Pension plan attacked

Jensen's proposal would let new UW hires opt out of state system

By Matt Pommer

The Capital Times

A key Democratic senator says he wants no part of a Republican leader's move to partially privatize the state's public employee pension program by letting new University of Wisconsin employees opt out.

"As they say, 'if it ain't broke, don't fix it,' " said state Sen. Robert Wirch, D-Kenosha.

Wisconsin has one of the best public employee pension programs, if not the best, Wirch said Thursday. Wirch is the chair of the Senate retirement committees.

Democrats control the Senate by a 17-16 margin. Republicans control the Assembly 55-44.

Assembly Speaker Scott Jensen, R-Waukesha, is reviving his move to partially privatize the pension system.

Jensen is often mentioned as a Republican gubernatorial hopeful for 2002.

Leaders of retired employees and union groups fear that the whole business would lead to the unraveling of the Wisconsin Retirement System.

Jensen wants to allow new faculty and academic staff members at UW campuses to opt out of the Wisconsin Retirement System.

The new academic hires could have the state send their pension contributions to private firms for investment. It would make their pensions a defined contribution program, rather than a defined benefit program.

Those currently employed would have to stay in the state system under his plan.

In a report to the Legislature, actuaries said people under the age of 45 probably would opt for the defined contribution

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Pension

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program rather than the current public employee system.

Jensen says the optional retirement system would help the university recruit faculty. Teachers would be more attracted to the UW if their pensions were portable, he said.

Forty-six other states have this type of pension option for the their university personnel, Jensen said.

He concedes that once the option is made available to new university personnel, other young state employees would want the same treatment.

Jensen adds that those pressures don't bother him at all. You can be sure that new legislators will want the option of a defined contribution program, he said.

Jensen's view isn't surprising. He is the champion of privatizing state government.

UW President Katharine Lyall said the most important fringe benefit issue in recruitment is the ability to provide employer contributions toward health insurance. Under current state law, all state workers — except those in the legislative branch and elected officials — must pay the entire cost of their own health insurance for six months.

Lyall said she knew of no other state which requires new faculty to pay the entire cost of health insurance for six months.

The Board of Regents has asked the Legislature for permission to pay the cost of the first six months of health insurance, even promising to take the money out of the existing UW base budget.

Jensen started pushing the privatization concept during the last session of the Legislature.

But state Rep. Judy Klusman, R-town of Clayton — chairwoman of the Assembly retirement committees — refused to consider the idea.

Jensen was furious at her independence. This year he removed Klusman from the retirement committees and named himself to the panels.

2. The JSCRS is required under this spring's Budget Adjustment Act to provide the UW Board of Regents with a study by January 1, 1999, to assist them in selecting a UWORS to recommend to the Legislature by June 1, 1999.

3. Under the direction of the current co-chairs, Sen. Rude and Rep. Klusman, I have been collaborating with the Wisconsin Retirement System ("WRS") actuaries to put this study together. Norman Jones is the main actuary, and Brian Murphy and other actuaries from their Gabriel, Roeder, Smith office are also involved with this study. We will be finished with it around mid-month, as I explain to Mr. Jensen at the beginning of this memo.

4. Our study will examine 4 versions of an "optional retirement plan" that could be offered to future faculty and academic staff employees hired by the University of Wisconsin. These four "ORPs" are described below.

ORP #1: This is the Speaker's concept as defined in his recent bill, A.B. 331. This is a defined contribution plan to be administered by a private insurance company. This is often referred to as "the TIAA-CREF bill" because of that insurance company's interest in the bill. The employer's contribution under the plan defined in this bill would be equal to the amount of Normal Cost that the university would have contributed under statute for future ORP members had they remained as members of the WRS. On the face of it, this would appear to be a revenue neutral arrangement, since the university's contribution to the defined contribution plan (the ORP) would seem to be the Normal Cost that measures the cost of benefits they would have received from the WRS if the ORP had never been set up.

However, there is a subtle but real actuarial issue here. Statute requires the university to contribute a Normal Cost that is computed on an aggregated basis for the entire group of "general" employees covered by the WRS. I noted late last April that because the affected group of university employees have much higher rates of turnover than the WRS' other "general" employees, this statutory amount is actually more than the university's employees referenced by A.B. 331 truly cost under WRS. Therefore, by letting them transfer out of the WRS, the employers of general employees still participating in the WRS will lose the benefit of a "subsidy" that the university has actually been contributing to the WRS, inasmuch as the university's statutory contribution actually exceeds the benefit costs of its own employees.

In April I estimated by hand, very roughly, that the amount of additional contributions shifted from the university to the other employers would be about 0.5% of "general" payroll, or about $35 million in current dollars. I knew at the time that this estimate was rough, and that it might be high—but it was in the right ballpark. It appears now from preliminary work the actuaries have done that a better estimate of this shifted cost will be about half this much, or around $16 to $20 million current dollars, which is 0.2% to 0.25% of general payroll.

ORP #2: This is simply the Speaker's concept with the amount of contribution to the ORP reduced to the amount of Normal Cost that the affected group appears to be truly costing the WRS. This ORP avoids doing something that ORP #1 would do—creating a higher level of average benefits for the affected group (and therefore creating some additional new benefits cost for the state as a whole). However, the cost-shifting problem caused by the "lost subsidy" would still occur with this ORP. In fact, this would occur with any optional retirement plan of any type that was set up outside of the existing Wisconsin Retirement System.

However, of ORP #2 it can truly be said that the total cost of benefits to all public employees after the ORP would equal the total cost of benefits to all public employees before the ORP—so that in the macro view ORP #2 would truly be revenue neutral, as the drafters of A.B. 331 evidently intended ORP #1 to be. However, cost burdens would still be shifted between employers unless some financing adjustments were also made that are not yet contemplated in the Speaker's original bill.

Referring back to paragraph 1. above, critics of the ORP idea argue that "portability" is not as much of an issue for the WRS as it is for typical pension plans, because the WRS is not a typical defined benefit pension plan. It is actually a "hybrid" plan, meaning a defined benefit plan with some features of a defined contribution plan. ORP #3 and ORP #4 examined in the UWORS study are actually improvements to the WRS itself that would allow it to meet the professors' need for suitable benefits better than the current version of the WRS does. Either of these "hybrid plan ORPs" (#3 or #4) would be offered on an optional basis to the same group of future university employees that the "defined contribution ORPs" (#1 and #2) would be offered to. An advantage of using the WRS to solve this portability problem is that the cost-shifting situation would be avoided by setting up the optional plan within the WRS rather than outside of it. Two disadvantages of using the WRS instead of, say, Speaker Jensen's concept are that (1) 47 other states have set up optional defined contribution plans for their university staffs, and many people want Wisconsin to do the same, and (2) it will obviously cost something to improve the WRS for this group of university employees, and that cost could be more than what the defined contribution alternatives would cost.

ORP #3: Specifically, ORP #3 would make two improvements to the version of the WRS now available to such university employees:

A. Improve the death benefits for active members of the optional plan (within WRS), to be more in accord with what federal law requires private pension plans to offer. This means that a surviving spouse would be eligible to elect an appropriate survivor's pension (in lieu of receiving a refund of double the member's contributions with interest) regardless of the age at which an active employee died. Currently this option is not open to widow(er)s of general employees who die before age 55.

B. Raise to 7% the 5% cap on the rate of return on fund assets that will be credited to a member's own contributions, in order to calculate the "money purchase" accrual amount at retirement age that will define the member's amount of pension, if larger than the defined benefit formula amount of pension (for general employees, the formula amount is 1.6% of final average pay times years of service). This is the "hybrid" feature of the WRS that I referred to above.

ORP #4: This final ORP studied in the UWORS report would improve the WRS death benefit as described in A. above, but instead of raising the "money purchase cap" from 5% to 7%, it would eliminate the cap altogether.

Although vested pensions under ORPs #3 and #4 might not actually be "portable" for departing employees (although they could easily be made portable), they would generate appropriatel larger pensions for them at retirement—so that nonportability would not be an objection to the WRS arrangement for most UW employes who left to take jobs elsewhere.

IIf you have questions about any of this, please call me at the office at 266-5251, or at home at (608) 849-3173. I don't mind being called at home, so please feel free to call me any time you want to talk about anything. Yesterday I sent the following memorandum to Sen. Rude and Rep. Klusman as well, so you all should be up to date once you read it.

Sincerely,

Scott

Memorandum

Date: December 1, 1998

To: Representative Scott Jensen

[redacted]

cc: Chad Taylor

Re: Progress and outlook of the UWORS study

To help you prepare for our meeting next Tuesday, here is a progress report and some preliminary feel for what the results of this study will be. I expect the final study report for the Board of Regents to be ready around mid-month, hopefully not later than the 18th of December, which is the target date I had realistically hoped for.

The actuaries have completed a first draft of the study's report which includes a trial run of the numbers, and are now working on the final report based on our discussions of the first draft. For the draft report they ran initial cost estimates on a trial basis, using as a model for future university hires the full current group of UW faculty and academic staff members (numbering 15,495) that were included in the database used to value the WRS as of 12/31/97.

Assumptions Used

The assumptions used in their trial-run calculations were these:

1. Actuarial assumptions as used in the valuation, except for retirement rates and withdrawal rates after 5 years of service (the so-called "ultimate" rates) for the affected university groups. At my suggestion these rates were rederived directly from the 1994-1996 experience study withdrawal and retirement data. Noting that the withdrawal rates used for the 1997 valuation were based only loosely on this experience study and had been oversimplified for purposes of the present study, we agreed that future turnover and retirement patterns would be better represented by rates drawn directly from the most recent three-year experience study. The select withdrawal rates to be used (that is, rates applicable for new employees with less than 5 years of service) are identical to those used in the valuation, since the amount of available experience data is insufficient to justify making any change to the valuation's select rates.

2. The actuaries are assuming that in the future all eligible university employees below age 45 at hire would elect to participate in the UWORS, while all aged 45 and older would elect to stay in the WRS. The actuaries note in their draft report that "Results would not be materially different if the break point had been set anywhere between 40 and 45."

3. For this initial study run, the actuaries assumed that the entire population of UW faculty/academic staff members present in the 1997 valuation (15,495 active members of the WRS) were representative of future entrants to this group. For the final study, they will base the expected demographics of future hires on only those among the 1997 valuation actives who were hired within the last year (or possibly the last two years, if the data seems to warrant that). We agreed that this is appropriate in order to avoid distortions in the age distributions of expected future hires due to high turnover at young ages that has taken its toll among those who were hired more than a couple of years ago, so that the age-at-hire distribution has been seriously distorted for the surviving members by past attrition.

4. Regarding possible improvements to the WRS that could potentially be offered to university employees: The actuaries will estimate the costs (i) of raising the current 5% cap to 7%, or else (ii) of eliminating the cap altogether. To estimate the costs of changing the cap, they will use the rate-of-return model they developed for their recent 50-year projections done for SWIB to estimate the expected average long-term rate of interest that would be credited to a WRS member's contributions to estimate the "money purchase pension" amount applicable when he/she eventually retires. They have not yet completed these cost estimates on the "SWIB basis" which will account mathematically for rates of return that vary year-by-year, but they did do them on a rough basis for purpose of including in their first draft report.

The only other change contemplated (along with either a 7% or unlimited money purchase cap) is to liberalize the death benefit to allow surviving spouses to select either an actuarially reduced joint and survivor benefit or a refund of twice the amount of the deceased member's contributions.

Preliminary Trial Results

Based on the actuaries' preliminary calculations, the preliminary cost estimates from their first draft report were as listed under A. through F. below.

The actuaries note that the Entry Age Normal Costs cited in their report are the most appropriate measure of what benefits are really costing under a plan. These normal costs are analogous to contribution rates under a defined contribution plan. Any comments appearing in brackets in the rest of this memo indicate my sense of how their trial costs are likely to change in the final report.

A. WRS general valuation group presently: 11.5% of payroll

B. WRS general valuation group ultimately, after adopting any UWORS that would induce all hired at age 44 or below to join the optional plan: 11.7% of payroll

C. Cost shifting effect = B - A: 0.2% of "general group" payroll

D. Item C. in terms of 1998 dollars: About $14 million

[Item A should not change in the final report. Items B, C, and D may increase somewhat because the actuaries will in their final calculations use only the most recent hires—not everyone now employed by the UW—to represent future new hires. Item D will increase numerically by two years inflation factor because they will express results in the final report in year 2000 dollars, clearly labeled as such. This is appropriate since that would be closer to the effective date of any legislation. The final result is likely to lie between $16 and $20 million, in year 2000 dollars, a "shifted cost" that would require about 30 years from creation of the UWORS to fully emerge.]

E. The actuaries projected the number of current (12/31/97) faculty and academics who would terminate not just by retiring, but for any cause, over each of the next 10 years. The results show about half as many retirements as the "25% retiring over the next 5 years" that I was told UW System Administration has recently estimated. However, when all sources of turnover are considered, the concerns about having to hire a great many teachers in a short time are obviously supported -- over 50% of the current faculty/academic employees at the university will be gone within 10 years for one reason or another, and will need to be replaced.

The actual table the actuaries generated, which will probably appear unchanged in their final report, is this:

Year	Beginning Number Active	Normal & Early Retirement	Total Terminations
1998	15,495	414	1,417
1999	14,078	393	1,154
2000	12,924	404	994
2001	11,930	411	874
2002	11,056	424	790
2003	10,266	430	730
2004	9,536	424	676
2005	8,860	427	643
2006	8,217	434	617
2007	7,600	433	592
2008	7,008		

[Note that the emergence of the $16-to-$20 million ultimate shifted cost over the first 30 years of UWORS operation would be approximately in proportion to the last column of this table -- 1417, 1154, 994, etc. The actuaries will include a table of the emergence of annual cost increments in their final report, as well as reporting the above population figures.]

F. Regarding the two proposals (1) to raise the 5% money purchase cap to 7% or (2) to eliminate it altogether, the actuaries roughly estimated that the 7% cap would cost about 0.3% of payoll and that no cap would cost about 0.5% of payroll. This estimate will be refined by using the SWIB rate-of-return model to allow for rates of return for the WRS fund that vary year by year, as noted earlier in this memo. The actuaries are adapting their model for this purpose now. Allowing for annual rates of return that vary realistically and that are subject to the buffering influence of the Transaction Amortization Account may or may not have a significant effect on the estimated cost of changing the cap, but in any case this will provide us with a better estimate than has been previously provided. [The revised cost estimates in the final report will probably be a bit lower than these 0.3% and 0.5% estimates. We won't know by how much until the study is completed.]

If you have any questions before our meeting, please give me a call at 266-5251. I'll be glad to discuss any of this with you.

From: Erickson, Pat
Sent: Friday, December 04, 1998 4:53 PM
To: Smith, Beth
Subject: FW: UWORS study

-----Original Message-----
[redacted]
Sent: Thursday, December 03, 1998 4:15 PM
To: Rep.Vrakas; Sen.Wirch
Subject: FW: UWORS study

Gentlemen,

Speaker Jensen has set up a meeting with me next Tuesday (Dec. 8th) to get updated on the UW Optional Retirement System ("UWORS") study, and I sent him this memo to get him up to speed for our meeting. Since you will be the new co-chairs of the Joint Survey Committee on Pensions & Retirement, I'm forwarding a copy of this memo to get you up to speed on this as well.

[Congratulations, by the way, on your appointments. Our office's purpose is to help the Joint Survey Committee and the Retirement Research Committee in any way possible, and Debra Breggeman, Deborah Turman, and I are looking forward to working with you. I will get an "FYI" memo off to you as soon as I can summarizing what all we expect to be involved in over the next year. I'm so busy with this UWORS study right now, however, that the other memo will be a couple of weeks coming. I expect to get it to you a few days before Christmas.]

Here is some background to prepare you for the attached memo, which is pretty technical ...

1. University of Wisconsin System Administration is concerned that an impending wave of retiring professors and academic staff members (teachers and researchers) will create a severe hiring crunch for the university. They say that it would be easier to hire people to replace those who leave if they had an optional retirement plan like most other states have. Professors do generally like these plans, and 47 of the 50 states now have them. Because university level teachers tend to be somewhat itinerant, a great attraction of such optional plans is that as defined contribution plans they tend to have very "portable" benefits—meaning that you can take your pension nest egg with you (transfer your accumulated account value from the plan you're leaving into the similar plan at the university you're going to), and then your transferred account will continue to grow with investment earnings in the new plan. Ultimately, the portion of your retirement accumulation deriving from these assets will provide a more substantial annuity than you would have had as a pension from the original plan if that had been a typical "defined benefit plan" (i.e., "pension plan") and you merely had a "vested accrued pension" under that plan.

State of Wisconsin

JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS
AND THE RETIREMENT RESEARCH COMMITTEE

Scott L. Dennison, FSA, MAAA
Now retired: BLAIR L. TESTIN
RESEARCH DIRECTOR
ROOM ~~816~~ 722; 110 E. MAIN STREET
MADISON WISCONSIN 53703
(608) 267-0507
FAX (608) 267-0675

December 28, 1998

President of the Wisconsin Senate
Speaker of the Wisconsin Assembly
University of Wisconsin Board of Regents

Ladies and Gentlemen:

The Budget Adjustment Bill enacted earlier in 1998 required the Joint Survey Committee on Retirement Systems to "contract for an actuarial study of the impact of the creation of a University of Wisconsin optional retirement system for eligible employees [of] the Wisconsin retirement system", and furthermore required the Joint Survey Committee to "report the results of the actuarial study to the president of the senate, the speaker of the assembly and the board of regents of the University of Wisconsin System no later than January 1, 1999."

Accordingly, the Joint Survey Committee has contracted with the regular actuaries for the Wisconsin Retirement System, Gabriel, Roeder, Smith & Company ("G.R.S."), to study the impact of the creation of a University of Wisconsin Optional Retirement System ("UWORS"), and their report is enclosed herewith.

Although transmittal of this report to you does fulfill the requirement of law, there are several respects in which this present report fails to provide as much or as accurate information as you will need for your deliberations on the possible establishment of a UWORS. *Therefore, I am studying this matter further myself and expect to provide you with a supplemental report during the latter part of January, 1999.*

The G.R.S. actuaries have given us a creditable report, considering the time constraints they were under and especially considering the lack of sufficient data discerning between U.W. faculty and academic staff to enable a straightforward analysis of the demographics of these two groups and their turnover patterns, which is necessary information for making accurate actuarial cost estimates. Specifically, the G.R.S. actuaries had insufficient time or means to study the following aspects of the UWORS proposal:

- The anticipated response by future U.W. employees hired at various ages to the offer of a retirement plan as an alternative to the current Wisconsin Retirement System.
- Some very significant differences in the turnover patterns of faculty and academic staff.
- The choice of an appropriate database to use for making the actuarial calculations reported in this study.

Moreover, their report omits the following information that it should ideally provide:

- The cost of offering an improved version of the WRS only to future employees of the University of Wisconsin System.

- The year-by-year emergence of that cost over approximately a 30-year period (similar to what appears on page 8 of this present report).

Finally, failure to correct a flaw in the data caused the total payrolls that G.R.S. recognized in their study to be understated by about 4% ($14 million) for academic staff and 1% ($5 million) for faculty. This was something that I discovered and explained to them, but too late for it to be fixed. This error decreased their estimate of UWORS cost-shifting by about 3%.

The supplemental report will address these issues, and will furthermore present a likely range of estimated costs, rather than a single estimated cost, for the defined contribution versions of an optional retirement system that are considered in the two reports.

In the meantime, I would caution readers of the Gabriel, Roeder, Smith report to regard the costs and ten year projections presented on pages 5, 6, 7, and 8 of this report as being only preliminary estimates. The information presented on all other pages of this report appears to be accurate and reliable, and to be based on appropriate data.

Sincerely,

Scott L. Dennison

Scott L. Dennison, FSA, MAAA
State of Wisconsin
Director of Retirement Research

Enclosure

May 4, 1999

Mr. Norman Jones
Gabriel, Roeder, Smith and Company
1000 Town Center, Suite 1000
Southfield, MI 48075

0.1% prospective

Dear Mr. Jones:

As President of the Wisconsin Senate, I would like to request a cost and time estimate for an actuarial study of the following proposed changes to the Wisconsin Retirement System:

1. A retroactive increase in multipliers for all four participant groups of 0.1 %, 0.2% applied to active participants on January 1, 2000 and a .05% prospective multiplier applied on that same date
2. A repeal of the 3% and 5% caps on interest earnings of participants, effective January 1, 2000.
3. Newly allow rollovers out of the WRS based on ~~of~~ the present-value of earned annuities for employees terminating and applying for benefits at or over age 55, age 50 for protectives.
4. A one-time transfer from the TAA of ~~$2.0~~ billion 3.0 billion on 12/31/99, before the regular annual distribution.
5. Proposed changes to the TAA and actuarial methods as described in the attached memo from the Department of Employee Trust Funds.

Much of this has been recently reviewed by GRS, and I desire completion as soon as possible. Please respond to my office or that of Senator Robert Wirch. You may contact Mr. Dave Stella for any needed clarification.

Sincerely,

Senator Fred Risser
President, Wisconsin State Senate

STATE OF WISCONSIN
DEPARTMENT OF EMPLOYE TRUST FUNDS
801 West Badger Road
Madison, WI 53702

CORRESPONDENCE MEMORANDUM

DATE: May 20, 1999

TO: Senator Robert Wirch
Wisconsin State Senate

FROM: Dave Stella, Administrator
Division of Retirement Services

SUBJECT: Requested Draft Description of Creation of an MRA and TAA transfer to Fund Payment of Employer UAAL

Blair Testin requested that I draft a description of how an Market Recognition Account (MRA) and a Transaction Amortization Account (TAA) transfer to fund a benefit improvement bill and pay down employer Unfunded Accrued Actuarial Liability (UAAL) would work. The following is one possible method. It is not the only method and there certainly are variations to this approach. Given the limited time available to think through the ramifications of this proposal I recommend that this approach be thoroughly discussed with the actuary to make sure there are no unforeseen technical problems.

TAA Distribution

On 12/31/99 $3 billion from the TAA will be transferred to the reserves of the Fixed Retirement Investment Trust. Following that transfer and on the same date, the normal 20% TAA distribution would occur calculated using the reduced balance of the TAA.

TAA Phase Out

In the calendar year following transfer of $3 billion from the TAA to fund the cost of benefit improvements the funding structure of the WRS is proposed to be amended as follows:

a. The balance of the TAA on the December 31,2000 will be frozen and phased-out over a 5 year period certain.
b. Each December 31 one-fifth of the beginning TAA balance will be flowed to the reserves of the fixed retirement investment trust and credited to the reserves

based on the percentage of each reserve to the total balance of the fixed trust fund.

Creation of a Market Recognition Account (MRA)

In the year following the $3 billion TAA transfer a Market Recognition Account (MRA) shall be created. The fixed fund shall be credited each year with assumed interest rate (currently 8%). The earnings attributed to the assumed rate will be compared with actual earnings of the fixed fund as reported by the Department. The excess or deficit that results from comparing the assumed interest earnings with the market return shall be recorded in the MRA. 20% of each calendar year's MRA shall flow to the fixed fund in each of the next three years (i.e. 20% each year for 5 years). This procedure will ultimately result in five separate amortization periods being blended in each year and flowed to the fixed retirement trust fund.

Pay down of Individual Employer UAAL Balances

In each year following the $3 billion TAA transfer, 20% of the funds credited to the employer reserve of the Fixed Fund from the transfer from the frozen TAA account shall first be applied to individual UAAL balances of all employers and the remainder applied toward current service costs. The amount credited against each employer's UAAL balance shall be a percentage of the total TAA transfer credited to the employer reserve in that year calculated by determining the percentage of each employer's payroll to the total WRS payroll.

Employers that do not have a UAAL balance or whose balance becomes zero after applying the TAA credit shall receive a credit against their current service contributions in the full amount determined using the calculation described above. This credit shall continue to be provided each year until the residual TAA balance in the employer reserve is exhausted. However, employers who first become participating employers after the effective date of this law will not receive any TAA credit as described above. In addition, employers who elect to recognize the prior service of some or all of their eligible employes after the effective date of the bill would not receive a credit toward prepayment of the increased prior service liability created by this election.

When the UAAL balances of all employers reaches zero all credits from the TAA transfer shall cease and future credits shall then be applied against the total current service liability of all participating employers.

Elimination of the BAC and sharing of contribution rate decreases and increases between employes and employers

Since the previous method of funding is being changed to pay-off the UAAL there is a likelihood that future current service contribution rates may rise in the event investment performance fails to meet actuarial assumptions. The resulting contribution rate increases will be shared equally between the employes and employer even though the primary reason for the increase will be due to the diversion of the TAA to pay UAAL instead of current service liabilties. This may result in litigation by employes who must pay half of the contribution rate increase in the form of a benefit adjustment contribution (BAC). BAC contributions are not credited to employe accounts but instead are considered an employer contribution. It is recommended that both the contribution rate sharing provision and the BAC be eliminated as part of this proposal.

Creation of a New Actuarial Method for Funding UAAL

I also strongly suggest that the ETF Board be given the authority to adjust UAAL balances of employers to reflect changes in actuarial assumptions as recommended by the actuary. In addition, the ETF Board, at the recommendation of the actuary, should have the authority to establish the funding method for paying any new UAAL created after the effective date of the bill. This will permit the ETF Board to adopt a methodology that is less problematic than the current process and more equitable.

STATE OF WISCONSIN

Department of Employe Trust Funds

Eric O. Stanchfield
Secretary
801 West Badger Road
P.O. Box 7931
Madison, WI 53707-7931

819 N. Sixth St., Rm. 550
Milwaukee, WI 53203

FAX TRANSMITTAL

DATE: 05/20/99

FROM: Dave Stella

PHONE #: 267-9038

TIME: 8:47 AM

Please deliver the following 2 pages (including this cover sheet) to:

Name: Beth Smith

Organization: Office of Senator Wirch

FAX #: 267-0984

Please reply when received ☐ Yes ☒ No

If you wish to reply, our FAX number is (608) 267-0633.

Message:

Attached are the edits you requested.

ET-8117 (REV 11/98)

WISCONSIN STATE SENATE

June 2, 1999

TO: Members of the Senate Committee on Organization

FROM: Senator Chuck Chvala, Chair
Senate Committee on Organization

SUBJECT: Actuarial Study

I am requesting approval of the Senate Committee on Organization to secure on behalf of the State Senate an actuarial study of proposed changes to the Wisconsin Retirement System. The Retirement Research Committee does not have funds available to secure a study at this time. Therefore, I am seeking authorization for the State Senate to pay for an actuarial study estimated to cost $24,000. The study would be completed in approximately 5 weeks.

If you have any questions, please contact me. Please indicate your approval by signing below.

REQUEST FOR ACTURARIAL STUDY OF WRS (Date)

Senator Chuck Chvala

Senator Fred A. Risser

Senator Rodney Moen

Senator Michael G. Ellis

Senator Brian Rude

GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries

1000 Town Center • Suite 1000 • Southfield, Michigan 48075 • 248-799-9000 • 800-521-0498 • fax 248-799-9020

May 26, 1999

Senator Chuck Chvala
Senate Majority Leader
State Capitol
Post Office Box 7882
Madison, Wisconsin 53707-7882

Re: Proposed Changes to the Wisconsin Retirement System

Dear Senator Chvala:

You have inquired about an actuarial study of the following proposed changes to WRS:

1. A past service increase in benefit multipliers for all four participant groups of 0.2% applied to active participants on January 1, 2000.

2. A 0.05% prospective service multiplier increase for all four participant groups on January 1, 2000.

3. A repeal of the 3% and 5% caps on interest credits to participant accounts effective January 1, 2000.

4. Permit rollovers out of the Wisconsin Retirement System based on the present value of earned annuities for participants terminating and applying for benefits at or over age 55, age 50 for protective occupation participants.

5. A one-time transfer from the TAA of $5.0 billion on December 31, 1999, before the regular annual distribution.

6. Proposed changes to the TAA and allocation of plan costs as described in the May 20, 1999 memo from the Department of Employe Trust Funds.

7. A model of the proposed Market Recognition Account (MRA) showing what the recognized rate of investment return and the funding value of assets would have been if the MRA had been adopted 5 years ago.

We propose to evaluate each of the proposed changes separately for each of the four rate groups and to show the combined effect of all changes. The cost is estimated to be between $22,000 and $24,000 including one meeting in Madison to review results. Completion time is estimated to be 5 weeks. In accordance with the provisions of our actuarial service contract with the Department of Employe Trust Funds, we will need their approval to begin the study.

We look forward to working with you and the Wisconsin State Senate Committee on Organization.

Sincerely,

Norm Jones

Norman L. Jones

NLJ:cg

CC: Brian B. Murphy

cc Sen. Robert Wirch

STATE OF WISCONSIN
DEPARTMENT OF EMPLOYE TRUST FUNDS

801 West Badger Road
Madison, WI 53702

CORRESPONDENCE MEMORANDUM

DATE: May 5, 1999

TO: Scott Dennison, Director
Retirement Research Committee

FROM: Dave Stella, Administrator
Division of Retirement Services

SUBJECT: Need to correct "substantial" error in the ongoing WRS 1998 valuation

I have reviewed your April 15, 1999 memo about your concern with a 3% underreporting of payroll for the UW and all other WRS employers. I have had two conversations with Norm Jones of Gabriel, Roeder, Smith & Company (GRS), the ETF Board's consulting actuary about this issue. In addition, I have requested and received some written analysis from Brian Murphy, a second GRS actuary also assigned to provide services to the ETF Board.

It appears that the issue you are raising involves the practice of not annualizing the pay of new hires in the annual actuarial valuation data. For example, if an employe is hired on December 1, GRS does not try to annualize this employe's earnings to anticipate that they will be on the payroll for a full year (assuming they remain employed). GRS is well aware of this issue. In fact, a related issue was raised during the five-year actuarial audit by Milliman and Robertson in 1991. As you may be aware, by statute the consulting actuary's work is audited by an independent actuarial firm every five years. As a result of that review GRS now tests the projected final average compensation against the final average compensation reported on the data tape from ETF. Consequently, the present value of future benefits tends to be more accurately related to the data and assumptions than it would otherwise be.

GRS has considered several ways to adjust the data to address the partial year salary. However, none of the solutions to this issue were found acceptable. The decision that GRS made in not trying to annualize the pay of new entrants was, based on some initial testing that showed a potential for introducing instability in the result and their judgement that it does not affect the results of the valuation very much, if at all. Their reasoning is that most other conditions are proportional to pay and many of the new entrants leave WRS coverage after a short time. This minimizes the impact of not annualizing pay for new hires.

GRS is willing to run tests again to determine the effect of various methods of annualizing pay for new hires. They will do this if the Department believes it would be helpful. Since this issue has been reviewed in the past we are not convinced at this point it would be worthwhile. However, it is a matter that we will discuss further with GRS to determine if it is a matter for concern in developing the 1998 annual actuarial valuation. We will also consider this item for possible review in the next actuarial audit, that is scheduled for next year.

In addition to the actuarial audit every five years, the review of the WRS actuary's work is the responsibility of the Department and the ETF Board. The Department carefully reviews valuation results with the actuary prior to the date the ETF Board considers the recommendations presented in the annual actuarial valuation. We believe that the audits and the Department's oversight have been effective in identifying potential data problems. The Department has a high degree of confidence that the current review system adequately addresses oversight of the work of the WRS actuary.

cc: Secretary Eric Stanchfield
State Senator Robert Wirch
State Representative Daniel Vrakas

STATE OF WISCONSIN
MINUTES OF MEETING
JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS
MONDAY, MARCH 22, 1999
1:00 P.M.
ROOM 417 NORTH (G.A.R. HALL), STATE CAPITOL BUILDING
MADISON, WISCONSIN

CALL TO ORDER AND ROLL CALL
(Agenda Item 1)

The meeting of the Joint Survey Committee on Retirement Systems was called to order by Co-Chair Vrakas at 1:06 p.m. in Room 417 North (G.A.R. Hall) of the State Capitol Building in Madison, Wisconsin.

Roll call was taken as follows:

Present:	(8)	Sen. Wirch, Rep. Vrakas, Speaker Jensen, Rep. Schneider, Mr. Stella, Mr. Heineck, Ms. Hamblen, Mr. Scott.
Absent:	(2)	Sen. Erpenbach, Sen. Panzer.
Others Present:		Pat Osborne, VALIC; Mark Feldman, VALIC; Ken Opin, WFT; Leigh Roberts, WREA; Elmer Homburg, WREA; Donald E. Krahn, WEAC; Esther Olson, ASPRO; Tony Studt, ASPRO; Lev De Back; Bob Schaefer, SEA; Roger Chase, WREA; Carol McCurry, WSP; David Kiekbusch, SEA; Tom Mugan, SEA; Bill Abromowicz, AETNA; Tom Strohmenger, AETNA; Carl Steinhilber, AETNA; Joe Strohl, PFFW/RPFFW; Gloria Waity, WREA; Priscilla Thain, PROFS; Allen J. Knop; Mary G. Hoglund; Jane Elmer, WREA; Priscilla Mather, SEA; Peter Maternowski, DOA; Nile Ostenso, SEA; Eunice Berg, WREA; Phyllis Pope, WEAC-R; Don McCloskey, WREA; Steve Werner, WPPA; Roy Kubista, AFSCME; Harold Rebholz, WREA; Noel Ness, WEAC-R; Eugene Lehrmann, WREA; Larry Legro, SEA; Mel Sensenbrenner, SEA; Gerald Martin, WEAC-R; Rita Martin, WEAC-R; Blair Testin, WREA; Dr. Philip Blank, Wis. Council of Sr. Citizens; Marilyn Nemeth, WEAC-R/WCSC; Mary Frickelton, LAB; Carolyn Stittleburg, LAB; Joel L. Lamke, WEAC-R; Ed Kehl, Wis. Coalition of Annuitants; Margaret Lewis, UWSA; Dick Lipke, RPFFU; Sue Chamberlain, UW System; Mary Anglim, UW System; Beth Smith, Staff for Sen. Wirch; Brian Pleva, Staff for Rep. Vrakas; Scott Dennison, JSCRS Director; Deb Breggeman, JSCRS Staff.

CONSIDERATION OF THE MINUTES OF MAY 6, 1998
(Agenda Item 2)

Rep. Vrakas moved, seconded by Mr. Stella, to approve the minutes of the May 6, 1998, meeting of the Joint Survey Committee on Retirement Systems.

Motion carried by voice vote.

OVERVIEWS
(Agenda Item 3)

Brief overviews were presented by the following:

- Ms. Patricia Lipton, State of Wisconsin Investment Board
- Mr. David Stella, Department of Employee Trust Funds
- Mr. Scott Dennison, Joint Survey Committee on Retirement Systems

Ms. Lipton, Mr. Stella, and Mr. Dennison each described their agency and its function.

PRESENTATION OF ACTUARIAL REPORTS ON THE OPTIONAL RETIREMENT PLAN (ORP)
(Agenda Item 4)

Mr. Norman Jones from Gabriel, Roeder, Smith, and Company presented the actuarial report entitled, *"Enhancements to Hybrid Plan Features of the Wisconsin Retirement System and a Separate Optional Retirement System for University of Wisconsin Employees"* dated December 21, 1998.

Mr. Scott Dennison, Director of Retirement Research, presented his actuarial report entitled, *"A Supplemental Actuarial Study of Proposals to Provide an Optional Retirement Plan"* dated March 22, 1999.

Representative Vrakas opened the meeting to public testimony on the Optional Retirement Plan. Appearing before the Committee were:

Name	Position
1. Ms. Margaret Lewis, U.W. System	Information
2. Professor Ronald Schultz, PROFS; University-Madison Faculty	Information
3. Mr. Michael Waltz, TIAA-CREF	In Favor
4. Mr. Harold Rebholz, Wisconsin Retired Educators Assoc.	Opposed
5. Mr. Eugene Lehrmann, Wisconsin Retired Educators Assoc.	Opposed
6. Mr. Blair Testin, Wisconsin Retired Educators Assoc.	Opposed
7. Mr. Michael Heller, TIAA-CREF	In Favor
8. Mr. William Abramowicz, AETNA	In Favor
9. Mr. Tom Strohmenger, AETNA	In Favor
10. Mr. Carl Steinhilber, AETNA	In Favor
11. Mr. Carston C. Koeller, AFT Local 212	Opposed
12. Mr. Mark Feldman, VALIC	In Favor
13. Mr. Mel Sensenbrenner, State Engineering Assoc./Retire. Consortium	Opposed
14. Mr. Robert Ring, TIAA-CREF	In Favor
15. Mr. Ken Opin, Wis. Federation of Teachers	Opposed
16. Mr. Peter C. Christianson, TIAA-CREF	In Favor
17. Dr. Philip Blank, AFT Local 212	Opposed
18. Mr. Gerald Martin, Wis. Education Association Council – Retired	Information
19. Ms. Esther Olson, ASPRO	Information
20. Dr. Edward J. Muzik, TAUWP	Opposed
21. Mr. Donald E. Krahn, Wis. Education Association Council	Opposed
22. Mr. Edwin Kehl	Opposed
23. Mr. Nile Ostenso, State Engineering Association	Opposed

Committee members asked questions of the speakers after they had presented their testimony.

Hearing no further requests for testimony, Representative Vrakas closed the public hearing on the Optional Retirement Plan.

Registering on the Optional Retirement Plan were:

Name	Position
1. Mr. Dennis Boyer, Councils 24 & 40 AFSCME	Opposed
2. Mr. Steve Werner, Wis. Professional Police Assoc.	Opposed
3. Mr. Timothy J. Hanson	Opposed
4. Ms. Priscilla B. Mather, State Engineering Association	Opposed
5. Mr. Allen Knof	Opposed
6. Ms. Jane Elmer, Wisconsin Retired Educators Assoc.	Opposed
7. Ms. Jennifer Kammerud, School Administrators Alliance	Opposed
8. Mr. James E. Boettcher	Opposed
9. Mr. Joel L. Lamke, Wis. Education Association Council – Retired	Opposed
10. Ms. Marilyn S. Nemeth, Wis. Education Association Council – Retired	Opposed
11. Mr. Noel Ness, Wis. Education Association Council – Retired	Opposed
12. Mr. Tom Warnke, State Employee	Opposed
13. Mr. Paul Caleb, State Employee	Opposed
14. Mr. Don Hendrikse, State Employee	Opposed
15. Ms. Susan North, State Employee	Opposed
16. Mr. Mark Bunge, State Employee	Opposed
17. Mr. Conrad Weiffenbach, State Engineering Association	Opposed
18. Mr. Richard Genschaw, State Engineering Association/State Employee	Opposed
19. Mr. Larry Legro, State Engineering Association	Opposed
20. Ms. Rita Martin, Wis. Education Association Council – Retired	Opposed
21. Ms. Eunice Berg, Wis. Retired Educators Assoc.	Opposed
22. Ms. Phyllis Pope, Wisconsin Education Association Council – Retired	Opposed
23. Mr. Don McCloskey, Wis. Retired Educators Assoc.	Opposed
24. Ms. Leigh Roberts, Wisconsin Retired Educators Assoc.	Opposed
25. Mr. Elmer Homburg, Wisconsin Retired Educators Assoc.	Opposed
26. Ms. Carol McCurry	Opposed
27. Mr. Phil Ciha, State Engineering Association	Opposed
28. Mr. Bob Schaefer	Opposed
29. Mr. Brian Pietz	Opposed
30. Mr. Gerald Stetzer	Opposed
31. Ms. Gloria Waity, Wis. Retired Educators Association	Opposed
32. Ms. Mary G. Hoglund, Wis. Education Association Council – Retired	Opposed
33. Mr. Terry Donovan, State Engineering Association	Opposed
34. Mr. Steve Dunn, State Engineering Association	Opposed
35. Mr. Mike Anderson, State Engineering Association	Opposed
36. Mr. Dave Hantz, State Engineering Association	Opposed
37. Mr. Jeff Kreider, State Engineering Association	Opposed
38. Mr. Mark Valleux, State Engineering Association	Opposed
39. Mr. Bernie Robertson, State Engineering Association	Opposed
40. Mr. Percy Mather, State Engineering Association	Opposed
41. Mr. David Kiekbusch, State Engineering Association	Opposed
42. Mr. John Gallagher, State Engineering Association	Opposed
43. Mr. Fred Grelle, State Engineering Association	Opposed
44. Mr. Tom Mugan	Opposed

OTHER MATTERS
(Agenda Item 4)

There were no other matters before the Committee at this time.

ADJOURNMENT
(Agenda Item 5)

The meeting of the Joint Survey Committee on Retirement Systems adjourned at 6:15 p.m. The next meeting will be at the call of the Co-Chairs.

Debra Breggeman, Recording Secretary

Senator Wirch

LEGISLATIVE RETIREMENT COMMITTEES

JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS AND THE RETIREMENT RESEARCH COMMITTEE

- Both the Joint Survey Committee on Retirement Systems and the Retirement Research Committee have been created by statute dealing with public retirement matters.

- The statutes governing these Committees are found under Chapter 13 (legislative branch), and the Committees function as a legislative service agency.

- The two Committees operate conjunctively and entirely in the public retirement area. They attempt to recognize and balance the interests of three parties involved – employees, employers, and taxpayers.

- The same officers serve both Committees and are appointed by the Assembly and the Senate.

- Our current Co-Chairs are Senator Bob Wirch and Representative Dan Vrakas.

- The same staff also serves both Committees.

- The staff consists of Scott Dennison, Director (since 1997), Deborah Turman, Office Management Specialist (since 1972) and Debra Breggeman, Committee Clerk/Program Assistant (since 1975).

- The Committee office is located in Room 722, 110 E. Main Street (Tenney Building).

JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS (JSCRS)

- Created by statute by the 1947 legislature with some changes in the governing laws in 1959, 1965, 1979, and 1981.

- Created as a "watchdog agency" over public retirement systems within the state.

- The Committee is composed of 10 members including three senators, three representatives, a representative of the Attorney General's office, a representative of the Commissioner of Insurance office, Secretary of the Employee Trust Funds or designee, and a public member appointed by the Governor.

- The JSCRS operates similar to standing legislative committees by holding public hearings, receiving testimony, offering amendments, and making recommendations on bills referred thereto.

Scott planned on delivering these remarks at the 3-22-99 JSC meeting, but decided to ad lib instead. Deb Breggeman

- 13.50 (6), Stats., provides that the legislature shall not act upon any bill or amendment which creates or modifies any system for, or making any provision for, the retirement of or payment of pensions to public employees, until it has been referred to the JSCRS and said committee has written a report on the bill.

- Committee reports include detailed descriptions as to the purpose of the bill, the actuarial effect, the probable cost in dollars and percent of payroll, the public policy issues involved, and the committee recommendation on the bill.

- By statute, all committee actions require the approval of a majority of all members (six out of ten), and the reports are printed as an appendix to the bill and accompany it through the remainder of the legislative process.

RETIREMENT RESEARCH COMMITTEE (RRC)

- The RRC was created in 1959 as a permanent study and problem-solving committee on public retirement issues.

- The Committee has 19 members including all 10 of the JSCRS plus 8 additional members who are ex officio or appointed by the Governor and 1 annuitant member of the ETF Board who is elected under s. 15.16 (1)(d).

- The functions of the RRC include reporting to the legislature on public employee retirement systems, requiring financial and actuarial information from such plans, and maintaining a library of major public pension plans across the country.

Table 1. Effective Money Purchase Crediting Rates for the WRS, Computed Using SWIB's Normal Distribution Model

Alternative*	GRS estimate (all but 1a,2a by Monte Carlo)	Exact Rates if...: Rate of return in SWIB studies	Exact Rates if...: ROR if current TAA not applied	Percent of Payroll Cost for ...: Future UW staff: Expected cost	Future UW staff: No-TAA cost	All WRS "General": Expected cost	All WRS "General": No-TAA cost
A	B	C	D	E	F	G	H
1a	7.0%	7.00%	6.20%	Rejected: This needs a "floor".			
1b	6.2%	4.70%	4.45%	Rejected: Reduces expected return!			
1c	6.5%	6.12%	6.05%	Rejected: Too small an improvement.			
2a ⇒ pre 84	8.0%	8.00%	7.20%	0.24%	0.13%	0.49%	0.31%
2b	6.7%	5.53%	5.25%	Rejected: Too small an improvement.			
2c	7.0%	6.76%	6.64%	0.11%	0.11%	0.25%	0.24%
3a	(New)	7.88%	7.24%	0.22%	0.14%	0.45%	0.32%
3b	(New)	7.34%	6.76%	0.15%	0.11%	0.33%	0.25%
3c	(New)	7.63%	7.09%	0.18%	0.13%	0.39%	0.29%
3d	(New)	7.96%	7.46%	0.23%	0.16%	0.48%	0.36%
3e	(New)	8.00%	7.63%	0.24%	0.18%	0.49%	0.39%

*Alternative 2a would credit the full rate of return (ROR), with no cap or floor applied to that rate. This was the method used before 1982. Alternatives 1a, 1b, 1c, and 2b were all described in Gabriel, Roeder, Smith's report. These were rejected for reasons noted in this table.
Alternative 2c credits investment return up to 8%, with a 5% floor.
Alternative 3a credits all investment return, less 1%, with a 0% floor.
Alternative 3b credits all investment return, less 2%, with a 1% floor.
Alternative 3c credits all investment return, less 2%, with a 2% floor.
Alternative 3d credits all investment return, less 2%, with a 3% floor.
Alternative 3e credits all investment return, less 3.5%, with a 5% floor.

ALTERNATIVE -->	2a	2c	3a	3b	3c	3d	3e
These values are	8.0000%	6.7565%	7.8752%	7.3356%	7.6263%	7.9608%	7.9980%
from Table 1.	7.1997%	6.6395%	7.2425%	6.7648%	7.0900%	7.4610%	7.6335%
Mean ROR:	7.60%	6.70%	7.56%	7.05%	7.36%	7.71%	7.82%

Table 2. Estimated Costs of Improving WRS Money Purchase Crediting (as percentages of the covered payrolls)

	Proposed Changes to WRS Money Purchase Accumulation						
WRS Groups	2a	2c	3a	3b	3c	3d	3e
Future UW employees							
. Expected cost	0.241%	0.111%	0.219%	0.147%	0.180%	0.234%	0.241%
. "No TAA" cost	0.135%	0.105%	0.138%	0.111%	0.127%	0.160%	0.181%
$Mil/yr->	1.38	0.79	1.31	0.94	1.13	1.44	1.55
General employees							
. Expected cost	0.490%	0.250%	0.455%	0.332%	0.392%	0.479%	0.489%
. "No TAA" cost	0.309%	0.236%	0.316%	0.251%	0.293%	0.357%	0.394%
$Mil/yr->	29.21	17.75	28.18	21.34	25.04	30.53	32.29
Executive & Elected							
. Expected cost	0.400%	0.161%	0.358%	0.225%	0.287%	0.386%	0.399%
. "No TAA" cost	0.204%	0.151%	0.210%	0.162%	0.190%	0.249%	0.289%
$Mil/yr->	0.22	0.11	0.21	0.14	0.17	0.23	0.25
Protectives with SS							
. Expected cost	0.170%	0.061%	0.150%	0.089%	0.117%	0.164%	0.170%
. "No TAA" cost	0.079%	0.057%	0.082%	0.061%	0.073%	0.100%	0.118%
$Mil/yr->	0.68	0.32	0.64	0.41	0.52	0.72	0.79
Protectives, no SS							
. Expected cost	0.060%	0.000%	0.046%	0.007%	0.024%	0.055%	0.060%
. "No TAA" cost	0.002%	0.000%	0.004%	0.000%	0.000%	0.013%	0.024%
$Mil/yr->	0.04	0.00	0.03	0.00	0.01	0.04	0.05
$Mil/yr-> All WRS:	30.16	18.19	29.06	21.89	25.76	31.53	33.38
% of PR: All WRS:	0.37%	0.23%	0.36%	0.27%	0.32%	0.39%	0.41%

lower rate of return on $ purchase

payroll

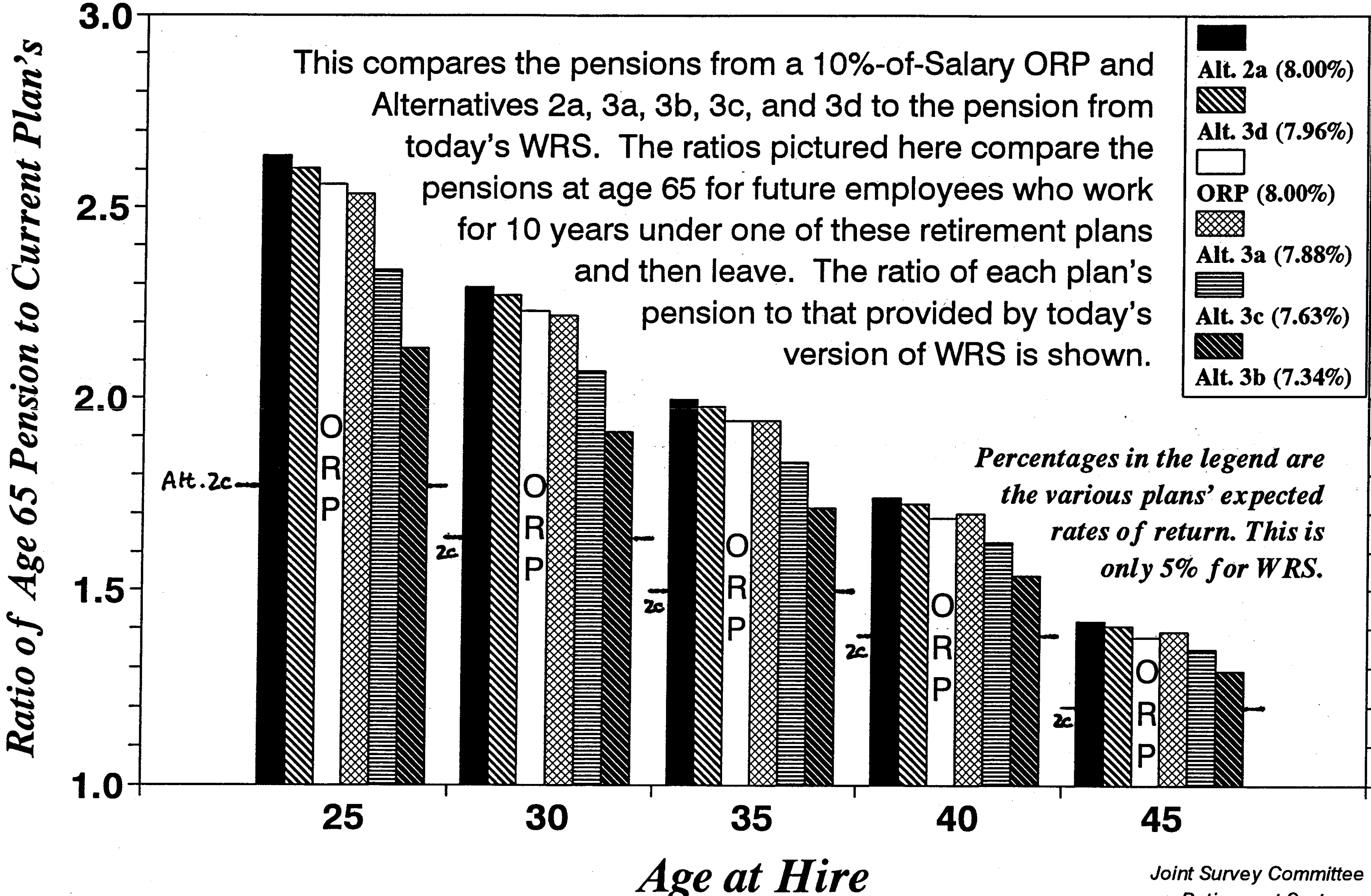
- notch effect

For those who work 10 years, LEAVE, and retire later.

Age hired	2a	3d	10% ORP	3a	3c	3b	2c
	Ratio of Age 65 Pension to Current Plan's Pension						
25	2.64	2.60	2.56	2.53	2.34	2.13	1.77
30	2.29	2.27	2.23	2.22	2.07	1.91	1.63
35	2.00	1.98	1.94	1.94	1.83	1.72	1.50
40	1.74	1.73	1.69	1.70	1.62	1.54	1.38
45	1.42	1.41	1.38	1.39	1.35	1.29	1.20

Vrapas scenario

"Portability" of 6 Proposed Plans for Those WHO LEAVE after 10 Years of Service



Joint Survey Committee on Retirement Systems

MAY 17 1999

State of Wisconsin

JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS
RETIREMENT RESEARCH COMMITTEE

Scott L. Dennison, FSA, MAAA
Director of Retirement Research
110 E. Main Street; Room 722
Madison, WI 53703
(608) 267-0507
Fax: (608) 267-0675
E-mail: scott.dennison@rrc.state.wi.us

Memorandum

May 13, 1999

To: Representative Dan Vrakas, Senator Bob Wirch

cc: Dave Stella

From: Scott Dennison Scott

Re: Unfunded Liability and Proposed RRC Topics

Two things. First, I promised to send you some info on the unfunded accrued liability situation for the WRS. The first graph (which my printer won't print without a streak) shows how the "Frozen Initial Liability" ("F.I.L.") has varied from the "Entry Age Unfunded Liability" which it was initially set equal to in the 1986 valuation. The past few years of huge asset gains have all but wiped out the Entry Age UAL. The F.I.L. by design ignores these, and is over $2 billion now.

The second graph interprets the F.I.L. in a more meaningful way. Although it is growing in absolute dollars, if you factor inflation out of it you can see that it has been steadily shrinking. If you measure "inflation" by the growth of Wisconsin's public payroll, then it has decreased even faster than if you take "inflation" to mean the Urban Consumer Price Index. The state's public payroll is probably a more meaningful measure for us to use, since it is an approximate yardstick of the growth of Wisconsin's economy.

The second thing I wanted to tell you is what the four subjects of study were that Sen. Rude and Rep. Klusman had decided the Retirement Research Committee should study. They were ...

1. A review of WRS benefit adequacy. For each group (General, Exec & Elected, Protective with SS, Firefighters) this means measuring the adequacy of retirement income (WRS pension plus Social Security) for sample employees with representative ages, salaries, and service. If there are any weak areas in the WRS as far as paying fair or adequate benefits goes, this study would pinpoint them. I could do this one, but GRS would have to help with the next three.

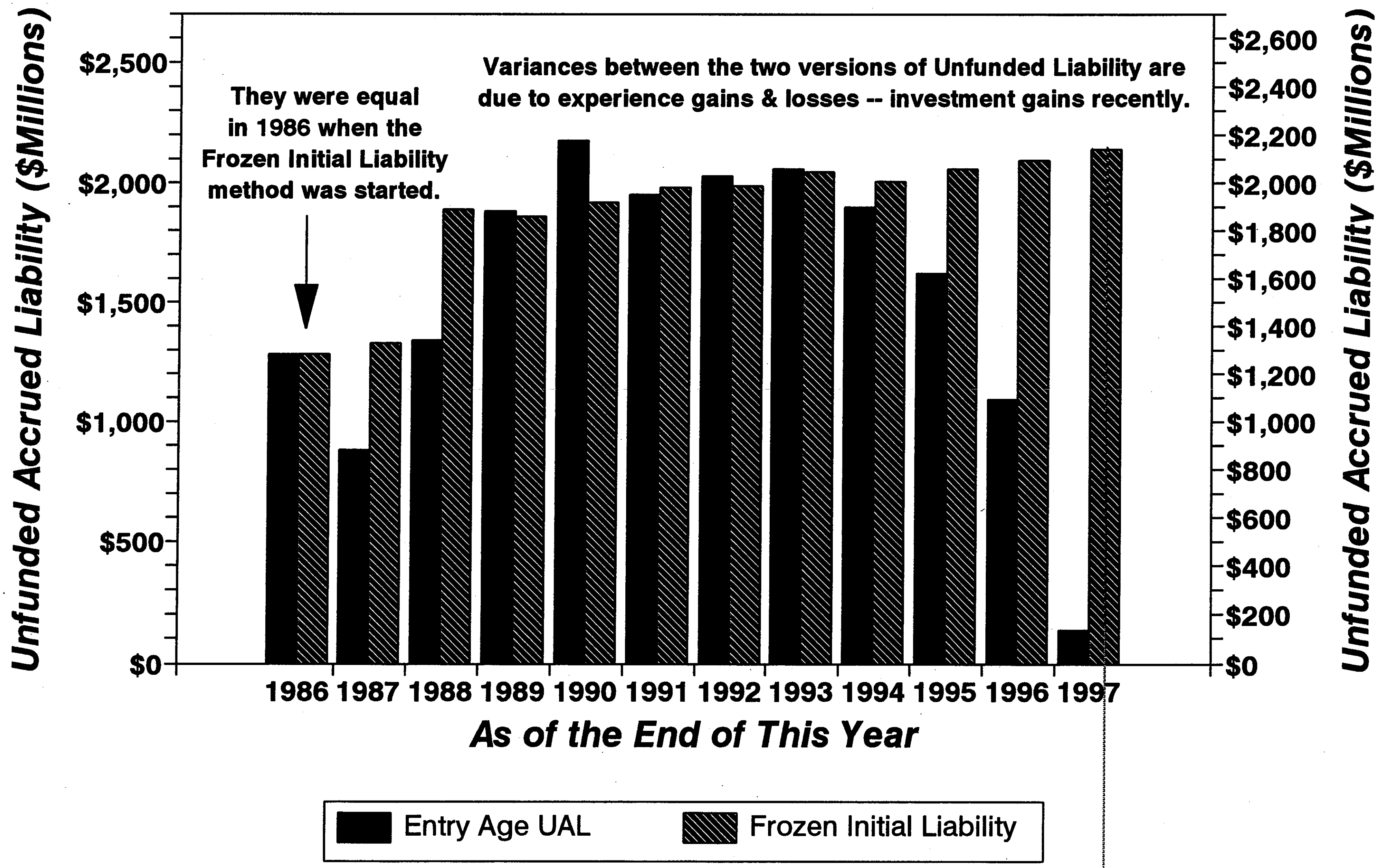
2. Resume the study of duty disability. The RRC began to do this already, I believe.

3. TAA versus MRA or other possible asset valuation methods.

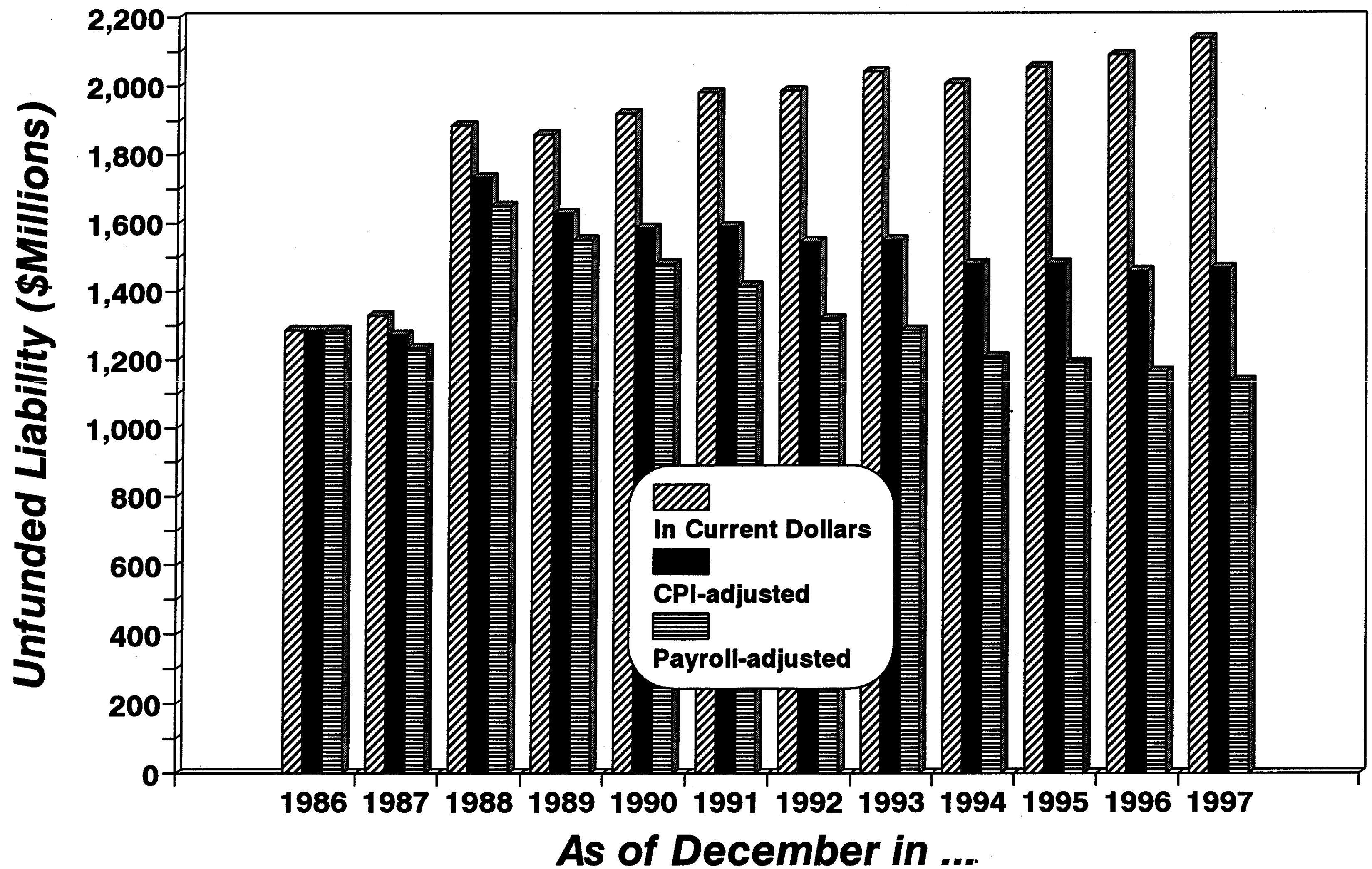
4. What to do about the Unfunded Accrued Liability problem. FYI, I'll also attach some memos I have that will get you up to speed on the UAL situation.

Attachments

History of WRS Unfunded Liability Under the Entry Age and F.I.L. Methods



WRS Frozen Initial Liability Adjusted for Inflation (CPI or Payroll)



STATE OF WISCONSIN
DEPARTMENT OF EMPLOYE TRUST FUNDS
201 East Washington Avenue
Madison, WI 53702

CORRESPONDENCE MEMORANDUM

DATE: January 5, 1996

TO: Blair Testin, Director
Retirement Research Committee

FROM: David Stella, Administrator David Stella
Division of Retirement Services

SUBJECT: WRS Unfunded Accrued Actuarial Liability (UAAL)

You asked that I provide the Committee with a report on the issues related to the creation and payment of the unfunded liability by public employers participating in the WRS. This memo will discuss some of the practical implications of the current method of amortizing unfunded accrued liabilities of the WRS. Norm Jones, consulting actuary to the Employe Trust Funds Board, will provide a more detailed description and possible alternative approaches for the Committee.

Background

For purposes of this discussion I will refer to the UAAL as "prior service liability" which represents all of the current unfunded liability in the WRS. Prior service liability has been a controversial issue for some employers especially since enactment of benefit improvements in 1989 Wisconsin Act 13. Prior service liability is created in two ways: when an employer first joins the WRS and chooses to recognize part or all of the service rendered for that employer prior to the date the employer was included in the WRS and when benefit improvements are granted in legislation and apply to service already rendered by covered employes.

As part of the funding mechanism to pay for benefit improvements 1989 Wis Act 13 increased the WRS existing prior service liability by $512 million and established a new 40 year amortization period. A previous benefit improvement bill, 1983 Wisconsin Act 141, had increased the prior service liability on January 1, 1986 by $530 million and had also reset the amortization period to 40 years. On December 31, 1983 the prior service liability of the WRS was $650 million. The prior service liability balance as of December 31, 1994 was $2.007 billion. Approximately 70% of the total is the liability of local government employers and 30% is the liability of state agencies.

Discussion of Issues

The existence of a prior service liability is not the sign of funding difficulties for a retirement system. The important consideration is whether the retirement system has a plan to pay off the liability over a realistic period of time and that employers are meeting their annual obligation to pay down the liability. In the WRS employers on average pay a contribution rate of 1.3% of payroll toward their prior service liability. That rate is frozen for the entire amortization period of 40 years, but the employer may, at its discretion, pay down the balance in larger installments or lump sum payments. Some WRS employers have chosen to pay off their unfunded liability balance completely in one lump sum payment.

As the consulting actuary will describe in his presentation, the amortization schedule for payment of the prior service liability includes a level percent of payroll method so that inter-generational equity is achieved. The amortization schedule assumes an ever increasing employer payroll using a salary growth assumption (currently 5.3%) and an interest rate charge on the unpaid balance based upon the WRS assumed interest rate (currently 8.0%). These assumptions are set by the Employe Trust Funds Board and may change if the Board, on the recommendation of the actuary, determines that a change is necessary to reflect the long term experience of the WRS.

Under the design of the amortization schedule an employer's prior service liability balance will grow (in nominal dollars) for about the first twenty years and then decline in the next twenty years of the schedule as payroll growth causes an ever increasing payment against the principal balance. For most employers the actual experience of salary growth will not be the same as the amortization schedule assumes. However, if on average wage increases grow at the assumed salary inflation rate, the liability will be fully paid within the forty year amortization period.

Issues of Concern to Employers

Since 1989 a series of events have caused concern among some local government employers who were alarmed by their increasing prior service liability balance. In particular, those employers who have experienced substantial downsizing of their employe payroll have expressed concern that their liability balance will continue to grow because their payments will never reach a level sufficient to pay the full interest and principle. This is particularly true for employers who experienced large payroll declines through the sale or closing of a nursing home, hospital or psychiatric facility. In one extreme case, using the current amortization method, the employer's liability was projected to grow from $3 million to more than $25 million by the end of 40 years.

In order to resolve this problem employers must make larger payments toward their unfunded liability than anticipated. This is particularly unpopular during a period that local governments are under expenditure caps.

A second issue is that many employers object to being charged interest on this debt. However, liabilities are interest bearing obligations of the WRS. The WRS must receive interest on its obligations in an amount it expects to earn over the long term on invested assets. If interest is not charged the result is a financial loss to the WRS which will cause an increase in WRS liabilities and would result in higher current service contribution rates for all employers (i.e. not just those who have an unfunded liability). Employers can avoid interest costs by paying their liability in full or reduce interest costs by paying down the principal balance faster than scheduled.

A third issue raised by employers concerns the fact that once established, the prior service liability remains the employer's obligation regardless of the status of the employees on which the liability is based. Under the current method of assessing prior service liability the allocation of the liability is based on each employer's payroll of participating employes on a specified date. The liability remains regardless of the status of each employe after that date. In some cases, employes move to other public employers, die, retire, separate from service and withdraw their contributions, or leave their contributions on account and become employed in private sector jobs.

Some employers believe that their prior service liability should be recalculated each year solely using the employes employed on the first day of the calendar year. Prior service liability recalculation each year is done in some retirement systems such as the Illinois. However, the logistics of tracking employes as they move in and out of employment with over 1200 employers makes this method extremely complex and expensive. These are experience rating issues that will be addressed in more detail by the actuary.

Alternative Method of Funding UAAL

In addition to the current method used by the WRS and the annual recalculation method by employer, the WRS consulting actuary has suggested that we explore the possibility of aggregating all employer prior service liabilities into one liability for the system and have all employers pay the average contribution rate necessary to pay-off the liability over the amortization period. Under this method there would be no individual employer prior service liability. All employers' prior service would be "pooled" and employers would pay the same percentage toward the system's unfunded liability. While this method may create the magical impression that all the individual prior service liabilities would disappear it is not without its drawbacks and possible legal implications. Employers who have already paid off their prior service liabilities would face higher total contribution rates. Employers with high prior service rates would be advantaged by having their rates lowered to the average rate, but those paying less than the average would face an increase in their total contribution rate. New employers might eventually be required to recognize the prior service of their employes when joining the WRS and would pay the same average contribution rate for prior service.

Many of these drawbacks can be accommodated through a phase-in of the prior service rate changes, however, there would be some loss in flexibility now available in the "non-pooled" arrangement. Despite these drawbacks the "pooled" prior service arrangement does offer some advantages that should be studied by the RRC if changes to the current UAAL method are contemplated.

Summary

A number of employers have expressed concern about the current amount of their unfunded prior service liability and the method by which the liability is determined and repaid. It is a matter the RRC should review and determine if a change to the current method of calculating and paying unfunded prior service liabilities is warranted and feasible.

If changes are proposed a careful review of the legal implications should also be completed to assure that these changes would withstand a legal challenge.

GRS

MEMORANDUM

To: Wisconsin Retirement System

From: Norman L. Jones and Brian B. Murphy

Date: March 16, 1994

Subject: Allocation of UAAL Financing Among Employers

Additions to the frozen unfunded accrued liability base are created when new groups join WRS or when all or a portion of new liabilities associated with a benefit change are distributed among employer groups. The original intent was to experience rate original past service, but pool experience after joining WRS. This arrangement works reasonably well if the UAAL is being amortized in level dollar amounts over a fixed period during which no significant benefit changes are being made. However, as times goes on, an increasing number of problems are surfacing:

- With level percent of payroll financing, an employer's UAAL balance may grow out of control if the employer's total covered payroll does not grow at the assumed rate (currently 5.6%). There is no provision for adjusting individual employer UAAL contribution rates to prevent this from happening and there is no provision for absorbing these liabilities elsewhere.

- If an employer group has no past service, the UAAL rate is zero. However, subsequent system amendments that create a new UAAL are distributed in proportion to covered payroll. This creates additional obligations for all participating employers even if they still have no employees with past service.

- Similarly, when new UAAL obligations are created by statute, they are distributed without regard to whether the employer elected to grant 0%, 25%, 50%, 75%, or 100% of past service.

- As time passes, the outstanding obligation of an employer is likely to bear less and less relationship to the demographics of the group. This may cause considerable unrest in cases where participation in WRS is no longer a "good deal". One example is an employer that assumes a significant obligation for a single employee who subsequently withdraws and forfeits an employer-financed benefit. The employer may still be paying for such forfeited service decades later.

- As anomalies arise, employers may seek other financing arrangements to deal with perceived weaknesses.

With this as background, we have listed some alternate financing structures:

Pool Total Contribution Rate. In several statewide plans there is a municipal division in which all participating employers contribute at the same rate. In WRS, this would probably have to be phased in by granting temporary credits for significant differences between current employer rates and the pooled rate. For example, if the pooled UAAL rate is 1.3% and the employer is currently paying 0%, the difference could be phased in at the rate of 0.1% a year for 13 years. Under this arrangement, all future employers would be required to grant 100% prior service credit.

Experience Rate All Employer Groups Annually. In several states, each participating employer contributes based on experience of its own group (retiree experience is usually still pooled). It may sound complicated, but after the initial set-up effort it probably would be no more cumbersome than the present arrangement. Most of the present problems could be eliminated and it would accommodate some local options at some point in the future. A variation of this approach would be to combine experience of small groups.

Establish a Limited Number of Additional Experience Rated Groups. This is a variation of experience rating for all groups. One possibility might be to pool all state agencies in one division and then separate local employers into a high, medium or low rate group based on the level of their present UAAL contribution rate. Within each new rate group, rate adjustments could be phased-in over several years.

Experience Rate Only Future Statutory UAAL Changes. This would address some of the issues while preserving the present overall structure. The distribution of new UAAL amounts would be more equitable.

Make Minor Adjustments to Present Structure. The problem of uncontrolled growth in an employer's UAAL balance could be addressed by adjusting contribution rates or limiting the obligation to a fixed percent of payroll for a fixed number of years.

These alternatives are intended to stimulate discussion. Other approaches may also be feasible.

State of Wisconsin \ JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS AND THE RETIREMENT RESEARCH COMMITTEE

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December 10, 1997

To: **JSCRS Members**

From: **Scott L. Dennison (Director of Retirement Research)**

Re: **1. Attached letter 2. Unfunded liability progress**

Today our office received the attached letter from Paul Sylvester, with its cover note requesting that it be distributed to all JSCRS members. I called Mr. Sylvester, and he told me that the letter's December 15th date is when he plans to send the letter to a number of newspapers, legislators, etc. -- and that he had wanted you to see it before the others.

He believes that the increase in Fond du Lac's share of unfunded liability over the seven-year period illustrated in his attachment is due to underpayment of contributions by the employers. I could not convince him that this was probably due to the unfunded liability being paid off as a fixed percentage of an increasing payroll, rather than by payments of a fixed dollar amount. However, this appears to me to be the case, since the unfunded liabilities shown in his table have increased at an annual rate of about 1.5% (compounded), which is typical of the early years of a percentage-of-payroll payoff schedule.

In terms of inflation-adjusted dollars, the unfunded liability has actually *decreased* during this seven year period. If we estimate the average rate of inflation to be 3% during these seven years, then the unfunded liabilities shown in Mr. Sylvester's letter have actually *shrunk* in value by about 1.5% per year (compounded). This is something that deserves to be explained, but in fact seldom is, so that all the readers of a plan's financial reports see is a growing number of dollars of debt.

I would suggest that an inflation-adjusted estimate of the unfunded liability be added to the valuation report for the WRS, to show its readers when the true amount of this debt is in fact decreasing under the state's funding policy. For example, in the 12/31/96 valuation report this could have been shown on pages I-19 and I-24.

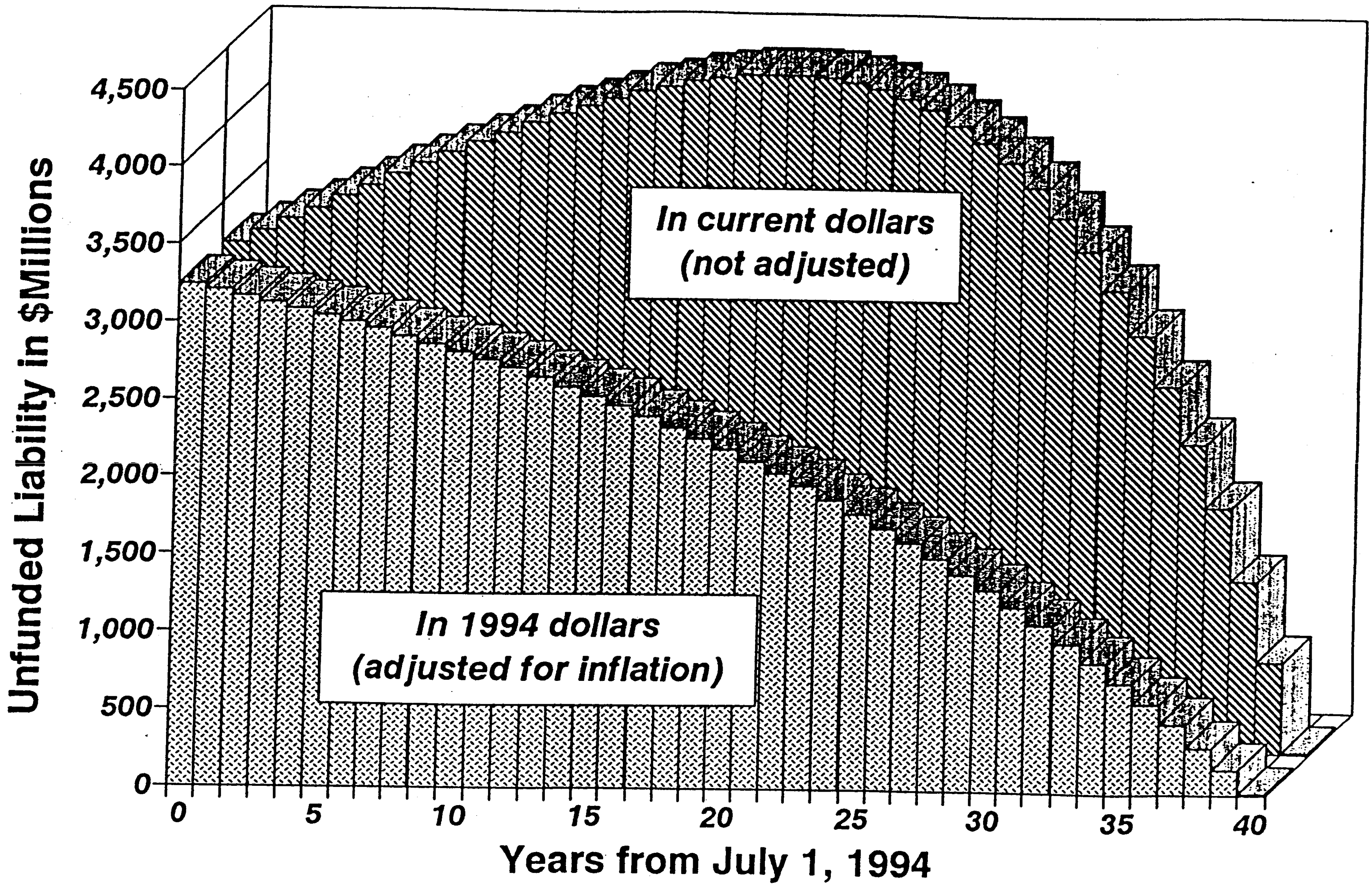
The next page is a graph that I included in the 1994 valuation report for West Virginia's Teachers' Retirement System. It speaks for itself.

SD:db

Attachments

12/10/97

Payoff of the Unfunded Liability



Graph 1B (see Table 1)

Scott L. Dennison, FSA
State Actuary, 11/29/94

Dennison, Scott

Subject: FW: UAAL

Hi, Tim. Yes, employers which had already paid off their share of UAAL would be the losers, because there would be no way to benefit them. However, they have benefited in another way by what was actually done as part of the 1997 valuation process -- as I'll explain below. This year, the experience gains were not used to reduce UAALs, but to reduce the Normal Cost portion of employers' contributions -- which benefited all employers alike in proportion to their WRS-covered payrolls.

In their 1994-1996 experience study report, the Gabriel, Roeder, Smith ("GRS") actuaries predicted that the favorable results of that experience study would reduce UAAL by about these amounts:

General: New UAAL = $1,597,563,000. Old UAAL = $1,994,332,000. Estimated reduction = $396,769,000 -- a reduction of 19.89% in the old UAAL.

Executive & Elected: New UAAL = $8,017,000 and old UAAL = $14,381,000 ... the difference represents a 44.25% reduction in UAAL for this employee category.

Protectives with SS: Old = $95,427,000 and new = $55,146,000. Reduced by 42.21%.

Protectives without SS: Old = $36,291,000 and new = $32,581,000. Reduced by 9.48%.

These estimates (and note that they are ESTIMATES published months before the final valuation was done and the exact UAAL reductions would have been determined) are from page 8 of GRS' experience study report, delivered to the DETF board in mid-December, 1997.

Apparently, employers who have been getting the short end of the stick whenever UAALs have been lowered (because they had paid theirs off early) have been complaining about this to Employee Trust Funds. On Feb. 2, 1998 the ETF sent a letter to the Attorney General seeking his opinion on whether it is lawful to use favorable experience study results to reduce unfunded liabilities in this manner. The first I knew of this is when Jane Hamblen from the Dept. of Justice (who worked on this for the A.G.) called me this summer to get my opinion on it. Based on state code she had me read, I am convinced that using actuarial experience gains to reduce UAALs is in fact unlawful -- which is a bummer, since that is what our actuaries and ETF have done after each of the previous few three-year experience studies have revealed actuarial gains. If the Supreme Court would address this issue and rule that the ETF had to go back and refigure these earlier years, one couldn't imagine a greater mess of eggs to unscramble. I would hope that instead legislation would be passed to clarify what ought to be done with actuarial gains in the future, and saying that what had been done in past years is OK and didn't need to be changed.

Learning of this situation early in the year, our actuaries at GRS decided to use the actuarial gains to favorably adjust the "Experience Amortization Reserve" ("EAR"), which in turn reduced the Normal Cost rates below what they would have been if the actuarial gains had been applied to reducing UAALs instead of Normal Costs. Since every employer pays Normal Cost each year as part of its contribution to WRS, this benefited ALL employers -- even those with no UAAL component in their contribution. Moreover, it is clear to me from reading the code that Jane Hamblen referred me to that this alternative treatment using the EAR is a lawful procedure.

I noted last week in my inbox what appeared to be the AG's response to DETF's February inquiry. However, I am totally swamped trying to get the study of the UW Optional Retirement Plan wrapped up for the Board of Regents, so haven't read it yet. I suggest you contact Dave Mills, Dave Stella, or Eric Stanchfield over at ETF to see what the A.G. has determined about this. They would know.

Regarding your question about breaking it down by counties and municipalities ... Actuary Norm Jones explained to me that they used to divide up the amount of experience gain in proportion to the various employers' payrolls and then use each employer's share to reduce its share of UAAL. There are some theoretical problems with dividing it this way, but Norm explained that it was the most practical approach. Toward the end of DETF's "1997 Comprehensive Annual Financial Report" (see pages 112-120) is a complete list of all employers with the Covered Payroll, Required Contributions, and Unfunded Liability of each. Using this list and what Norm told me, yes, one could compile a list of the potential amount of UAAL reductions if the actuarial gain from the experience study were to be applied that way. However, I believe that employers have already been told their 1999 contribution rates (including reduced Normal Cost contributions) and it is too late to revise them.

12/9/98

The particular basis for figuring Unfunded Actuarial Accrued Liabilities for WRS is fraught with serious problems, and we want to have the Retirement Research Committee study the situation and propose legislation at some point to change us over to a different system of reckoning UAALs. It is not hard to think of a better way to define UAALs. What will be very tricky is to figure out the best way to transition us from the present system to a new way of doing it -- in such a way as to cause the least inequities among the employers.

What a mess. Nothing is ever simple with pension systems.

Take care.

Scott

-----Original Message-----
From: Haering, Tim
Sent: Wednesday, December 09, 1998 12:05 PM
To: Dennison, Scott
Subject: UAAL

Scott, good afternon. I want to prepare a qick analysis of the possigble reduction of UAAL due to the new actuarial assumptions. Assuming we do redice the uAAL, how much would it be reduced by nad who would be the benefactors? can it be broken down by counties, municiplties, townships, etc. I assuem losersa would be employers with no UAAL?

Thanks for you help.

tim