following motions were passed.
MSC The WCOA donate $200 to the WPPA in appreciation for the monthly use of the conference room.
MSC The WCOA provide a $50 honorarium to Julie Neeley for her assistance in coordinating the conference room and providing coffee.

TREASURER'S REPORT: No changes

NEXT MEETING: September 17, 2012 9:30 am, WI. Professional Police Association Building.

The meeting adjourned at 12:15 pm.
Respectfully submitted – Dick Kratz