

A Summary of Proposals to Provide an Optional Retirement Plan (ORP) for University of Wisconsin Faculty and Academic Staff

(By the Retirement Research Director for the Joint Survey Committee on Retirement Systems, May 10, 1999)

General Background: The 1998 Budget Adjustment Bill required the Joint Survey Committee on Retirement Systems (the "JSCRS") to obtain an actuarial study of providing some kind of optional retirement plan ("ORP") to future University of Wisconsin System faculty and academic staff. That study was done by the actuary for the Wisconsin Retirement System (the "WRS") and sent to the UWS Board of Regents on December 28, 1998. The budget bill requires the regents to recommend legislation for some type of optional retirement plan for UWS faculty and academic staff members who will be hired in the future. They must do so by June 1, 1999.

The study by the WRS actuaries (Gabriel, Roeder, Smith & Co., or "GRS") was flawed due to lack of data and the short time allowed by the budget bill for doing the study. The JSCRS Retirement Research Director therefore extended the GRS investigation, presenting a preliminary "*Supplemental Actuarial Study*" to a committee that advises the Board of Regents on February 16, 1999.

Subsequently, a final "*Supplemental Actuarial Study*" was completed and presented to the JSCRS at their March 22, 1999 public hearing on ORP proposals. This final study replaced only the first part of the preliminary study's report, leaving the final sections of the earlier report unchanged.

Need for This Summary: To date, there have been more than twenty requests by legislators and others for a readable, condensed summary of the GRS study and the "*Supplemental Actuarial Study*".

Contents of This Summary: This summary has an "**Executive Summary**" of the optional retirement plan issue and an "**FAQ**" (Frequently Asked Questions) section. Finally, a "**Synopsis**" is provided of the main part of the "*Supplemental Actuarial Study*". Readers of this summary may prefer to read only the executive summary and the FAQ, skimming the synopsis for its highlights.

Executive Summary

The Wisconsin Retirement System is really two retirement plans: (1) A "formula plan" that determines a pension amount by formula, and (2) a "money purchase plan" that determines another amount equal to however much pension the accumulation of two times a member's contributions to the WRS will buy. The WRS pension a member actually receives is the larger of these two plans' pension amounts.

1984 legislation reduced the interest rate applied to money purchase accounts of employees hired after 1981 from the full return earned by WRS assets to a flat 5% rate. It is likely that this "5% earnings cap" will significantly reduce the pensions paid to half or more of the "general" WRS employees hired after 1981 who continue in Wisconsin public service until they retire. Furthermore, the "5% earnings cap" has a devastating effect on pensions paid by WRS to post-1981 members who leave before they retire.

Thus, the WRS money purchase plan is not very "portable" for employees being hired today -- meaning basically that the WRS does not let them take an equitable amount of pension with them when they leave their jobs. This is the root of the problem to be addressed in the proposed ORP legislation.

This problem affects virtually anyone working for a government in Wisconsin who leaves in mid-career. In particular, this is often the situation for university educators, many of whom work at several colleges or universities during their careers. This is why the lack of a very "portable" retirement plan to offer potential recruits to the UW System's faculty and academic staff is making it more difficult to recruit talented staff than would be the case if Wisconsin would offer them a truly portable retirement plan.

Most other states have addressed this problem by establishing money purchase plans for university staff. Some offer these plans on an optional basis, with the state's "formula" pension plan being an alternative. In such cases, the money purchase plan is often called an "optional retirement plan", or an "ORP".

The great majority of other states do not have a dual (or "hybrid") retirement system like Wisconsin's, that already includes a money purchase plan that could be made "fully portable". So for most states the addition of a money purchase plan separate from the state's existing "formula based" retirement system is a natural way to solve the pension portability problem existing at their state universities. Some states manage such plans themselves, while others use plans offered by TIAA-CREF, Aetna, or other insurers.

It has been proposed that Wisconsin relieve the University of Wisconsin System's recruiting problem by offering through an insurance company an optional money purchase plan to UWS faculty and academic staff members hired in the future. A contribution rate of 10% of salary has been suggested for this ORP.

As a counter-proposal, some would prefer to see interest crediting rules under the existing WRS money purchase plan restored to something like the rules for employees hired before 1982, arguing that doing so would not only help the university but would benefit many nonuniversity employees as well.

Establishing an insurance company ORP would have these consequences.

1. UW System officials point out that an ORP is something that many academic personnel are already familiar and comfortable with, and that having one would significantly help their recruiting efforts.
2. Members of the ORP would not have the guaranteed level of benefits that the WRS "formula plan" provides for WRS members. They would bear the entire investment risk of their retirement plan.
3. Benefits from an ORP with a 10%-of-salary contribution would cost about 0.42% - 0.64% of payroll more than WRS benefits would have cost for those expected to elect the ORP. After 30 to 40 years, this would mean an additional cost of \$2.2 to \$4.1 million (in year 2000 dollars). However, an ORP with only a 9.4% of salary contribution level would create no such additional cost.
4. In this time, an ORP with contributions around 10% of pay would cause WRS contribution rates for employers to climb by an estimated \$9.6 to \$13 million (in year 2000 dollars). However, read on.
5. Special payments could be made to the WRS to counteract this cost increase. To do this, additional administration would have to be set up to enable the WRS actuary to compute the cost impact of the ORP on the WRS. (The cost for this administration has not yet been estimated.)
6. Insurance companies offering an ORP always provide basic administration for their plan. The UW System would prefer, however, that the state's Department of Employee Trust Funds ("ETF") assume administrative oversight for any ORP set up for the university. How administration could be divided between insurance companies and ETF is not clear at this point, or what cost ETF might incur.

Restoring the WRS Money Purchase Plan would have these consequences.

1. This would probably facilitate UW System recruiting about as much as an ORP would. A restored WRS money purchase plan would be very similar to an ORP with 10%-of-salary contributions.
2. Affected employees would still have the benefit guarantees that the WRS "formula plan" provides. They would not bear all the investment risk of their retirement system (which consists of both plans).
3. If an improved WRS money purchase plan were given outright only to future UW System employees, this would after 30 to 40 years cost from 0.13% to 0.21% of payroll, about \$940,000 to \$1.5 million annually (in year 2000 dollars). This is the range of costs for five different formulas that have been proposed for relating the interest credited under WRS' money purchase plan to the full rate of return WRS earns on its assets. ("Alternatives 3a - 3e", explained on page 8 of this summary.) The exact cost would depend on which of Alternatives 3a - 3e were used to "uncap" the money purchase plan.

If offered optionally only to future UWS employees, with employees who elect an improved version of WRS' money purchase plan splitting the cost evenly with the UWS, then each would contribute 0.07% to 0.12% of salary to pay for one of the money purchase "alternatives". Here again, the exact cost would depend on which of Alternatives 3a - 3e were used. Perhaps more than one "alternative" could be offered as an option to employees, with an appropriate price for choosing each. This might help recruiting even more than merely uncapping the plan, since people like being given choices.

An "uncapped" WRS, if given outright to all WRS members, would in every year cost from 0.27% to 0.39% of WRS payroll, or \$22 to \$33 million (in year 2000 dollars). Again, this is the range of costs for Alternatives 3a - 3e, with the exact cost depending on which one alternative would be chosen to uncap the money purchase plan. These costs would be fully payable from the very first year.

An "uncapped" WRS money purchase plan could also be offered optionally to all WRS members. In this case, if employees who elect the improved benefits would have to bear the cost evenly with their employers, then each would pay 0.16% to 0.24% of salary. The exact cost would depend on which "alternative" interest basis was used to uncap the money purchase plan, and also on which group an employee was in (see Point 4. for details). As in the "UW-only" case, it is possible that more than one "alternative" could be offered for employees to choose from.

4. There are different costs for "uncapping" the money purchase plan for each employee group in the WRS, as well as for each "alternative" method that might be used to do it. If this improvement to the WRS were given outright, and also depending on which of Alternatives 3a - 3e were used, then this would cost 0.29% - 0.44% of payroll for "General" employees, 0.19% - 0.34% for "Executive and Elected" employees, 0.07% - 0.14% for most "Protective" employees, and about 0.01% - 0.04% for firefighters. If offered optionally with costs split evenly, then employees and employers would each incur a cost equal to 58% (not 50%!) of the cost of giving the benefit outright. (This is more than 50% because when employees share in costs, then their contributions increase, which increases both their money purchase pensions and their death benefits a little bit more.)
5. No additional administration would be needed, other than a one-time enrollment in case the better money purchase plan would be offered optionally, rather than given outright. If multiple options were offered, even this would probably not add significantly to WRS administration.

Frequently Asked Questions

Question 1: What is the main problem the state is trying to solve?

Answer: To make it easier for the University of Wisconsin to hire good faculty and academic staff by providing a retirement plan that has “portable” benefits. This means a plan that will pay new employees an equitable amount of pension if they eventually leave the UW for a position elsewhere and have to “take their pension with them”. The Wisconsin Retirement System’s money purchase plan was changed in 1984 so that it has become substandard in this regard. This is a very important issue with professors, since research and teaching opportunities often take them to several universities during their career.

Question 2: What is meant by “portable” pension benefits?

Answer: Literally, “portable” means “you can carry it with you”. The real issue, however, is to earn pension benefits from each job held during the early years of one’s career that will be reasonably related to the number of years worked at that early job. Most “formula” (or “defined benefit”) pension plans pay relatively low pensions to employees who leave in mid-career and then retire years later. Money purchase or similar retirement plans do much better for younger employees who leave for other jobs.

Question 3: What is a “money purchase plan”?

Answer: A money purchase plan is a retirement plan that maintains an account for each employee. This account receives contributions each year from the employer and/or the employee, invests them, and credits appropriate investment earnings to the account until the employee finally retires. At retirement, the money accumulated in the employee’s money purchase account is used to purchase a pension. The amount finally accumulated in the account and the price being charged at that time for annuities will determine how much monthly pension the retiree will receive.

Question 4: Does the money purchase plan in the Wisconsin Retirement System provide employees with portable benefits?

Answer: They are more “portable” (in the sense of Question 2 above) than the benefits that the WRS “formula plan” would pay them, but they are less portable than most money purchase plans would pay. This is because the WRS money purchase plan was weakened by 1984 legislation imposing a 5% rate of return (called the “5% cap”) to be credited on money purchase accounts of employees hired after 1981.

Question 5: How can this lack of a portable retirement plan for the University of Wisconsin be fixed?

Answer: There are basically three ways this problem could be solved. The first two involve improving the Wisconsin Retirement System, and the third leaves the WRS unchanged. The three ways are:

1. Change the formula used by the WRS “formula plan” to another one that gives better portability.
2. Increase the rate of interest credited under WRS’ money purchase plan (remove the “5% cap”).
3. Create a new money purchase plan (or other “defined contribution” plan) outside of the WRS.

Question 6: What are the pros and cons of changing the WRS “formula”?

Answer: To create pension portability by changing the WRS benefit formula would require using an entirely different kind of formula (for example, an “indexed career average” formula). This would be hard to do in a way that was fair to all members. Since the other two methods of increasing pension portability are so simple, there really isn’t much reason to consider this first course of action.

Question 7: What are the pros and cons of increasing the WRS money purchase plan’s interest rate?

Answer: This could either be done (1) only for future UW employees or (2) for all WRS members. To do the former would cost only \$42,000-\$70,000 in the first year, with this cost growing each year until after about 35 years it would level out at about \$940,000 to \$1.5 million annually (in year 2000 dollars). Administrative costs would be negligible. This would ease the UW’s hiring problem, but it would also upset the retirement system’s 240,000 employees who would be excluded. Although this appears to be the least expensive of all solutions considered in this summary, it would be difficult because of politics to do this for the UW people and not end up doing it for everyone else in the WRS as well.

To improve the money purchase plan for all members of the WRS would be popular with the state’s public employees. However, it would cost about \$22 to \$33 million annually in additional benefit costs, which would be payable from the first year. No new administration would be required, however.

Advantages of using this method to fix the university’s problem are that it is a simple solution that uses existing administration, and that it would fix a general “lack of portability” problem that in fact goes far beyond just the University of Wisconsin and its hiring needs.

Question 8: What are the pros and cons of using a money purchase plan like the proposed “optional retirement plan” that would not be a part of the WRS?

Answer: Many professors and other university employees have been members of insurance company retirement plans before, or they still are, so an “optional retirement plan” like the one proposed for the UW System is familiar to them. This would help the UW System recruit these people.

With a 10%-of-pay contribution, costs would start out low, increasing over 30 to 40 years to \$2.2 to \$4.1 million as the cost of additional benefits (in year 2000 dollars). To this add a cost for administration that is not yet known, plus an estimated \$10 to \$13 million annually if it is desired to prevent any impact on the WRS. *However, the UW would otherwise pay this \$10 - \$13 million as part of its contribution to the WRS. So this amount would not be a new “cost”, but merely a new budget item for the university.*

Thus, the State’s added cost when this ORP matured in 30 to 40 years would be about \$2 to \$4 million annually plus any cost of administration it would incur. This is more than the \$940,000 to \$1.5 million cost of restoring the WRS money purchase plan for only future UW employees, but it is far less than the \$22 to \$33 million cost of restoring the WRS money purchase plan for all members.

Finally, the Wisconsin Retirement System is a well-run and well-financed state retirement system that owes much of its success to its size. It has achieved this over decades by the process of consolidating many smaller public retirement plans into the present day WRS. Some critics of the ORP proposal fear that creating a new state retirement plan would be like “the camel’s nose under the tent”, leading to the unraveling of this process of consolidation, which could ultimately ruin the WRS.

Synopsis of the “Supplemental Actuarial Report” (pp. 1-41 only)

Report Section: “Overview” (pages 1-4)

Pages 1-2: Explains that the 1984 change to the WRS money purchase plan that reduced its interest rate to only 5% for those hired after 1981 has made the WRS money purchase plan much less effective than it used to be. This has created demand for an effective money purchase plan for UW System employees (and for other members of WRS as well). *The graph on page 2 explains why allowing UW employees to leave the WRS for another retirement plan would increase employers’ contribution rates for the WRS.*

Page 2: Alternatives being suggested to an insurance company managed money purchase plan for the UW System involve improving the WRS in two areas where it is weak: (1) liberalizing death benefits for nonretired members to bring them up to the federal standard for private plans, and (2) eliminating or at least easing the current restriction on money purchase earnings (the so-called “5% earnings cap”).

Page 3: The graph shows the cyclical nature of the UW’s hiring needs, and indicates that, while hiring demand is always pressing, the highest level of demand will probably occur around the year 2008.

Page 4: An improved WRS death benefit would cost only about 0.02% of payroll if given to future UW faculty and academic staff, and would cost 0.03% of payroll or less if given to all WRS members.

Notable Points: 1. Any improvements to the WRS (such as better death benefits or lifting the 5% money purchase “cap”) could either be made optional, requiring employees wanting the benefits to help pay for them, or else could be given outright to all employees. 2. Any optional retirement plan not part of the WRS would create some administrative cost for the state. 3. Some special administration would be required if the “depooling cost” to the WRS (a concept explained with page 2’s graph and on page 3) would have to be neutralized. 4. Neutralizing that cost might be advisable to avoid a major lawsuit.

Report Section: “The Problem” (pages 5-11)

Page 5: Observes that the “hybrid” Wisconsin Retirement System, by having both a money purchase plan and a “formula plan”, should be able to meet the different kinds of needs of public employees who work either the first or the last part of their careers for Wisconsin employers. But the WRS fails to meet this expectation, because *“The problem is that ... the money purchase plan was hamstrung by 1984 legislation as a way to help pay for improving the other plan’s formula.”* (In 1984, Wisconsin Act 141 increased the formula plan’s benefit and imposed the 5% money purchase “cap” to help pay for it.)

Pages 5-6: Shows how to calculate a money purchase pension. *Reveals that money purchase pensions are cheaper to purchase from the WRS than from CREF, a leading insurance company that sells them.*

Pages 7-8: These pages explain why the pension paid to a “short-term” employee (meaning one who works under the WRS only during the early or middle part of his/her career) will usually be quite a bit more under the WRS (or any similar) money purchase plan than under the WRS “formula plan”.

The graph on page 8 shows that the WRS money purchase plan with its 5% earnings cap pays less than half as much pension to typical employees who leave before retirement than a standard money purchase plan would. This means that either an insurance company "ORP" or else the WRS plan (with the 5% "cap" lifted) would pay these employees more than twice as much pension as WRS pays them now.

The graph shows that an uncapped WRS money purchase plan might pay short-term employees a higher pension than an otherwise similar insurance company plan, due to WRS' lower pricing of annuities.

Page 9: Today WRS' money purchase plan is of no value whatever to long-term employees hired after 1981. Either an ORP or a restored WRS money purchase plan would probably give half of Wisconsin's long-term public employees (those who stay until retirement) a boost in their pensions.

Page 10: This illustrates how much pension is being lost to the state's "short-term" public employees by the 5% interest cap on the WRS money purchase plan. This situation could be corrected for those hired in the future either by establishing an ORP or by uncapping the WRS plan. Either action would be likely to benefit nearly all "short-term" employees to whom it applied.

Page 11: Examines "long-term" employees, who end their working years in public service. About 75% of future employees who will finish their working days in the WRS would probably have gotten larger pensions from an ORP, or if the WRS money purchase plan had not had its 5% interest restriction.

Report Section: "Proposed Solutions" (pages 12-18)

Page 12: The "in-house solution" to the portability problem for the UW System would be to "uncap" the WRS money purchase plan. Doing this only for future UW System employees would, of course, cause other employees to demand equal treatment. Another possible solution would be to set up an insurance company money purchase plan (an "ORP") outside of the WRS. As now being considered, this would only benefit future UWS staff. Probably this too would make other employees envious.

Simplicity and parity with the WRS money purchase plan's 10% contribution rate are given as reasons for recommending 10% of salary as an appropriate contribution rate for any ORP to be established.

Page 13: Six specific "alternatives" to an insurance company ORP are suggested. These are simple formulas for figuring each year's interest rate under the WRS money purchase plan. Any of these would restore some or all of that plan's effectiveness that has been lost because of the 5% "interest cap".

"**Alternative 2a**" is simply a return to pre-1982 crediting of all investment return, whether positive or negative. The other "alternatives" seen in the report each guarantee some minimum rate of return, called a "floor", and would compensate the WRS employers for the cost of the floor's guarantee by holding a bit back from the trust fund's full rate of investment return in good investment years. The basic costs shown for these alternatives in the table on page 13 of the report are explained better on page 21.

Page 14: The two graphs on page 14 show how the WRS money purchase plan credits interest to the accounts of those hired before 1982 and those hired more recently – before and after the "5% cap".

Pages 15-17: These pages have graphs that illustrate the five main “alternatives” suggested in the report for improving the interest rates used under the WRS money purchase plan.

- “**Alternative 2c**” would keep the current 5% rate as a “floor”, but would credit up to 8% interest in years when the WRS has an 8% or higher rate of return. This alternative would probably credit the lowest interest rate over time of all the alternatives, and so it is the least “portable” of them all.
- “**Alternative 3a**” would credit 1% less than the WRS’ full rate of return, but would not reduce money purchase accounts in any year when the fund earned less than a 1% return.
- “**Alternative 3b**” would credit 2% less than the fund’s full rate of return, but would never credit less than 1% interest in any year.
- “**Alternative 3c**” would credit 2% less than the fund’s full rate of return, but would never credit less than 2% interest in any year.
- “**Alternative 3d**” would credit 2% less than the fund’s full rate of return, but would never credit less than 3% interest in any year.
- “**Alternative 3e**” is a related formula that uses the current 5% cap as its floor. It was omitted from the report for the sake of brevity, but deserves mention here. “Alternative 3e” would credit money purchase accounts with 3.5% less than the full WRS rate of return, but would never credit less than 5% in any year. The expected rate of return under “3e” is 7.998% -- almost exactly the 8% expected to be the long-term rate of return for WRS. This means that we expect “3e” to provide pensions on the average very close to those produced by the pre-1982 version of WRS (Alternative 2a), but with less variation than “2a” from expected averages due to its greater insulation from investment risk.

Page 17: Compares the “alternatives”. It is stressed here that raising the interest rate’s “floor” insulates employees’ somewhat from investment risk. This statement from page 17 applies to Alternative 3e (not in the report) as well as it does to Alternative 3d:

Alternative 3d is a balanced blend of a fair amount of risk and reward with a good “safety net” – its expected performance and cost are very close to that of [the WRS money purchase plan with full crediting of investment return].

Page 18 – The Portability Graph: The bar graph here illustrates “portability”, revealing how much pension would probably be provided for employees who leave public employment after 10 years of service. It shows this for an insurance company ORP and for five of the “alternatives”. The largest projected pensions shown in this graph are not produced by the ORP, but by Alternatives 2a and 3d. Alternative 3e, if it had been shown, would have closely matched Alternative 2a’s pension levels.

The reason pensions from some of the WRS alternatives exceed the ORP pensions is that annuities from insurance companies cost more than that they do from the WRS. Insurance companies generally have to load their pricing rates for profit margin and certain contingencies. Page 6 shows that the same number of pension dollars per month cost from 3% to 7% more if bought from an insurance company than from the WRS, depending on the age of the person retiring.

Report Section: “Costs” (pages 19-24)

Page 19: This is a general discussion of costs under an ORP or the WRS “alternatives”. The different kinds of “cost” shown in the report are explained. (This is also discussed in FAQ “Question 8”.)

Page 20: Here are two estimates of the amount by which WRS contributions would increase if an ORP were adopted for future UW System employees. Over a 30- to 40-year period an ORP would cause the contribution rates for WRS employers to increase by about 0.14% to 0.20% of their “general” payrolls. For all employers combined this is about a \$9.6 to \$13 million increase (in year 2000 dollars). *This is not a true cost, as explained in FAQ “Question 8”, and it is possible to neutralize it by having the UW System make a special contribution to the WRS equal to the amount of this “cost”.*

Note: This is one part of the “Supplemental Actuarial Study” where some useful information from the preliminary report did not carry over to the final (March 22nd) report. Pages 12 through 14 of the earlier report show some detailed information that clarifies page 20 of the final report.

Page 21: We can estimate the cost of any of the “alternatives” for improving the WRS money purchase plan by averaging the two levels of cost shown in the table on page 21 for each employee group. For example, if employees hired after 1981 were given the full interest crediting that pre-1982 employees have (“Alternative 2a”), then this would cost about ...

- 0.19% of the payroll of future UW System employees if this were given only to those employees (the average of 0.135% and 0.241%).
- 0.40% of the payroll of all “General” employees, if given to them (this is the average of 0.490% and 0.309%).
- 0.30% of the payroll of “Executive and Elected” employees (the average of 0.400% and 0.204%).
- 0.12% of the payroll of all “Protective” employees who are covered by Social Security, if given to them (the average of 0.170% and 0.079%).
- 0.03% of the payroll of all “Protective” employees not covered by Social Security, if given to them (the average of 0.060% and 0.002%). This refers to Wisconsin’s firefighters.

Page 22: This page translates costs into dollars. For example, the expected cost to completely restore full interest crediting to the WRS money purchase plan (for future years only, not retroactively from 1982 through the present) is the average of these numbers from the lower table’s “2a” column:

$$\text{“Current Cost”} = \$35,818,000 + \$292,000 + \$934,000 + \$74,000 = \underline{\$37,118,000}$$

$$\text{“Ultimate Cost”} = \$22,611,000 + \$149,000 + \$434,000 + \$3,000 = \underline{\$23,197,000}$$

The average of these two estimates is the expected cost of restoring the WRS money purchase plan to the equivalent of its pre-1984 rules, an estimated \$30,000,000 annually, in year 2000 dollars.

Pages 23 and 24: These pages show how costs for benefits given only to future UWS employees will grow each year until all current UWS staff members are replaced 30 to 40 years from now. The table on page 24 was used to calculate the table of ORP “costs” printed on page 20.

If the first six months of health insurance premium were to be picked up for new UW System employees, then the table on page 24 could be used to develop cost estimates for that as well.

Report Section: “Benefit Projections” (pages 25-39)

Page 25: This is a discussion of how benefits are compared under the ORP and the WRS “alternatives”.

Pages 26-27: These pages illustrate the amount of pension estimated to be payable from the current version of WRS or from an ORP with a moderate or a high rate of return to future employees hired at ages 25 through 55 who either ...

1. Work until either age 55 or 65 and then retire, or
2. Work for some multiple of 5 years and then quit, eventually retiring at age 55 or 65.

The table on page 27 shows all possible 5-year combinations of these scenarios. Page 26 pictures this information in two graphs, but omits some older hire ages and only shows the pensions for “short-term” employees who work exactly 10 years before leaving. *The graphs on page 26 show how much pensions are being reduced for employees by the “5% interest cap”. This could be fixed for future employees by giving them an ORP or else by restoring the WRS money purchase plan.*

Pages 28-39: These pages show the same information as pages 26 and 27 for the “alternatives”.

Report Section: “Electing the Standard ORP” (pages 40-41)

Pages 40 and 41: These pages discuss these main topics:

1. Reasons why employees might prefer a money purchase plan to a “formula plan”, or conversely.
2. How it was decided for study purposes what percentages of future employees would be likely to select an ORP over the WRS if given that choice. Note: In the preliminary “*Supplemental Actuarial Study*” it was estimated that 71% or more of future UW employees would probably join the ORP.
3. The phenomenon of “antiselection” (also called “adverse selection”) is discussed on page 41. This is the tendency for employees who are given a choice between benefits to choose the benefit or plan that is more valuable to them, which is always the more expensive for the plan sponsor. Since the employee bases this decision partly on information known only to him or her, and not to the plan’s sponsor or its actuary, unexpected expenses can develop when employees are given choices. This must be predicted as well as possible, but data to do so accurately is often unavailable. Lack of such data was in fact a problem with this study’s estimate of an ORP’s future cost impact on the WRS.



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DATE: <u>5-10-99</u>	This fax transmission consists of <u>6</u> pages, including this cover sheet. If there are questions, or if the transmission is not readable, please call: Kathy Dickerson at (608) 263-5512
TO: <u>Senator Robert Wisch</u>	
FROM: <u>Margaret Lewis</u>	
SUBJECT: <u>ORS</u>	
Additional Information/Comments: <u>Attached is a press release and drafting instructions for a state ORS adopted by the Board of Regents on Friday, May 7. Let me know if you have any concerns?</u>	

Draft Reporting Instructions for an
Optional Retirement System

BUSINESS AND FINANCE COMMITTEE

Resolution

That the Board of Regents hereby expresses its continued support for its faculty and staff, reaffirming its budget requests for (1) competitive salary plans; (2) the provision of health insurance from the first day of employment; and (3) the elimination of the 5% cap on the amount of interest that may be earned on WRS retirement accounts; and further

That the attached Drafting Instructions for an Optional Retirement System be approved, and the UW System President be directed to forward them to the legislature in compliance with the requirement of the 1998 Budget Bill.

5/7/99

I.2.a

**DRAFTING INSTRUCTIONS FOR LEGISLATION
CREATING AN OPTIONAL RETIREMENT SYSTEM**

Consistent with the Principles for an Optional Retirement System approved by the Board of Regents at its April 9, 1999 meeting, the following are the elements that are necessary for inclusion in legislation creating an Optional Retirement System (ORS):

1. The Employe Trust Funds Board (ETF) must serve as the Plan Sponsor.
2. As Plan Sponsor, ETF must be directed to establish the ORS as a qualified, defined contribution plan under s. 401(a) of the Internal Revenue Code (IRC), and not under other IRC provisions.
3. As Plan Sponsor, ETF must be directed to establish and maintain the ORS as a separate trust fund, with ETF members as the trustees, solely for the benefit of ORS participants and their beneficiaries and to ensure that contributions to the ORS cannot be refunded to the employer or otherwise diverted.
4. As Plan Sponsor, ETF must have responsibility for the oversight and control of the ORS.
5. As Plan Sponsor, ETF, through the Department of Employe Trust Funds (DETF), must be granted authority for the administration and management of the ORS, including authority for:
 - a. Plan design and amendment;
 - b. Promulgating administrative rules necessary for the implementation and administration of ORS;
 - c. Establishing, consistent with Instruction 8 below, eligibility requirements for participation in the ORS;
 - d. Creating grievance and appeals processes to resolve disputes concerning matters related to the ORS;
 - e. Developing criteria for the recruitment, selection and periodic evaluation of administrative services providers, consultants, vendors and investment products;
 - f. Selecting and contracting for appropriate investment products for the ORS, in accordance with established criteria, and ensuring that ORS participants are

provided with a choice of more than one vendor and an array of insurance and mutual fund products sufficient to permit diversification across asset classes;

- g. Enforcing contracts with entities listed in paragraph (f);
- h. Ensuring compliance with applicable state and federal tax laws;
- i. Providing continuing investment education and counseling for employees eligible to elect the ORS, and for ORS participants; and
- j. Establishing, on recommendation of the ORS Plan actuary, ORS employer and employee contribution rates for ORS employees in the categories described in ss. 40.04(55) and 40.23(2m)(e)2 and 3, Wis. Stats., to provide ORS participants a retirement contribution equal to the actuarial value of the WRS contribution made for UW System WRS participants in the same employee categories.

6. ORS participants must be guaranteed the right to participate in current and future benefit programs, other than the WRS, that are available to participants in the WRS and administered by DETF or authorized by its governing boards. (Such benefit programs currently include life, health and income continuation insurance, and employee reimbursement accounts.)

7. ETF must be required to provide long-term disability insurance for ORS participants, funded from the ORS retirement contributions made by or on behalf of the participants.

8. Employees must be enrolled in the WRS as required under s. 40.22, Wis. Stats., unless they elect to participate in the ORS within the time period and in the manner established by ETF. The election to participate in the ORS is available only to UW System unclassified employees and only at the time they first become eligible for the WRS.

9. An employee's election of the ORS, or election of or default to the WRS, must be irrevocable.

10. An employee must be solely responsible for the consequences of his or her choice of retirement plans. The UW System shall not be responsible for the consequences of an employee's choice.

11. ETF must be authorized to charge the State of Wisconsin, on behalf of the UW System, an amount determined by the WRS actuary to be necessary to defray WRS contribution increases resulting from the ORS.

12. A board appointed by the UW System President, consisting of nine representatives from UW System employee groups, must be created to advise ETF on implementation and administration of the ORS.

13. Funds must be appropriated to the UW System, both for the initial costs of the ORS, and for recurring costs. The initial, one-time costs necessary to be appropriated are \$400,000; recurring costs are \$602,400 annually.

14. The legislation must require implementation of the ORS no earlier than the 2001-2002 academic year.

May 7, 1999

Agenda Item I.2.a.

DRAFTING INSTRUCTIONS FOR AN OPTIONAL RETIREMENT SYSTEM

EXECUTIVE SUMMARY

BACKGROUND

The 1998 Budget Bill required the Board of Regents to submit to the legislature, by June 1, 1999, recommended legislation to create an Optional Retirement System (ORS) for UW System unclassified staff members. At its meeting on April 9, 1999, the Board approved Principles for an Optional Retirement System (the Principles), consisting of 12 elements that reflect Board's concern with providing new faculty and academic staff a retirement plan alternative to the Wisconsin Retirement System (WRS). The Principles were designed to provide the basis for the Board's legislative proposal.

The attached Drafting Instructions for an Optional Retirement System reflect and incorporate the Principles approved by the Board. Submission of the Drafting Instructions complies with the Budget Bill's mandate for the submission of recommended legislation.

RECOMMENDED ACTION

Approval of Resolution I.2.a.

Approval of this resolution will allow the UW System President to forward the Drafting Instructions to the Legislative Reference Bureau, for preparation as a bill and subsequent submission to the legislature.

DISCUSSION AND RECOMMENDATIONS

The Instructions provide that the ORS will be in place in the 2001-2002 academic year, thus ensuring that there is adequate time for implementation. And, recognizing the importance of faculty and staff involvement in the program, the Instructions call for the establishment of a committee of UW System employees to advise the Employe Trust Funds Board on ORS matters.

The resolution approving the Instructions also reaffirms the Board's commitment to improving salary and fringe benefits for UW System staff

RELATED REGENT POLICIES

Regent Resolution 7606, December 7, 1997

Regent Resolution 7892, April 9, 1999.



State of Wisconsin Investment Board

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MADISON, WI 53707-7842

121 EAST WILSON ST
MADISON, WI 53702
(608) 266-2381
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May 27, 1999

HAND DELIVERED

Senator Robert Wirch
State Capitol
P.O. Box 7882
Madison, WI 53707-7882

Dear Senator Wirch:

Thank you for meeting with me to discuss management initiatives at the Investment Board. As a follow-up to our conversation and my March 29 letter, I thought you might find the following additional information helpful in understanding our approach to the use of passive management (index funds).

We make the decision to use active or passive management (or some combination of the two) on a market-by-market basis. Economic fundamentals support a role for a passive strategy in markets that are more efficient. In those markets, information is incorporated into prices more quickly, making it more difficult for a portfolio manager to add value through active buying and selling of individual securities. In less efficient markets, information is not available to the investing public as quickly, nor is it as broadly disseminated. This provides an opportunity for a trained and focused portfolio manager to profit from information that is not yet incorporated into the asset price.

As markets have become more efficient, we have increased the role of index funds in our investment strategy. Over the last five years, the share of Wisconsin Retirement Fund assets managed in index funds has risen from 4% to 32%.

Year	Total Retirement Assets (millions)	Passive Investments (millions)	Percent of Assets Passively Managed
1993	\$30,268	\$1,269	4.2%
1998	55,565	17,803	32.0%

In large-cap domestic stocks, one of the more efficient markets, our use of index funds has increased from 12% in 1993 to over 80%. We established an index fund component for mid-cap domestic stocks, and this year we are shifting \$1.0 billion of small-cap assets from active management to an index fund. We also have moved over one-third of our domestic bond holdings to an index fund.

The performance of our actively managed portfolios in less efficient markets has generally resulted in added value to the trust funds. The following table illustrates areas where this has been the case:

Asset Class	Five-Year Annual Average Return (12/31/98)	
	SWIB Portfolio	Market Index
International Equities (internal portfolio)	14.0%	11.9% (MSCI World, x US w/half weight Japan)
Core Public Bonds	9.1%	8.1% (Lehman Public Bonds)
Intermediate Duration Bonds	8.7%	6.7% (Merrill Lynch 5-Year Govt. Bonds)
Private Placements	7.8%	7.7% (Corporate Bond Index + .1% premium)
Cash	5.2%	4.9% (90-day US Treasury Bills)
Real Estate	10.4%	8.9% (Russell NCREIF Index)

You asked about the use of passive management by other public pension funds. A June 30, 1998 survey of 53 public pension funds representing \$1.3 trillion in assets showed that none of these funds relies exclusively on passive management. All employ active management to some degree in publicly traded asset classes such as stocks and bonds. On average, other pension funds use passive investments for 31.4% of their assets, an amount close to SWIB's current position. The mix of active and passive management SWIB uses in each asset class is also similar to the average of other public funds.

Like SWIB, the experience of many other public funds has been that returns from actively managed portfolios have often exceeded index returns. A survey of total fund returns for over 40 public pension funds as of June 30, 1998 showed that their returns exceeded a passive blended benchmark (made up of widely known and accepted indices for each major asset class) for the three-, five- and ten-year time periods.

It is important to recognize that the exceptional performance of many index funds, and the favor they have enjoyed with investors in recent years, could change. For example, recent gains in the S&P 500 index have come from a relative handful of stocks. The advantages of passive management have not been tested in a sustained market downturn. Even in the most efficient markets, we need an active component to our strategy to monitor and anticipate market changes. This gives us the option to move money out of index funds should market conditions warrant.

As a practical matter, there are some markets in which there is no index fund option. This is the case for the private equity markets in which our leveraged buy-out, venture capital and non traditional portfolios invest. In our strategic planning, outside experts confirmed that these markets may outperform many public markets over the next decade. We intend to expand our presence in these areas.

The objective of a budget flexibility initiative would be to give us the ability to make these decisions based on what makes the most sense from a total return perspective. This will enable us to continue to manage assets internally and actively where there is a cost and return advantage to do so.

Thank you once again for the opportunity to present our ideas for the future management of SWIB assets. I would appreciate the opportunity for a follow-up meeting and will contact your office to arrange it.

Sincerely,



Patricia Lipton
Executive Director

ORP OR WRS: THE PROS AND CONS

Edward J. Muzik

The Association of University of Wisconsin Professionals (TAUWP)

ARGUMENTS STATED BY TIAA-CREF IN FAVOR OF AN ORP

Meets the mobility needs of faculty -- hence, helps in recruiting and retention by providing portability.

Enhances institutional vitality by enabling employees to retire or move to another university when it is mutually desirable.

Provides budgetary predictability and cost containment. ORP is not affected by changes in the plan and has no unfunded liabilities.

Is easy and cost-free to administer

Has potential for greater retirement benefit

ARGUMENTS AGAINST AN ORP

WRS is a large system with an excellent record for funding and earnings. Since the WRS is run by the State of Wisconsin there is no question about its continued viability.

WRS is a defined benefit plan (formula determined annuity or money purchase whichever is greater); provides lifetime floor; and has a remarkable dividend process; ORP is a defined contribution plan (money purchase plan) with annuities determined by stock market levels at time of retirement.

The UW System has not requested an ORP. No one has ever refused to come to the UW because it did not provide an optional retirement plan.

Optional plans almost always cause problems because, inevitably, wrong choices are made. Legislators are then asked to help those who made the wrong choice.

University of Wisconsin System would be better served for recruiting purposes if the state paid health insurance premiums for the 1st six months.

WRS would be significantly improved by eliminating the 5% interest earnings cap.

Long term employees fare better under WRS.

Irrevocable choice between an ORP or the WRS must be made in first 60 days of employment.

ORP, as proposed in 1997-99, will increase employer and employee costs.

TIAA-CREF is already an option for discretionary funds of faculty and academic staff under a 403 (b) plan. About 15 different tax sheltered annuities are available.

Employees opting for an ORP will not receive future benefit changes.

Portability can be provided under the WRS. Authority to provide for incoming rollovers exists and limited roll-outs are possible but do not include employer contributions. The law could be changed to provide for portability. If funds are left in the WRS, the employer and employee contributions plus earnings determine the amount of the annuity. Removal of the 5% interest earnings cap would provide a significant retirement benefit for those who leave their money in the WRS.

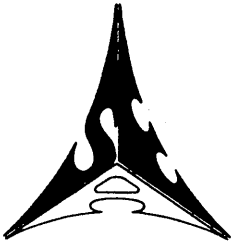
The strength of the WRS is that it includes all state employees, most county and municipal employees, elected officials, judges, firefighters, police officers, and others. Any action that might cause an unraveling or breakup of the WRS is potentially dangerous. Privatization of the WRS should be avoided as the current system works exceptionally well.

A formula factor improvement is an area where the WRS is below the average of other states and passage of legislation could remedy this problem.

A summary of legislative actions needed:

- Pickup of six-months health insurance premium for faculty and academic staff
- Elimination of the 5% interest earnings cap
- Provide portability
- Provide for an automatic joint survivorship benefit at any age
- Allow choice of any beneficiary of retirement benefits
- Restore the variable option
- Improve the formula to at least 1.8

March 22, 1999



STATE ENGINEERING ASSOCIATION

4510 REGENT STREET

MADISON, WISCONSIN 53705

(608) 233-4696

March 19, 1999

TO: Co-chairs Senator Robert Wirch &
Representative Daniel Vrakas of the
Joint Survey Committee on Retirement Systems

The State Engineering Association is registering in opposition to the proposed Optional Retirement Plan (ORP) because it is a poor public policy for the following reasons:

1. The University of Wisconsin and the University Systems are not the only employers within State Government that have problems with recruitment and retention.
2. This ORP will provide a benefit to a small group, which will create another class of employees within the Wisconsin Retirement System (WRS).
3. The ORP will establish another equity issue within the WRS.
4. I do not believe that the State of Wisconsin should reward the employees that are leaving employment more than those who remain within state service.

I trust that your committee will consider the above information in determining the public policy regarding the ORP.

Sincerely,

Tom Miller, President
STATE ENGINEERING ASSOCIATION

WHO IS SEA?

The State Engineering Association is a bargaining unit of approximately 1300 engineers and engineering related professionals employed in the various state agencies as follows:

Department of Transportation
Department of Natural Resources
Department of Commerce
Department of Administration
Public Service Commission
Department of Health and Family Services
University of Wisconsin-Madison
University of Wisconsin-Systems
Department of Agriculture, Trade and Consumer Protection
Department of Workforce Development
State Historical Society
Department of Military Affairs
Department of Corrections

We are responsible for: the design and construction of our highway systems; the health, safety and welfare of our citizens; the quality of our land, air and water environments; building safety and adequate utility services and the implementation of a myriad of engineering projects conducted by Wisconsin's state agencies.

Our work as State employees directly and indirectly influences the quality of life of every Wisconsin resident. We are frequently instrumental in getting businesses satisfactorily located in our state and maintaining the positive aspects of Wisconsin's social and economic environments. Clearly, the State Engineering Association professionals play a vital role in the economic and social well-being of the State of Wisconsin.

SEA represents all persons assigned to the bargaining unit, whether they are members of the Association or not, as provided by state statutes (§. 111.84-111.94). A membership card must be signed to become a member.

SEA ORGANIZATION

The early organizers wanted a group of state employees with common needs, goals and backgrounds to be more than a union and settled on forming an Association.

The Board of Directors for the Association consists of five officers and eleven section presidents. The statewide officers are elected at large and include: President, Vice President-Grievance Officer, Second Vice President-Legislative Liaison, Secretary and Treasurer. Section presidents are elected by each section located statewide and/or representing agencies in Madison.

SEA retains a professional researcher and legislative consultant to assist us in labor issues and communications with state agencies and elected officials. A consultant on benefits is also retained to follow retirement related legislation and to represent us on this important topic. An attorney is on a permanent retainer to take care of our legal needs and requirements.

We are an independent association without affiliation with other state or national labor organizations. The above mentioned professionals help us deal with the demands of our ever changing times. This enables us to act independently yet develop alliances with other groups on specific issues or common goals. Otherwise, we are a volunteer organization.

The Board of Directors has the responsibility for bargaining contracts, arbitrating grievances and promoting the objectives of the Association. SEA members have the responsibility of assuring that the contract is followed by keeping the Association informed of all activities that may pertain to our members.

SEA ACTIVITIES

Success follows from being well informed with facts, by knowing where to obtain the correct information and by delivering the information to the right place at the opportune time to be most effective. The Board of Directors meets monthly or bimonthly to conduct routine business, share information and address special issues. Besides the section presidents being a source of information, the Association prepares and sends a newsletter.

Our newsletter details recent Board meeting activities and issues, legislative developments, results of ongoing grievances, Association activities and upcoming events. Our members are also kept informed by special mailings and other forms of communications.

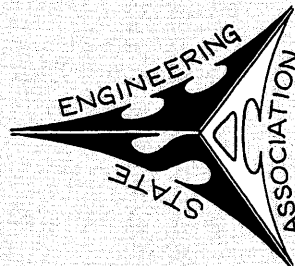
The Association holds an annual meeting open to all members at revolving locations throughout the state to involve all parts of Wisconsin. We are always seeking ways to improve communications with our members and helping them to participate more directly in SEA activities.

SEA CONCERNS

Wages. Past contracts have caused member salaries to fall considerably below wage data averages available from government and private surveys of the employment market. This trend is unfair toward career state employees and will result in hiring and retention problems as experienced in the past. We still lack a technical career ladder system for progressing through the pay range and creating a positive working environment.

Retirement. The Wisconsin Retirement System (WRS) does not treat all employees and annuitants equally. The WRS is a well-defined and well-funded system. SEA will support and work with other organizations to improve benefits (equal annual interest crediting and increased formula multiplier) as long as the integrity of the FUND is maintained.

SEA will continue to be a watchdog of the WRS as seen by our 1988 legal action that challenged the illegal SIPD distribution of \$84.7 million from the Annuity



Reserve. This resulted in the 1997 State Supreme Court ruling that replaced the funds plus interest (\$206.6 million) to make it whole.

Privatization. Over the years, the state has progressed toward more work being done by outside consultants. In some agencies more than 50% of the work once completed in-house is now contracted to for-profit companies. The process of contracting out has been scrutinized by the State Engineering Association. SEA recognizes contracting out has its place in government operations. Yet there is a concern that continued privatizing of government would result in the citizens of Wisconsin not getting the same quality of work and value that state employees provide.

Reorganization. Agency reorganization has raised concerns for relocating members, suitable work conditions, compensation and job security. SEA is committed to representing our members in these matters and assuring conformance with our contract.

Quality Public Service and Professionalism. Reduced budgets, shrinking resources, downsizing, reorganization and politicizing have put increased pressure and stress on the professional integrity of SEA represented employees. The quality of life, health and safety of Wisconsin citizens may be impaired as a result of such pressures. SEA communicates these concerns in bargaining and to the respective agencies, commissions, legislature and the Governor.

Contract Agreements. SEA has always been prepared to bargain and agree to a reasonable contract in a positive and professional manner. We intend to do what we can to insure that the State bargains in good faith and deals with our issues and concerns.

FUTURE OF SEA

The State Engineering Association depends on having an appropriate knowledge base and taking action within the political processes that exists in Wisconsin. All members are encouraged to communicate with the Association Board members about issues and concerns, and to help further our common interests.

We trust that our Board of Directors will continue to represent our interest and concerns in a professional manner.

SEA Board of Directors

STATE OFFICERS — 1998 - 1999

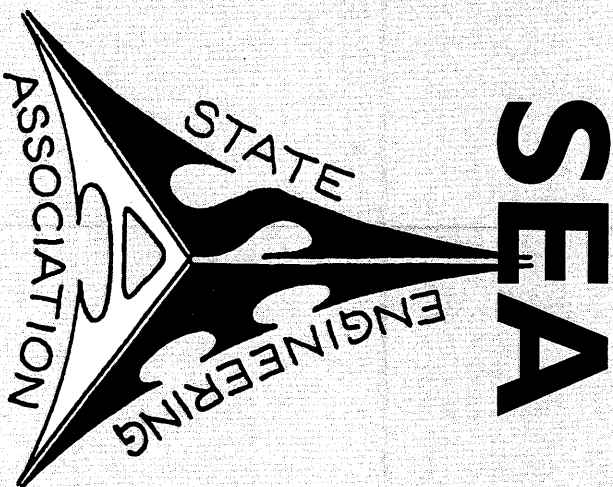
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Treasurer	John S. Bolka 573 W25295 W. High Ridge Dr. Waukesha, WI 53189	(414) 662-9826 (H) 548-6716 (O)

SECTION PRESIDENTS

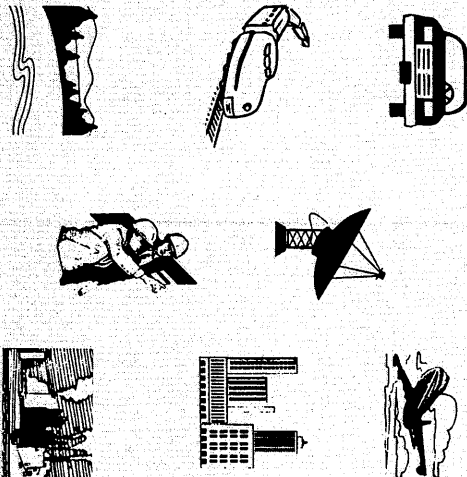
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Green Bay Section Robert C. Paulik 258 Glacier Drive Green Bay, WI 54302	(920) 468-8829 (H) 492-3646 (O)	Central Office Section David J. Kiekbusch 2510 Westbrook Lane Madison, WI 53711	(608) 276-9451 (H) 266-5084 (O)
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State Engineering Association

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The University of Wisconsin System

NEWS RELEASE

University Relations • 1856 Van Hise Hall, 1220 Linden Drive • Madison, Wisconsin 53706 • (608) 263-3961 • FAX (608) 262-5739

March 31, 1999
FOR IMMEDIATE RELEASE

Contact: David W. Olien
(608) 262-4048

UNIVERSITY OF WISCONSIN BOARD OF REGENTS TO CONSIDER PRINCIPLES FOR AN OPTIONAL RETIREMENT SYSTEM PLAN

MADISON – The University of Wisconsin System Regents will consider a set of principles to frame optional retirement system legislation at their April 8th meeting.

The development of these principles is the result of a legislatively-mandated timetable that requires the Regents to submit legislation by June 1, 1999 which would establish an optional retirement system (ORS). An ORS would allow newly hired UW faculty and academic staff to choose between the current Wisconsin Retirement System (WRS) and individually directed retirement accounts.

“The ability to offer an ORS may enhance recruiting of new faculty and academic staff,” said UW System Senior Vice President David W. Olien. “With recent studies indicating that nearly 40% of UW faculty and staff may retire over the next decade, offering competitive compensation and benefits will be a top priority as we seek to preserve the quality of our institutions. While offering competitive salaries is of primary importance, other benefits such as health insurance and a flexible retirement program will be critical as well.”

The UW System Administration recommends that the state Employee Trust Funds Board serve as the Plan Sponsor to establish the ORS. The Department of Employee Trust Funds (ETF) currently manages a large and sophisticated retirement plan for public employees as well as a major supplemental retirement plan, the Wisconsin Deferred Compensation Program.

-more-

“After examining the experience in other states, we feel that the fiduciary responsibility and administrative oversight should be located with the state entity best suited to provide legal expertise, plan design experience, employee education and counseling, appropriate information systems, and adequate auditing and accounting functions,” said Olien.

He added, “The Department of Employee Trust Funds maintains individual records for retirement and ancillary benefits. They do an outstanding job with the State’s Deferred Compensation Plan and have a national reputation for efficiency. For this reason the UW System Fringe Benefits Advisory Committee recommended that the expertise and resources currently available at ETF be used if an ORS is created.”

Other principles for an optional retirement system include:

- Acknowledging the University’s interest in preserving the excellence of the Wisconsin Retirement System by not passing the cost of an ORS on to other WRS participants, both employees and employers.
- Authorizing ETF to determine retirement contribution rates to ensure equity among all employee groups.
- Continuing full state funding of retirement plans.
- New employees will be given a one-time choice to select a retirement plan.
- Participants will be responsible for any of the consequences of their choice.

Olien said, “Following adoption of ORS principles the UW System Administration would prepare draft language creating an ORS that Regents would consider at the May Board meeting. This timetable gives all interested parties the opportunity to participate in an open, deliberative process on this important issue,” Olien said.

Any plan would have to be enacted into law by the legislature before it could be available to University participants.

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Retirement Services

Aetna Life Insurance And Annuity
Company
151 Farmington Avenue
Hartford, CT 06156

Carl P. Steinhilber
Product Manager, Education Market
Product & Brand Management, TS41
(860) 273-9066
(860) 273-7196

January 18, 1999

Ms. Cindi Broydrick
Broydrick & Associates
44 East Mifflin Street
Suite 404
Madison, WI 53703

Dear Cindi,

Thank you for sharing the *Wisconsin Retirement System Supplemental Actuarial Valuations of Enhancements to Hybrid Plan Features of the Wisconsin Retirement System and a Separate Optional Retirement System for University of Wisconsin Employees* report with us. We appreciate the opportunity to review the information and participate in some small way in this important process. Also, we look forward to working with you and others on developing and introducing an Optional Retirement System for the University of Wisconsin (UWORS) that meets the needs of both the state and the future participants.

The report provides useful insights and statistics on the University of Wisconsin Retirement System participants and the larger "general" group in which they are placed for valuation purposes. It also provides an important framework to advance the discussion of the impacts of introducing a defined contribution plan option or, as an alternative, of enhancing various options under the existing defined benefit plan. In this regard, we would like to offer some suggestions that might further enhance the value of this initial report as Mr. Dennison prepares his more comprehensive final report.

One key area where some additional analysis might provide information to help focus on the true costs that might emerge over time is the rate of election into UWORS. In particular, the assumption that 100% of all employees under age 45 would elect UWORS while 100% over 45 would stay with WRS provides a useful "upper limit" on the potential costs. With this as an important benchmark, evaluating the costs associated with other possible election patterns would provide a range of costs that the decision-makers in the legislature might find useful in their deliberations. As an example, based on our experience in the market and our knowledge of insurance buying behavior, we find many participants, whether older or younger, will include many other factors in addition to strict economic self-interest to make their defined benefit vs. defined contribution decisions. For example, tolerance for risk, breadth of choice of investment options, preference for control over their investments and the availability of other sources of retirement savings play a significant role in the decision. As a consequence, these other factors could result in a very different set of election rates by age. A recent study, dated November 18, 1998, prepared by Edward Macdonald and Vince Tobin from Buck Consultants for the Georgia

Legislature presents some interesting results of DB/DC preferences by age. It is interesting to note that significantly less than 100% of over age 44 employees elect DB. Similarly, much less than 100% of those under 45 elect DC. The following table presents the results from that study:

Age	21-24	25-34	35-44	45-54	55-64	Over 64
Elect DB	28%	36%	46%	52%	71%	94%
Elect DC	72%	64%	54%	48%	29%	6%

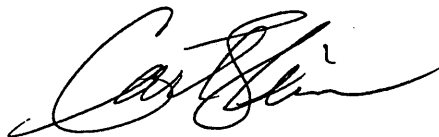
Whether or not these election rates apply without adjustment to University of Wisconsin employees, they are strongly suggestive that a range of assumptions should be considered since these election rates would cut the \$14.6 million estimated cost approximately in half.

Another area where we might suggest additional analysis is in the cost of the UW employees versus the general population. There is a general assumption in the report that UW employees are less expensive to WRS than the rest of the general group because of higher turnover. The turnover rate may or may not be higher, but other factors should be reviewed and reflected, including the entry age of the population. The average entry age (after taking salary into account) of the UW employee might likely be higher than that of the general population, and this may more than offset the "savings" of the higher turnover.

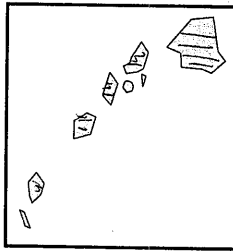
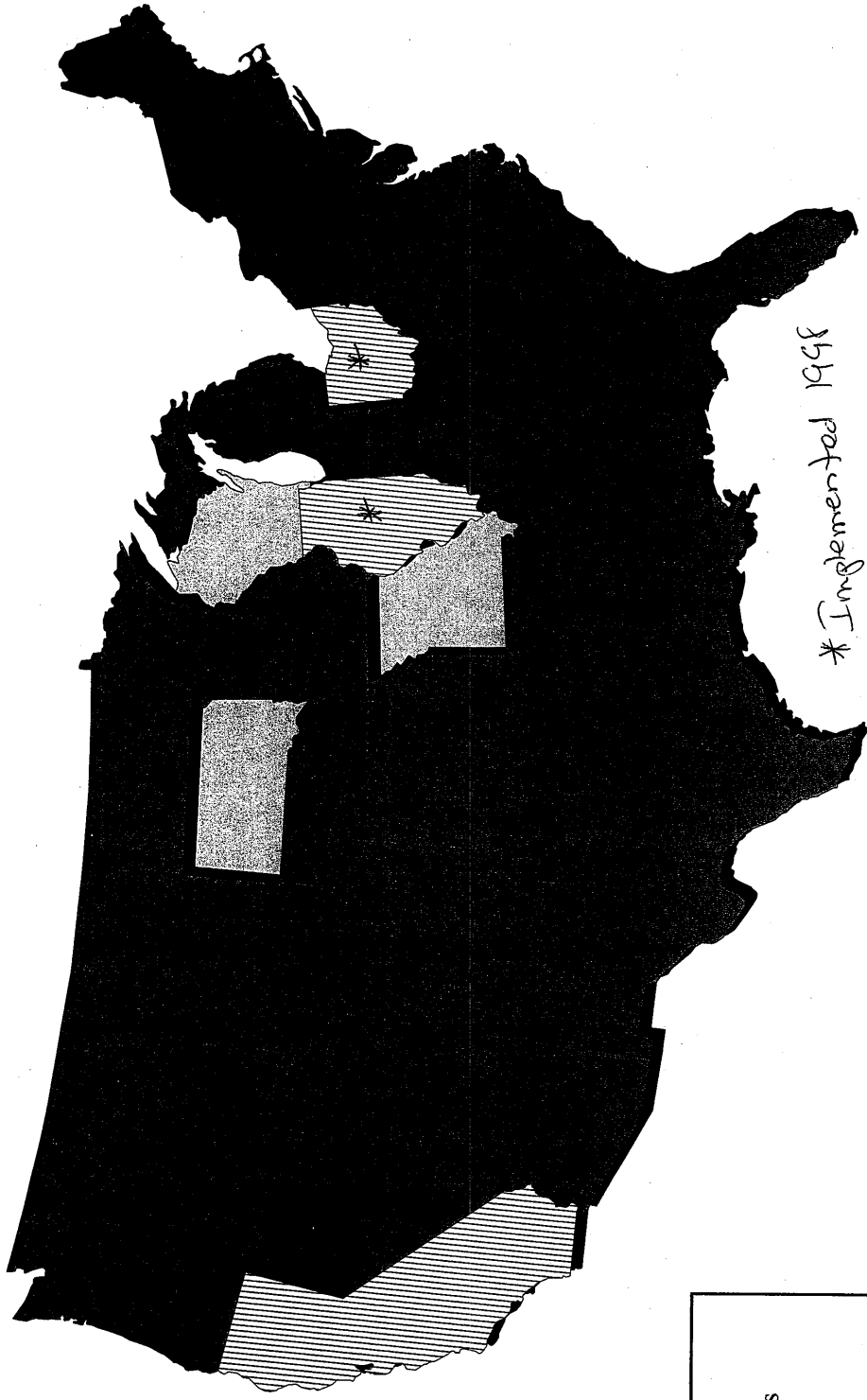
Lastly, although not a direct cost impact, one of the key reasons for developing a defined contribution plan is to attract and retain high quality faculty and staff. A defined contribution plan that offers not only portability of assets (including employer deferrals after separation from service), but also gives the participants *control* over the investment choices for their retirement assets, is often a great retention tool. Without this type of plan, UW might need to find other ways to attract and retain high quality employees, probably including increased salaries and other expenses above what would be required if UWORS was offered. This expense is difficult to quantify, but that makes it no less real for the state.

In summary, we found the report to be very helpful in setting a context for examining the potential actuarial costs of introducing a defined contribution component to an already high quality retirement benefit system and as a great place to start educating people about the positive aspects of a UWORS defined contribution plan. We look forward to working with you through the additional studies and discussions to help present likely outcomes of offering UWORS and through the eventual roll out of a cost neutral plan.

Sincerely,



STATES WITH ORP-TYPE PLANS



- With ORP-Type Plans
- Without ORP-Type Plans
- ▨ ORP legislation enacted; implementation pending

ORP-type plans are available at public colleges and universities in 43 states and the District of Columbia. Three additional states, California, Illinois, and Ohio, enacted ORP legislation and their implementations are currently pending.

Note: In some states, not all of the public colleges and universities are covered under the existing ORP-type plan.

UWORS Discussion Points

- The Budget Adjustment Bill contains a provision instructing the Joint Survey Committee on Retirement Systems to commission an actuarial study on the impact of a University of Wisconsin Optional Retirement System (UWORS), a defined contribution option to the Wisconsin Retirement System (WRS). Another provision instructs the University of Wisconsin Board of Regents to submit proposed legislation to the General Assembly by June 1, 1999 creating UWORS.
- Several vocal critics have assaulted these provisions as detrimental to WRS and a threat to the retirement security of current WRS retirees. However, we should keep in mind that the retirement provisions in AB 768 do not create UWORS. Rather, the current legislation merely orders a study of the impact UWORS would have on WRS. The assumptions, preconceptions and fears about UWORS cannot be accurately addressed without such a study. Upon completion of this study legislation to create UWORS can be drafted in such a way as to protect WRS from any negative impact. The goal is to create a competitive retirement plan option for the UW System without hurting existing or future WRS participants.
- The idea of UWORS is not a radical new concept. A defined contribution plan is the standard pension plan design throughout higher education and is a proven approach to providing retirement benefits for a highly mobile workforce. Defined contribution optional retirement plans like UWORS are currently available to public higher education employees in 45 states, including all of the states bordering Wisconsin, and in the District of Columbia. Two additional states have passed legislation with implementation pending. Only Missouri, South Dakota and Wisconsin do not have an optional retirement plan for higher education or have not passed legislation. Virtually every private college and university in the country offers a defined contribution retirement plan.
- The prevalence of defined contribution plans in higher education is in recognition of the highly mobile academic workforce that is critical to the vitality of higher education. The portability of defined contribution plans effectively creates a nationwide portable pension system for higher education. Defined contribution plan participants who leave their employer continue to benefit from the accumulation of interest and investment earnings on their retirement plan account. Therefore, faculty members who work at several different institutions during their careers are not penalized for their mobility.
- It has been documented that the UW System anticipates a significant increase in faculty retirements over the next ten years. In light of this trend it will become increasingly important that the UW System be able to recruit high quality faculty from a national pool of talent. The UW System risks being a less attractive employer than other public or private institutions if it lacks a retirement plan on par with its peer groups. While there are many other factors in a prospective faculty member's employment decision, it is conceivable in a highly competitive employment market that some faculty candidates may elect other institutions with retirement systems more familiar to them.

- At its December 1997 monthly meeting the Board of Regents of the University of Wisconsin endorsed the ORP concept.
- If the experience of other states with optional retirement systems is an indication, creation of UWORS should not negatively impact WRS. Other states which have created similar plans have done so without a negative fiscal impact on the existing state retirement plan. Some have reported the new plan has even lowered the cost of the old plan. It is difficult to believe that the experience of WRS would be dramatically different from that of other state systems.
- A report that UWORS would cost taxpayers \$35 million annually was premature and appeared to be based on an inflated estimate of how many UW employees would elect the UWORS; even the author of this report called the estimate "preliminary" and stated that it "should not be regarded as a final report." Experience of other states shows that employee election of plans like UWORS is a gradual process, so any impact on WRS should be minor. In fact, since the employees eligible for the UWORS are such a small percentage of the total WRS participant population, the expected impact should be even less.
- If the proposed UWORS resembles the plan that was introduced in AB 331, several features of UWORS may actually result in a cost savings. First, the 1.6% employer contribution to WRS for unfunded liabilities will continue to be made for UWORS participants, even though WRS will accrue no future liabilities for these employees. This should have a positive impact on WRS funding. Second, the .8% benefit adjustment contribution made for WRS participants for the next five years will not be needed for UWORS participants, so overall funding costs for UWORS participants may be less than WRS participants.
- Ensuring the best possible education for the state must be a high priority for state government. UWORS will help maintain the high quality of public higher education in Wisconsin without risking the retirement benefits of those who have been employed for many years in Wisconsin.

What Educators and State Officials Say About an Optional Retirement Plan (ORP) for Public Colleges and Universities

The Optional Retirement Program for employees of the State University of New York was authorized by the enactment of Chapter 337, Laws of 1964. The operation of the Optional Retirement Program since that time has had no adverse fiscal impact upon the New York State and Local Retirement Systems.

John S. Mauhs, Deputy Comptroller
New York State and Local Retirement Systems

The participation of those Higher Education Employees who elected to participate in the [Optional] Retirement Plan, rather than the plan offered through the State Teachers Retirement System, has had no adverse actuarial impact on the initial Teachers Retirement System. In fact, based on historic data, it is our personal opinion that the ORP has impacted the initial plan in a positive manner.

Willard M. Ansel, Executive Secretary
Teachers Retirement Board, West Virginia

I can confirm that such plan [Tennessee Optional Retirement Plan] has not had an adverse fiscal impact on the Tennessee Consolidated Retirement System (TCRS). The ORP became available to higher education faculty and administrative employees in 1978. The TCRS funded status has improved on a strong and steady basis during the past 15 years.

Steven L. Curry, Director, Treasury Department
Consolidated Retirement System, State of Tennessee

The members of higher education institutions have had the ability to participate in the ORP since 1969 in the State of Wyoming ... The Wyoming Retirement System has never encountered any actuarial problem with the split systems due to the fact that each one is independent of the other.

Jeffrey E. Gardner, Deputy Director
Wyoming Retirement System

In Washington State, we recently had statutory changes that brought the employees of five vocational-technical institutes into the state community and technical college system. The resulting new option to enroll in the ORP was seen as a very positive opportunity for the faculty involved. The assistance and information provided by the annuity company during this time of change was first rate.

Larry E. Lael, Personnel Director
Washington State Board for
Community and Technical Colleges

z no instances
where it's harmed a state

Being able to offer [ORP] to our faculty and staff has allowed us to compete in the nationwide marketplace for academic and professional talent.

Robert L. Woodbury, Chancellor
University of Maine System

I am convinced that the presence of the alternative retirement option at Utah State University has been a significant recruiting tool for the institution. Competition for faculty and staff is extremely fierce throughout the United States and having an alternative system such as [ORP] allows the institution to have one more "carrot" to attract quality faculty and staff.

Clark M. England, Director of Personnel Services
Utah State University

The ORP is meeting the objectives for which it was designed in that it assists in the recruiting of quality personnel for the State University System. It has not caused any adverse fiscal impact to the Florida Retirement System (FRS) Trust Fund.

A. J. McMullian III
State Retirement Director, Florida

We can confirm that the Optional Retirement Program for the faculty of the University of North Carolina, which became effective in 1972, has not caused an adverse fiscal or actuarial impact on the Teachers' and State Employees' Retirement System. There are also budgetary cost savings to the State.

Dennis Ducker, Assistant Director
State of North Carolina, Department of State Treasurer

The Optional Retirement Plan of the Commonwealth of Virginia was initially offered July 1, 1985 as an alternative plan to the defined benefit pension program offered under the Virginia Retirement System ... The Commonwealth of Virginia Optional Retirement Plan is open to the president and all full-time salaried employees of all institutions of higher education in the state who have the rank of faculty, and are engaged in teaching, administration or research. Since the inception of the Optional Retirement Plan in 1985, the Virginia Retirement system has experienced no negative impact with regard to funding levels or administration.

Wallace G. Harris, Deputy Director
Virginia Retirement System

From our examination of the available data, we have concluded that the members who have selected the ORP have been a representative group. There does not appear to be adverse selection against the Montana Teachers' Retirement System (TRS). The actuarial valuation indicated that the ORP did not have a detrimental impact upon TRS.

Alton P. Hendrickson, Member of American Academy of Actuaries
Hendrickson, Miller & Associates, Inc.
Actuarial Consultants retained by the Montana Teachers' Retirement System

As one of the largest public institutions of higher learning in Utah, our mission includes providing a comprehensive curriculum that ranges from Automotive Collision and Repair to Anatomy. Our faculty are equally diverse. Our defined contribution plan gives us the flexibility to compete effectively for both vocational/technical and general education faculty.

J. Clark Whitehead, Ph.D., SPHR
Director, Personnel Services
Salt Lake Community College (Utah)

I find the option of a defined contribution plan, in addition to the two defined benefit plans offered by Community College of Philadelphia, to be very advantageous to both the employee and the employer. From the employee's perspective, there are certain features of the defined contribution plan which are highly attractive which, at least in our case, are immediate vesting and portability to any other organization or institution that offers the same defined contribution plan. From an employer's perspective, the option of a defined contribution plan can be a great assist in attracting and retaining key employees. The portability of a defined contribution plan is an important career planning element.

Frank Skahill, Vice President for Human Resources
Community College of Philadelphia (Pennsylvania)

An optional retirement plan would certainly help make our colleges more competitive in recruiting faculty and staff. It would also help the state in the long run by reducing its "unfunded" liability for participants in the state plan.

Eileen Farley, President
Bristol Community College (Massachusetts)

**Wisconsin
Retirement
Consortium**

December 8, 1998

Mr. John Peterson, President
State of Wisconsin Investment Board
P. O. Box 7842
Madison, WI 53707

Dear Mr. Peterson and SWIB Trustees:

I am writing on behalf of the Wisconsin Retirement Consortium, a group which represents nineteen member organizations of both active public employees and annuitants. A listing of those groups is on the reverse side of this page. After reviewing the current SWIB budget request for 1999-2001, the Consortium has taken the following positions:

The Consortium recommends approval of the proposed information technology budget.

The Consortium supports internal investment staff and adequate resources to add positions and encourage retention of existing staff.

We continue to hear that SWIB is committed to principals of maximizing internal investment management. However, as indicated below, the outside investment management has continued to increase both in cost ratio and in the total amount of funds invested. The amount in () indicates the percentage of outside management.

	<u>FY 97--6/30/97</u>	<u>FY 98--9/30/98</u>
Fixed Fund	\$40.458 billion (9.7%)	\$44.463 billion (13.2%)
Variable Fund	\$ 5.814 billion (10.1%)	\$ 5.735 billion (14.7%)
Internal Costs	1.8 basis points	4 basis points
External Costs	11.5 basis points	30 basis points

We also understand that budget restrictions over the past years have forced the Investment Board to contract out for investment services. The cost for outside management has risen to 7.5 times the cost of internal management. This amounts to millions of dollars each year which increases employee and employer contributions and decreases dividends to annuitants of the Wisconsin Retirement System (WRS).

To reinforce the Investment Board's position on emphasizing internal investment management, a board policy should be adopted to assure the current and future staff that adequate internal staff will be maintained with adequate, competitive salaries and compensation.

**Wisconsin
Retirement
Consortium**

The Consortium opposes the requested 50% outside management limit.

There was no support within the Consortium for the proposed limit increase to 50%. Some member organizations could support an increase much less than 50% until the internal staff could be added and trained. Other organizations within the Consortium are against any increase above the current 15%.

The Consortium recommends that SWIB provide a forum for dialog between the Board of Trustees and participant organizations.

Members of the Wisconsin Retirement Consortium appreciate the commitment that all of you have made to serving the WRS. We desire to work with you to maintain the integrity of the fund and to improve this system for the participants and the citizens of Wisconsin.

I will look forward to your response.

Sincerely,



Mel Sensenbrenner
President, Wisconsin Retirement Consortium

cc: Pat Lipton, SWIB Executive Director
Ken Johnson, SWIB Chief Administrative Officer

**WISCONSIN RETIREMENT CONSORTIUM MEMBERS
SUPPORTING THIS STATEMENT**

Association of Career Employees
AFSCME Council 24
AFSCME Council 40

Association of Supervisors and Counselors (MPS)
Milwaukee Teachers Education Association
Milwaukee Teachers Retirement Fund Association
Professional Fire Fighters of Wisconsin
PFFW-Retired

School Administrators Alliance
State Engineers Association

The Association of UW Professionals
Wisconsin Association of School District Administrators
Wisconsin Association of School District Administrators-Retired
Wisconsin Council of Carpenters
Wisconsin Education Association Council
WEAC-Retired
Wisconsin Federation of Teachers
Wisconsin Retired Educators' Association
Wisconsin Professional Police Association

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**4701 Goldfinch Drive, Madison, WI 53714-3329 • (608) 222-9255
Mel Sensenbrenner — President**

- Pat Lipton, Ken Johnson, Vrakas, Wirth

- "pay for performance"

- budget prop - takes them to
25% outside mgt.

- allows to increase bonus pool

- salary increases

- positions

SPOTO
ident
Platteville, Foreign Languages
Platteville, WI 53818
phone 608-342-1171
mail: spoto@uwplatt.edu
608-277-7708

MUZIK
WFT Representative
4 Applegate Road
Platteville, WI 53713-3184
phone 608-277-7700, x238
toll free 800-362-7390, x238
mail: muziksr@aol.com
608-277-7708

To: Members of the Board of Regents of the University of Wisconsin System

From: Edward J. Muzik *Edward J. Muzik*

Date: October 15, 1998

Re: Optional Retirement Plan (ORP, also called UWORS)

Enclosed are two discussion papers TAUWP prepared for a group of active and retired participants in the Wisconsin Retirement System. In them we raise concerns that should be carefully reviewed by anyone who looks at the issue of an optional retirement proposal.

First, will removal of a significant number of individuals from the WRS have a negative effect? Under the proposal in the last session of the Legislature, the answer is yes. It will increase contribution levels. It may lower dividends to annuitants. Far reaching effects on the strength and soundness of the current system might occur. Why take unnecessary risks? Why change a system that is the ninth largest public retirement system in the United States and is solidly funded?

Second, is an individual better off under a defined benefit plan in a sound, well-funded retirement system or under a defined contribution in which the individual's annuity is determined by the stock market at the time of retirement? The answer for all but the most risk-oriented person is to opt for a defined benefit. The ORP is a defined contribution plan, that is, a money purchase plan. The WRS plan is a hybrid in which the retiring member gets the better of a money purchase plan or the formula for calculating the defined benefit. In addition, the WRS has a good dividend program which has doubled the retirement income of individuals who retired in 1985. Further, for those individuals and all others under the WRS defined benefit plan, the retirement income receivable can never be less than the original annuity.

Third, is the ORP beneficial to the UW System? Does it help in recruiting? Every faculty and academic staff member currently has the option of using discretionary money to invest in TIAA-CREF. I have money invested in TIAA-CREF and so do many of my colleagues. There is no evidence that anyone ever refused employment in a UW institution because an ORP was not available. Will this situation change in the future? Any affirmative answer is simply conjecture. This argument was first

Regents
October 15, 1998
page 2

expounded before 1991. It was irrelevant then; it is irrelevant now. And chances are it will be irrelevant in the future.

Fourth, in an event of the creation of two primary retirement systems, does the Board acquire a fiduciary responsibility that is better placed elsewhere? Do we create potential problems for the future? If we have two retirement systems, one of which does significantly better than the other, will employees argue that they received bad, ill-informed, biased, and/or inappropriate advice when they were forced to make an irrevocable choice within 60 days of being hired?

Finally, what changes would be helpful in making the WRS better?

(A) One is increased portability. The concept is simple but achieving it may be expensive. No actuarial study has been made so far as I know.

(B) Removal of the 5% cap on interest earnings, first imposed on employees hired after January 1, 1982, is more achievable but has a cost of about .4% of payroll. There is widespread agreement that this cap must be eliminated.

(C) Improvement in the formula factor would be very helpful. Wisconsin's 1.6% formula factor is below the national average of about 1.8%. This improvement is the most important retirement benefit needed by faculty and academic staff.

(D) Pickup of the health insurance premium for new faculty and academic staff is the best recruiting option the UW System could possibly possess. This provision is in the Regents' budget request. Since the UW System is committed to funding this program, this objective has a good chance of success in 1999-2000.

I hope the enclosures and the above commentary are useful in your deliberations on this issue.

CC: Katharine Lyall
George Brooks
Chancellors

THE OPTIONAL RETIREMENT PLAN: IMPLICATIONS AND PROBLEMS

Edward J. Muzik

INTRODUCTION

For the past year and a half a vigorous discussion has taken place on the merits of adopting an ORP (Optional Retirement Plan) which would apply originally only to new faculty and academic staff in the UW System. The initiative for the proposal came from TIAA-CREF, one of the largest insurance and annuity companies in the world which primarily serves higher education professionals, and from certain legislative leaders. It is notable that the initiative did not come from the university. The situation that has developed is unique in that some politicians are extremely anxious to help the university even in the absence of any expressed need.

The Wisconsin Retirement System is the culmination of half a century of consolidation, improvements in funding, and increases in investment earnings, which for many years have provided substantial benefits to annuitants through the dividend process. The WRS always needs improvement, but basically the system works quite well.

STRENGTHENING THE WRS: IMMEDIATE VESTING AND THE CLIFF BILL; NEXT IS ELIMINATING THE 5% INTEREST CAP

Two recent enactments have strengthened the WRS and weakened arguments of the proponents of an ORP. The five-year vesting requirement has been eliminated. Now all participants have immediate vesting. In addition, reducing to 55 the age at which an automatic joint survivorship annuity, usually to a widow, occurs in case of death improves the WRS immeasurably. A significant new step which would improve the WRS would be the effective repeal of the 5% interest cap imposed on participants employed after January 1, 1982.

PRIVATIZATION OF THE WRS

The WRS faces a major threat from proponents of the ORP who are also the leaders of the current fad for contracting out state services. They seek to lower employer costs and to destroy the defined benefit plan; eventually their actions will increase costs substantially for both employers and employees, up to \$35,000,000 a year according to preliminary estimates.

Some 15,000 university employees are the potential participants in an ORP whether by gradual accrual or, more likely, by expansion once the entry into the university has been achieved. Surely the expenditure of so much time and money has not been for the sole purpose of picking up a few new hires every year. If that were the case, it would rank, perhaps, as the most costly effort per new entrant in the history of Wisconsin politics.

Some people perceive an additional threat in the effort to increase the percentage of the Wisconsin retirement funds which can be handled by private brokerage firms. The initial amount placed in private firms four years ago was 10%. Then two years ago the effort was made to increase the percentage to 25; that failed but the percentage was increased to 15. In the SWIB budget proposal for 1999-2001 there is a request to increase the amount to 50%. The ORP proposal and the SWIB request, taken together, are seen as a grave danger to the continued health of the WRS.

HEALTH INSURANCE OR AN ORP

Legislative leaders who promote the ORP argue primarily that it is a necessary tool for recruiting new faculty. This is a recent invention since no one expressed that view until these legislative leaders discovered it. It is now adopted by some university administrators even though a thorough survey did not reveal a single individual who decided not to come to a UW institution because there was no ORP. However, proponents claim, it is needed for the future. There is no evidence to sustain that claim.

Last session, a litmus test of the intentions of those who want to help the university revealed no interest on their part. The test was SB 213, the pickup of the premiums for health insurance for new faculty and academic staff in the UW System. Passage of this bill would have been a major and

immediate recruiting tool. SB 213 died in the Joint Finance Committee because it had a price tag of about \$2,000,000. Earlier, the Regents and System Administration had assured sponsors of the legislation that the money would be found internally. TAUWP will be reintroducing the bill again, and once more TAUWP has assurances that the money will be available.

Which is more important to a 30-year-old newly hired faculty member: retirement or health insurance? Of course, the answer is health insurance. The state already provides a good retirement system, but the state does not provide health insurance premium pickup for the first six months. TAUWP will be seeking support from public employee groups and others for its bill.

DEFINED CONTRIBUTION VERSUS DEFINED BENEFIT

Proponents want to establish a defined contribution plan to replace the current defined benefit plan. The proposed ORP is a defined contribution plan; in other words, a money purchase plan. Its value depends on the market price of an individual's portfolio at the time of retirement. What happens when the shift to a defined contribution plan is implemented is that the risk is shifted from the employer to the employee. It is alleged to reduce employer costs, although that may not be the actual result. In the WRS a formula determines the value of the fixed annuity, and it is guaranteed to the retiree regardless of the stock market.

The WRS is a hybrid pension plan which contains elements of a defined contribution plan and a defined benefit plan. The amount of the annuity will be calculated using both the money purchase approach and a defined benefit formula approach, and the annuitant will receive the higher benefit. Under the formula the annuity can be anticipated within a few dollars, and plans for retirement can be pursued with a greater sense of security (that is, not being subject to the vagaries of the stock market).

The WRS defined benefit plan has a guaranteed floor which means that the amount of the original annuity, before any dividends, at the time of retirement is the least amount that one will ever get. A variable annuity, however, is subject to the risks of the stock market and there is no floor for variable annuities offered under the WRS or the ORP.

On the basis of models prepared by TIAA-CREF, short-term employees fare better under the ORP than the current WRS plan. For long-term employees

the WRS is better, according to these models prepared by TIAA-CREF. For example, an employee entering at age 45 who quits in 10 years will do better under TIAA-CREF (benefit replacement would be 14.8% compared to 9.8% under the WRS). However, if he stays until age 65 under the defined benefit plan of the WRS the benefit replacement is 32% for WRS compared to 25% for TIAA-CREF. A difference that favors long-term employees in WRS is found at every age. Presumably, TIAA-CREF calculated these for like salary, career lengths, and using the current WRS formula factor of 1.6% each year of service.

THE DIVIDEND PROCESS

It should be noted that an ORP does not provide a dividend process as does the WRS. In 1996 the dividend added 5.6% to annuities of retired public employees, 6.6% on May 1, 1997 and 7.7% on May 1, 1998. Annuitants who retired in 1985 have nearly doubled their retirement income from WRS due to the dividend process.

Annuitants see the removal of a significant portion of the participants in the WRS as a potential threat to these earnings and are fearful of changing a system that has worked so well.

EXPERIENCE IN OTHER STATES

ORPs are found in many other states and the experience is that once the plan is established on a limited basis there is then a concerted and often successful effort to expand the program beyond the original limited number of potential participants. In Minnesota where an ORP was enacted in 1997, efforts were made to expand it in 1998, so far with only partial success. In Illinois the ORP has now expanded to include all university employees.

COSTS

It is difficult to believe that individuals or the WRS or the UW System will be better off in the long run if a large number of individuals opt for an ORP. Having two different retirement systems may result in claims of inequity and calls for legislative remedies in the future.

5.

A preliminary actuarial overview estimated that when the ORP matures the cost will have risen by \$35,000,000 a year for employers and employees remaining in the system.

BYPASSING GOOD GOVERNMENT PRACTICES

Proponents tried to put an ORP plan (Assembly Bill 331) in the regular budget and when that failed tried again in the so-called Mini Budget bill. These were blatant attempts to bypass the normal and essential public hearing process required by Wisconsin Statutes. Certainly we should have learned something from the raid on the retirement fund in 1987 which bypassed the normal process and which cost Wisconsin taxpayers more than \$200,000,000.

Active and retired participants were greatly disturbed by the unprecedented efforts to undermine the normal processes of government. Responsible members of the Joint Survey Committee on Retirement Systems were equally disturbed by the flagrant efforts to bypass the Committee. It is they who must decide if retirement legislation merits the recommendation of good public policy.

Wisconsin Statutes require that. Active employees and annuitants must insist on it.

October 1998

Principles for An Optional
Retirement System

BUSINESS AND FINANCE COMMITTEE

Resolution:

That upon the recommendation of the President of the University of Wisconsin System, the Board of Regents (Board) declares that it could support a bill authorizing an Optional Retirement System (ORS) for any unclassified University staff providing that the bill --

1. Authorizes the Board to establish an ORS as a qualified plan pursuant to 401(a) of the Internal Revenue Code at such time and incorporating such plan provisions as it deems advisable for the good of the University and its employees, including the provisions that the ORS must be established and maintained solely for the benefit of participants and their beneficiaries and that the contributions to the ORS are held in trust for this purpose and cannot be refunded to the employer or otherwise diverted;
2. Authorizes the Board to retain oversight and control of the ORS;
3. Authorizes the Board to determine the number of vendors in the ORS and the types of products offered by the vendors;
4. Guarantees the contractual rights of ORS participants to benefits accrued under the Wisconsin Retirement System (WRS);
5. Authorizes the Board to provide long-term disability insurance for ORS participants by deducting from the retirement contribution the cost of participants' long-term disability insurance;
6. Authorizes the Board to charge to ORS participants and/or ORS vendors any new administrative costs directly related to the ORS;
7. Authorizes the Board to ensure equity in employer-paid retirement contributions among all employee groups;
8. Authorizes the Board to modify or to terminate any vendor contract;
9. Authorizes the Board to allow new staff to elect to participate in the ORS or the WRS; to determine whether current staff may also elect prospective participation in the ORS, and to determine the irrevocability of any such election;
10. Acknowledges the University's interest in preserving the excellence of the WRS by permitting the University to consider the potential impact of plan provisions on the ability of the WRS to meet its current and future liabilities and on the State Investment Board's investment of assets in the State of Wisconsin, as determined by a state-funded actuarial study; and,
11. Continues full state funding of retirement plans.

The Board further declares that its purpose in providing an ORS will be to enhance the University's efforts to recruit and to retain faculty and academic staff of the highest quality.

ORP OR WRS: THE PROS AND CONS

Edward J. Muzik

ARGUMENTS STATED BY TIAA-CREF IN FAVOR OF AN ORP

Meets the mobility needs of faculty -- hence, helps in recruiting and retention by providing portability.

Enhances institutional vitality by enabling employees to retire or move to another university when it is mutually desirable.

Provides budgetary predictability and cost containment. ORP is not affected by changes in the plan and has no unfunded liabilities.

Is easy and cost-free to administer

Has potential for greater retirement benefit

ARGUMENTS AGAINST AN ORP

WRS is a large system with an excellent record for funding and earnings. Since the WRS is run by the State of Wisconsin there is no question about its continued viability. .

WRS is a defined benefit plan (formula determined annuity or money purchase whichever is greater); provides lifetime floor; and has a remarkable dividend process; ORP is a defined contribution plan (money purchase plan) with annuities determined by stock market levels at time of retirement.

Optional plans almost always cause problems because, inevitably, wrong choices are made. Legislators are then asked to help those who made the wrong choice.

The UW System has not requested an ORP.

University of Wisconsin System would be better served for recruiting purposes if the state paid health insurance premiums for the 1st six months.

WRS would be significantly improved by eliminating the 5% interest earnings cap.

Long term employees fare better under WRS.

(OVER)

Irrevocable choice between an ORP or the WRS must be made in first 60 days of employment.

ORP, as proposed in 1997-99, will increase employer and employee costs.

TIAA-CREF is already an option for discretionary funds of faculty and academic staff under a 403 (b) plan. About 15 different tax sheltered annuities are available.

Employees opting for an ORP will not receive future benefit changes.

Portability can be provided under the WRS. Authority to provide for incoming rollovers exists and limited roll-outs are possible but do not include employer contributions. The law could be changed to provide for portability. If funds are left in the WRS, the employer and employee contributions plus earnings determine the amount of the annuity. Removal of the 5% interest earnings cap would provide a significant retirement benefit for those who leave their money in the WRS.

The strength of the WRS is that it includes all state employees, most county and municipal employees, elected officials, judges, firefighters, police officers, and others. Any action that might cause an unraveling or breakup of the WRS is potentially dangerous. Privatization of the WRS should be avoided as the current system works exceptionally well.

A formula factor improvement is an area where the WRS is below the average of other states and passage of legislation could remedy this problem.

A summary of legislative actions needed:

- Pickup of six-months health insurance premium for faculty and academic staff
- Elimination of the 5% interest earnings cap
- Provide portability
- Improve the formula factor to at least 1.8

October 1998