

Wisconsin Coalition of Annuitants

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Minutes of Meeting January 12, 2015

The meeting was held at the Wisconsin Education Association Council, Media Room, 33 Nob Hill, Madison, and was called to order by the Chair James Palmer at 9:30 a.m.

DIRECTORS & ALTERNATES PRESENT: R. Beglinger, WFT-R; D. Chickering, WREA; S. Drew, SWIB; E. Frank, DNR; J. Grosklaus, West Allis; R. Hoessel, DOT; B. Holahan, UWMRA; C. Howard, WEAC-R; A. Knop, WEAC-R; D. Kratz, CORR; J. Maydak, West Allis; J. Munro, WARSDA; F. Nepple, OCI; J. Palmer, WPPA; D. Rohweder, ESP; B. Schaefer, SEA; J. Skiles, UW-R; T. Speranza, RPPFW; M. Turner, WARSDA; J. Vreeland, Wauwatosa; A. Wallace, UWRA.

GUESTS: D. Felsmann, P. Henning, C. Preisler, S. Sweet, C. Welch, M. Williamson, R. Wojciak.

EXCUSED: D. Bennett, B. Davis, J. Egan, B. Fendel, J. Miller.

MINUTES of the November meeting were approved as mailed.

GUEST: Michael Williamson, Executive Director, SWIB.

Looking back at 2014 and SWIB's performance and strategy.

A handout was provided showing the triangle of SWIB's three jobs; making money, managing risk, and controlling cost. All are equally important. A dollar saved on cost is as good earning a dollar. Risk is key to balancing and being prudent with the investment funds.

The preliminary returns for 2014 are the core fund at 5.7% return with a benchmark of 5.6%. The variable fund preliminary return is 7.3% with a benchmark of 7.5%. Long term both funds have exceeded their benchmarks in the three, five, and 10 year returns. Long-term assumed returns are 7.2% over 20 years.

Performance by asset class finds real estate and private equity exceeding their benchmarks by double digits. Multi-asset strategies, risk parity and hedge funds all performed well. Global international equities struggled and pulled down the overall returns, including the core and variable funds. Equities make up 85% of investment risk.

Returns for SWIB are lower than market returns by design. Investment strategy is to reduce the risk in any market downturns. Investments have been made in lower returns with lower risk maintaining the long term 7.2% return.

With a strong return ETF is able to project a positive annuity adjustment. It is a preliminary guess that the core adjustment will be between 2% and 3%. This will be the second consecutive year of positive adjustments for retirees. It also means a positive effective rate adjustment for active employees and will have a positive impact on future contribution rates for active employers and employees. For the past 31 years the average adjustment has been 4.1% with average inflation at 2.9%.

SWIB continues to implement strategies to reduce fund volatility. There will be a slight reduction in performance in times of strong stock markets, but better protection against down markets. The impact will be minimized on both high and low markets. This is the strategy designed to decrease the impact of markets such as 2008 and still meet the investment goal of 7.2%. The goal is simply to maximize returns while limiting risk. WRS is one of eight US public pension systems funded at or above 100%. In 2001 there were 46 systems funded over 100%. Today system funding average across the country is 73%. A number of those systems are taking considerable risk to make up for what they have lost. We want to have a stabilized rate for employers and active employees and have positive adjustments for retirees. We cannot predict when the next downturn will occur but when it does we want to minimize the impact on all involved. The WRS is unique by design in that the members, employers, and retirees all share investment risk making the WRS 100% funded. Investment returns make up 80-85% of the funds.

There was discussion on the smoothing of the core and the impact on the variable in the 2008 losses. The oldest retirees would like some type of protection beyond their floor annuity. Since 2008 everyone is closer to their floor annuity. We will probably never see the rapid market growth of the 90s, and annuity adjustments going forward will be conservative. The 2009 earnings were not made on the stock market but on the bond market. The goal is to generate alpha or earnings above the market. SWIB has 33% in index funds to match the market at low cost. The 7.2% assumed earning rate is reviewed every three years. It does not appear to need an adjustment.

At the December board meeting CEM Benchmarking and Callan Associates reported that SWIB continues to be a low-cost pension fund manager that produces favorable results. With a similar mix of assets cost of management is lower than our peers. Management of the WRS provided significant financial benefit to the system and the mix of investments, diversification, and long-term strategy allowed for favorable returns. Also decisions by the board have led to lower costs. Other consultant comments:

SWIB uses more internal and passive management than their peers. Using 54% internal management compared to their peers of 30% and passive or indexed management 38% compared to their peers of 23%.

SWIB external management of 35% is less than its peers of 59%. The savings is that external cost is four times more than the cost of internal management.

SWIB strategic asset allocation includes fewer high-cost asset classes than its peers and private market and hedge fund management internally is less costly than the peers.

SWIB internal effectiveness and performance resulted in paying \$175 million less in fees than comparable public pension systems, earning \$171.5 million above market returns in 2013, and over the past five years having earned \$1.8 billion over market returns.

Mr. Williamson stated that looking ahead SWIB will continue to monitor world issues. Concerns are China's financial and credit crisis growing at 6-7%, high unemployment in stalled economies in Western Europe, continued drop in crude oil prices, and challenges to the US economy. Jobs are returning to North America from overseas but are lower-paid jobs. SWIB is being optimistic and cautious during these challenging times.

Hedge funds have doing been doing fairly well. They are designed to protect against down markets but have been doing well in the present markets.

Relationships with the legislature appear to be in good shape with very few inquiries. Several legislators and the governor have been speaking positively of the WRS.

We are fortunate to have the quality of board members that we have. The Governor has made solid appointments.

Turnover of managers has been almost nonexistent. In the last three years we have had one manager move to his home state. There are several managers who will be retiring. SWIB has been successful in recruiting staff because of the agency reputation and the competitive compensation plan.

There was mention of the Milwaukee County Pension Benefits Supreme Court case which will be further detailed by ETF analyst Diane Felsmann. Systems throughout the nation are drastically changing benefits and how formulas are interpreted.

GUEST: Chris Preisler, Communications, SWIB.

Mr. Preisler provided a handout on the Asset Allocation Summary and Performance of the SWIB as of December 31, 2014. Total assets under management are \$102.821 billion. The core fund is at \$88.739 billion and the variable fund is at \$7.29 billion. Assets managed internally are 58% with 42% managed externally.

GUEST: Pam Henning, Assistant Deputy Secretary, ETF.

Ms. Henning provided the names of the Joint Survey Committee on Retirement Systems members (JSCRS). Secretary Conlin, ETF, who is also a member of the committee, is reaching out to the new members for information sharing.

JSCRS members: Sen. Frank Lasee (R) DePere (Co-Chair), Rep. David Murphy (R) Greenville (Co-Chair), Sen. Howard Marklein (R) Spring Green, Sen. Jon Erpenbach (D) Middleton, Rep. Mike Kuglitsch (R) New Berlin, and Rep. Cory Mason (D) Racine.

The Governor will present his budget on February 3. There is talk of agency consolidations. In the past the Governor indicated that the WRS is the only state pension plan that does not have an unfunded liability. He is also questioning healthcare costs and ETF has been involved in the study for HSA's and self insurance.

The new building at Hill Farms is moving along but the last deadline in December has not been met.

The WRS/SWIB newsletter will be available online within the next week and retirees will receive a printed copy. Actives will receive it online.

GUEST: Diana Felsmann, Policy Analyst, Division of Retirement Services, ETF.

Ms. Felsmann was asked to provide clarification on the Milwaukee County Pension Benefits case Supreme Court decision of December 19, 2014. A handout was provided. The basic issue was whether an employee was entitled to the most favorable pension formula available during her employment. Milwaukee County was originally under state statutes and in 1965 the Wisconsin Legislature gave them "home rule" over the retirement system.

The Milwaukee County benefit is a five-year salary average times years of service and times a formula multiplier. This is quite similar to the WRS.

The employee, Ms. Stoker, began employment in 1982 when the formula multiplier was 1.5%. In 2000 the formula multiplier increased to 2% and into 2011 the formula multiplier decreased to 1.6%. The employee argue that she was entitled to the 2% formula multiplier for service after the multiplier was reduced in 2011. Her argument was based on the Milwaukee county ordinance stating that members have a vested right to increases in benefits.

The Wisconsin Supreme Court determined it would be unreasonable to conclude Milwaukee County could never prospectively change/reduce pension benefits. The court stated the multiplier accrued over time and thus was not a "vested" right for service not yet earned.

The court viewed the change in the multiplier was prospective when it dropped from 2% to 1.6% and the employee had no vested right to continue at 2%.

This case does not have impact on the WRS. We are governed differently under Chapter 40 of the Wisconsin Statutes and Administrative Code. "Rights exercised and benefits accrued to an employee under this chapter for service rendered shall be due as a contractual right and shall not be abrogated by any subsequent legislative act." WRS benefits may be changed prospectively for active employees. In the past there have been multiplier changes for active employees, most recently with Act 10 and elected officials.

Milwaukee County also has three Supreme Court cases, two represented and one non-represented, on reimbursement for the Medicare part B premiums. Prior to 2011 an employee with 15 years service was reimbursed for Medicare part B. In 2011 the county began a shared premium. This does not involve retirees but active employees claiming a vested benefit. (See addendum received 1/14/2015, following minutes)

CORRESPONDENCE: None

OLD BUSINESS: None

NEW BUSINESS: There was question on school districts and municipalities taking a holiday for contributions to the WRS. ETF has the authority and right to obtain payment from the employers' shared revenues, and there would be no benefit to school districts or municipalities.

TREASURER'S REPORT: Checkbook balance \$8,207.36

MSC The WCOA approves payment of \$600 to our webmaster for services and web-hosting.

As of today 17 organizations have paid their \$50 annual dues.

Treasure's report was approved as presented.

NEXT MEETING: February 16, 2015, 9:30 a.m., Wisconsin Education Association Council, Media Room, 33 Nob Hill, Madison, WI.

WCOA Annual Conference, Monday, May 18, 2015.

The meeting adjourned at 11:05 a.m.

Respectfully submitted – Dick Kratz

Addendum to the minutes - Pam Henning's response to a question from the WCOA meeting Monday, January 12, 2015.

Diana Felsmann did further research on the constitutional question raised by Bob Schaefer regarding benefit rights. I thought it would be beneficial to pass on her response to you. You can decide if it warrants forwarding on to the WCOA. Any questions, please contact Tarna or me. Thanks.

The Wisconsin State Constitution does not explicitly protect pension benefits, though it does protect contractual rights in general W.S.A. Const. Art. 1, § 12. As Diana noted in her presentation, the statutory language providing a contractual right to benefits for Wisconsin Retirement System members is found in Wis. Stat. §40.19. In Wisconsin Professional Police Association v. Lightbourn, 2001 WI 59, 243 Wis.2d 512, 627 N.W.2d 807 (2001), the Wisconsin Supreme Court recognized that all WRS members are protected by Wis. Stat. §40.19(1) from the abrogation of accrued benefits unless those benefits are replaced by benefits of equal or greater value.