STATE OF WISCONSIN

APPENDIX TO 2003 SENATE BILL 344

REPORT OF JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS

(Introduced by Senators Schultz and Wirch; cosponsored by Representatives Vrakas, Musser, Albers, Hahn, Hines, Seratti, Stone and J. Lehman.)

An Act relating to: payment of fixed annuity increases under the Wisconsin Retirement System.

SUMMARY OF BILL

Under current law, state statutes provide that annual surpluses in the fixed annuity reserve in the Wisconsin Retirement System (WRS) are distributed to annuitants as a percentage increase in the amount of their annuities, if the amount of the surplus will result in at least a 2% increase in annuities. [s. 40.27 (2), Stats.] Surpluses in the fixed annuity reserve that are not distributed to annuitants in any year because they would not result in at least a 2% increase are retained in the fixed annuity reserve and are distributed to annuitants in the first year that the 2% threshold is reached. [Under a policy adopted by the Employee Trust Funds Board, annual deficits in the fixed annuity reserve result in a percentage decrease in the amount of annuities if the amount of the deficit will result in at least a .5% dividend reduction. State statutes do not address the threshold amount for reductions in fixed annuities.]

This bill eliminates the statutory 2% threshold and, instead, provides that the percentage threshold for fixed annuity increases is to be established by administrative rule promulgated by the Department of Employee Trust Funds (DETF). In addition, under this bill, proposed administrative rules relating to the percentage threshold for increases in fixed annuities are approved by the Employee Trust Funds Board but not by the Teacher's Retirement Board or the Wisconsin Retirement Board.

CURRENT LAW

Under the WRS, amounts that are estimated as necessary to pay for the retirement benefits of employees are paid into the WRS as employer and employee contributions. The employer and employee contributions are paid as a percentage of payroll during the period of employment. The financing principal underlying the WRS is that employer contributions, employee contributions, and investment earnings on employer and employee contributions must be sufficient to pay both present retirement benefits and commitments to pay retirement benefits in the future. Under this principle, at any point in time the amount of assets currently available and estimated to be available in the future are to be equal to both current and expected future retirement obligations. Periodic actuarial valuations of the WRS are conducted to help fulfill this goal.

When an employee covered under the WRS retires, becomes disabled and eligible to receive a disability annuity, or dies and leaves a beneficiary eligible for benefits, an amount estimated as sufficient to pay the benefit obligations is transferred to an annuity reserve account established for the individual. The amount transferred to the annuity reserve account is less than the actual amount necessary to pay the benefit obligations because the WRS assumes that 5% annual interest will be earned on the annuity reserve account. [The process is somewhat different for employees who participated in the variable fund, which is not discussed in this report because it is not relevant to the bill.]

Amounts in the annuity reserve account, together with other assets of the WRS, are managed and invested by the State of Wisconsin Investment Board (SWIB). These assets are invested in common and preferred stocks, bonds, real estate, and certain other investments. Annual investment results on assets in the fixed fund, after being averaged with the investment results for the previous four years, are distributed proportionately to each of the accounts in the fixed fund, including the annuity reserve account.

Surpluses or deficits in the fixed fund annuity reserve account increase or decrease the annuities of WRS retirees. The fixed annuities of WRS employees may be reduced due to deficits in the fixed fund annuity reserve, but may not be reduced to a level lower than that initially received by the employee on his or her retirement. Although investment results are the primary cause of surpluses or deficits, other factors include earnings or losses generated by carryover surpluses or deficits, gains or losses from mortality experience and changes in actuarial assumptions.

Because of the 5% annual interest assumption, only surpluses in the fixed fund annuity reserve that exceed the assumed 5% annual interest rate are distributed to retirees as annuity increases. In addition, s. 40.27 (2), Stats., provides that surpluses in the fixed annuity reserve are to be distributed only if the amount of the surpluses are sufficient to generate an increase in annuities of at least 2%. This 2% threshold was enacted in Chapter 96, Laws of 1981, which merged the State Teachers Retirement System, the Milwaukee Teachers Retirement Fund, and the Wisconsin Retirement Fund.

The following table shows fixed annuity increases, by the year in which the increases were payable.

WRS Fixed Annuity Increases by Year Payable

Year Payable	Percentage Increase
1993	4.4%
1994	4.9%
1995	2.8%
1996	5.6%
1997	6.6%
1998	7.7%
1999	7.2%
2000 (increased from 7.5% by 1999 Wisconsin Act 11)	17.1%
2001	5.7%
2002	3.3%
2003	0%

DESCRIPTION OF THE BILL

This bill eliminates the statutory 2% threshold and, instead, provides that the percentage threshold for fixed annuity increases is to be established by administrative rule promulgated by DETF. Under the administrative rules procedure, administrative rules promulgated by a state agency are published in the Wisconsin Administrative Register and the Wisconsin Administrative Code.

Administrative rules and proposed administrative rules are subject to oversight by the Legislature. First, proposed administrative rules of a state agency must, by statute, be submitted to the Legislative Council staff for review. The Legislative Council staff prepares a written report on the proposed rule, which is distributed both to the agency and to the Legislature, that discusses whether there is statutory authority for the rule, whether the rule conflicts with other rules of the agency, and whether the rule is properly drafted.

Second, generally all rule-making by an agency must be preceded by a public notice and a public hearing. The agency is required to send a written notice of hearing of a proposed rule to every member of the Legislature who filed a request for such notice. An agency is also required to take whatever steps are necessary to provide public notice to interested persons, including sending press releases to local newspapers, giving notice to interested parties, and making radio spots available in the area where a hearing will be held. In addition, a fiscal estimate is required to be prepared for the proposed rule.

Third, proposed administrative rules of the state agency are subject to review by a standing committee in each house of the Legislature. A standing committee may request an agency to modify a proposed rule or may vote to object to a proposed rule or part of a proposed rule. If a standing committee votes to object to a proposed rule, the rule is referred to the Joint Committee for Review of Administrative Rules.

Fourth, the Joint Committee for Review of Administrative Rules has authority to suspend both proposed administrative rules that are objected to by standing committees of the Legislature and administrative rules that have been promulgated, but only for reasons that are specified in the statutes. If a rule is suspended, legislation is introduced to uphold the suspension. The agency may not promulgate a suspended rule unless the legislation to uphold the suspension is defeated.

The bill would authorize DETF to promulgate an administrative rule related to the percentage threshold for fixed annuity increases using an expedited procedure for "emergency" administrative rules that is less time-consuming, but that is temporary. Following the adoption of an emergency administrative rule, the department would be required, within 150 days, to promulgate a permanent rule.

The Employee Trust Funds Board has not taken an official position as to what would be the percentage threshold for fixed annuity increases, but it would likely be less than the 2% statutory threshold under current law and is likely to be in the range of 0.5%, which is the percentage threshold for fixed annuity decreases in a policy adopted by the Employee Trust Funds Board. In a letter to Senator Dale Schultz and Representative Daniel Vrakas, Co-Chairs of the Joint Survey Committee on Retirement Systems, dated September 15, 2003, Dave Mills, Deputy Secretary, DETF, discussed the issue as follows:

> The Employee Trust Funds Board and the department believe that WRS annuitants would be better served by lowering the threshold for annuity increases. This would allow the board to distribute smaller increases more quickly. Fixed fund investment losses from the last three years will continue to be distributed through the market recognition account for several more years, resulting in less money available for annuity adjustments. As you know, 2003 was the first year in history in which there was no fixed fund annuity increase. Our financial modeling shows that under the current 2% threshold, the next few years could see either no dividends or, for the first time, a negative dividend (a repealing of a portion of past dividends). The board's opinion is that we should distribute any significant amount as quickly as possible, and has concluded that 0.5% constitutes a significant amount to many annuitants. Health care costs and other living expenses continue to rise, and even a small dividend would be very appreciated by annuitants. [A 0.5% increase would increase the average WRS annuity by approximately $108 per year.]

For 2003, SWIB reports a preliminary 24.1% return for the fixed retirement fund. Because this amount will be averaged together with losses from prior years and because of the 5% interest earnings assumption, it is possible that there will be no increase in fixed annuities paid in 2004 at the 2% threshold currently in the statutes.

ACTUARIAL EFFECT

This bill will have no significant actuarial effect on the WRS. Surpluses in the fixed annuity reserve that are not paid because they do not exceed the threshold amount remain in the fixed annuity reserve fund and are distributed, together with earnings on these amounts, in future years.

PROBABLE COSTS

This bill will have no effect on the costs of the WRS.

COMMITTEE RECOMMENDATION

The Joint Survey Committee on Retirement Systems recommends that a substitute amendment containing the following provisions be adopted to this bill:

1. Provide by statute that annuities paid from the fixed annuity reserve fund shall be increased in any year that a surplus in the fixed annuity reserve fund for the prior year will result in at least a 0.5% increase in fixed annuities in force, on recommendation of the actuary, unless the Department of Employee Trust Funds has promulgated an administrative rule that establishes a different percentage threshold for increases in fixed annuities.

2. Provide by statute that annuities paid from the fixed annuity reserve fund shall be decreased, to the extent authorized in s. 40.27 (2) (c), Stats., in any year that a deficit in the fixed annuity reserve fund for the prior year will result in at least a 0.5% decrease in fixed annuities in force, on recommendation of the actuary, unless the Department of Employee Trust Funds has promulgated an administrative rule that establishes a different percentage threshold for decreases in fixed annuities.

3. Authorize the Department of Employee Trust Funds to promulgate administrative rules that establish threshold percentages for increases or decreases in annuities paid from the fixed annuity reserve fund that differ from those established by statute.

The Joint Survey Committee on Retirement Systems finds that this bill, as amended by the substitute amendment described in this report, is good public policy.

January 14, 2004