



## The Effect of Current Market Conditions on Wisconsin Retirement System Participants Who Participate in the Variable Fund

This document is designed to help employees who currently participate in the Wisconsin Retirement System (WRS) Variable Fund understand the impact that WRS investment losses and current market conditions may have on future retirement benefits and help these employees make an informed decision about whether or not to remain in the Variable Fund. It is important to note that it is impossible to predict future investment returns and an employee's best retirement date given the current market conditions.

If you participate in the Variable Fund, half of your annual WRS contributions are invested in the Variable Fund and the other half are invested in the Core Fund. The variable portion of your account is credited with the variable interest rate on December 31<sup>st</sup> of each year. Everyone in the Variable Fund has either a variable excess or deficiency. This is an accounting mechanism that tracks whether or not there is more or less money in your total WRS account because of your Variable Fund participation. Due to the market downturn in 2008, the Variable Fund ended the year with a -40% effective rate of interest. In other words, the variable portion of your WRS account lost 40% if its value in 2008.

The Variable Fund rebounded in 2009 and ended the year with a positive 33% effective rate of interest. In 2010, the Variable Fund gained back more of what was lost in 2008 and finished the year with a positive 16% effective rate of interest. Even though the Variable Fund gained back much of what was lost in 2008, most Variable Fund participants who began Variable Fund participation prior to 2008, still have a variable deficiency (*your account balance will be smaller because of your variable participation*). Your current variable excess or deficiency is listed on the annual ETF Statement of Benefits that you received in the spring of 2011 (available in [My UW System portal](#) in Benefit Information - Statements).

As of October 31, 2011, the Variable Fund was -1.8% for the year and the Core Fund was up 2.8%. If this trend continues for the last months of 2011, WRS participants who both first participated in the Variable Fund prior to 2008 and are still in the Variable Fund, will likely have a larger variable deficiency as of January 1, 2012.

Those who first participated in the Variable Fund in 2008 or later have only received the positive variable interest rates for 2009 and 2010 so these employees should have a variable excess as of January 1, 2011. If there is a Variable Fund loss in 2011, these employees will either have a smaller variable excess or a variable deficiency as of January 1, 2012 (depends on amount of loss).

### Options Available to Cancel Variable Fund Participation

Current Variable Fund participants have the option to cancel variable participation by submitting an [Election to Cancel Variable Participation](#) (ET-2313) directly to the Department of Employee Trust Funds (ETF). The cancellation becomes effective on the first of the year after it is received by the ETF. ***If you want your cancellation to be effective January 1, 2012, ETF must receive a completed ET-2313 on or before the first working day of 2012.*** A fax is acceptable. When variable participation is cancelled, you still receive the variable gain or loss for the year in which the form is filed. If you are currently in the Variable Fund, you will

receive 2011 variable interest crediting on your account, even if you cancel variable participation effective January 1, 2012.

At the time of variable cancellation, a record of an excess or deficiency amount is created and stored on your record, based on a comparison of the variable account at the time of transfer versus what the account balance would have been if you had not participated in the variable program. Each year prior to retirement, the variable excess or deficiency is credited with the core interest rate and your formula annuity calculation at retirement will be adjusted upwards or downwards accordingly.

### **Three Variable Fund Cancellation Options**

#### **1. Cancel unconditionally**

- Effective January 1<sup>st</sup> of the year after ETF receives cancellation form - all new contributions are credited to the Core Fund.
- After core and variable interest is applied for the year in which ETF received the cancellation, variable balance is transferred to Core Fund.
- A variable excess/deficiency balance is recorded and is multiplied by the Core Fund interest rate every year until retirement. If you cancel with a variable deficiency, the value of the deficiency will grow when there is a positive Core Fund interest rate (it will also shrink. ***If there is a variable deficiency on your account at the time of retirement, it will reduce your formula retirement annuity.***)

#### **2. Cancel conditionally**

- Effective January 1<sup>st</sup> of the year after ETF receives cancellation form - all new contributions are credited to the Core Fund.
- Core and variable interest is applied for the year in which ETF received the cancellation form.
- Existing variable balance is not transferred to Core Fund until variable balance equals or exceeds amount that would have been in account if the participant had never been in Variable Fund.
- If variable balance is not moved the first year after cancellation is received, account will be reviewed on an annual basis and moved to the Core Fund when above conditions are met.

#### **3. Cancel future contributions only**

- Effective January 1<sup>st</sup> of the year after ETF receives cancellation form
- Variable funds stay in variable, but all new contributions after January 1<sup>st</sup> after the year that ETF receives the cancellation form are credited to the Core Fund.

### **Brief Explanation of How Variable Fund Participation Affects Retirement Benefit Calculations**

At retirement, your retirement annuity is calculated under two different methods, the formula and the money purchase calculation methods. The retirement annuity you receive is based on the HIGHER of the two calculations. You do not select your calculation method; you automatically receive the higher of the two calculations.

A **money purchase calculation** is based on the total value of your WRS account and a money purchase factor based on your age at the time of retirement. If you have ever participated in the Variable Fund, it will affect the value of your WRS account either upwards or downwards.

A **formula calculation** is based on years of WRS service, three highest years of earnings, formula factors based on employment category and age at retirement. Once the formula retirement annuity is calculated, it is adjusted upwards if you have a variable excess or downwards if you have a variable deficiency. If you are a Variable Fund participant at the time of retirement or if you ever participated in the Variable Fund, you will have either a variable excess or deficiency on your WRS account at the time of retirement. For a detailed explanation of retirement benefit calculations, see the ETF brochure, [Calculating Your Retirement Benefits](#).

**Examples of How a Variable Deficiency Grows and Impacts Formula Retirement Benefits**

If you retire with a variable deficiency on your WRS account at retirement, your formula retirement annuity calculation will decrease. The size of this decrease is based on your total variable deficiency. If you unconditionally canceled variable participation effective January 1, 2010 or 2011, you will most likely have a variable deficiency on your account because of the large variable losses in 2008. If you cancel with a variable deficiency on your account, each year the value will change according to the Core Fund interest rate for that year.

**Example of How a Variable Deficiency Grows Over the Years**

- Unconditionally cancel Variable Fund participation on 1-1-12
- WRS account is credited with both Core and Variable Effective Interest for 2011
- Once interest is credited, you have a -\$10,000 variable deficiency (your WRS account has \$10,000 less than it would have if you never participated in the Variable Fund)

<b>1-1-12 Variable Deficiency</b>	<b>-\$10,000</b>
3% 2012 Core Interest Rate	x <u>1.03</u>
<b>1-1-13 Variable Deficiency</b>	<b>-\$10,300</b>
5% 2013 Core Interest Rate	x <u>1.05</u>
<b>1-1-14 Variable Deficiency</b>	<b>-\$10,815</b>

*\* 2012 and 2013 Core Fund interest rate amounts are for illustrative purposes only*

The total value of your WRS account funds your eventual retirement annuity. If you cancel variable participation with a deficiency, your WRS account is smaller than it would have been if you were never in the Variable Fund and there is less money available to fund your annuity. For example, if you cancel variable participation with a -\$10,000 deficiency, that \$10,000 is not available to fund your annuity or accrue interest over the years. The deficiency grows according to the Core Fund interest rate each year because if that money had been in your account, it would have been growing by the annual Core Fund interest rate. The “hole” in your account gets bigger each year there is a positive Core Fund interest rate because the positive interest rate increases the amount of funds missing from your account because that money was not invested in the Core Fund. At retirement, a variable deficiency will decrease your formula retirement annuity calculation. Your formula retirement benefit will be calculated as usual (based on years of WRS service, three highest years of earnings, a formula factor based on employment category and age) and then it will be adjusted downward relative to your variable deficiency.

At the time of retirement, your variable excess or deficiency is multiplied by the money purchase factor for your age at retirement (money purchase factors available on [ETF's website](#)) to determine the effect on your

formula retirement annuity. The examples below outline the effect of a variable deficiency on the formula annuity of a 60 year old.

**Example 1: Small variable deficiency**

-\$1,000 variable deficiency x .00616 (money purchase factor at age 60) = -\$6.16

- ➔ The *For Annuitant's Life Only* annuity option under Formula Calculation would decrease by \$6.16/month due to the variable deficiency.

**Example 2: Mid-size variable deficiency**

-\$10,000 variable deficiency x .00616 (money purchase factor at age 60) = -\$61.60

- ➔ The *For Annuitant's Life Only* annuity option under Formula Calculation will be reduced by \$61.60/month due to the variable deficiency. If the employee had a \$10,000 variable excess, the monthly annuity would increase by \$61.60/month.

**Example 3: Large variable deficiency**

-\$50,000 variable deficiency x .00616 (money purchase factor at age 60) = -\$308.00

- ➔ The *For Annuitant's Life Only* annuity option under Formula Calculation will be decreased by \$308.00/month due to the variable deficiency.

Per the previous examples, it is clear that the larger your variable deficiency, the larger the total impact on your retirement annuity.

**Choices Available to Current Variable Participants**

1. If you are many years from retirement or are not concerned about current losses, you can stay the course and remain in the Variable Fund and/or cancel future contributions only. Everyone must examine their personal risk tolerance.
2. Elect to cancel variable participation conditionally. If you cancel conditionally effective January 1, 2012, all WRS contributions beginning January 1, 2012, will be sent to the Core Fund and your variable balance will be transferred to the Core Fund when you either break even or have a variable excess. If you are more than a few years away from retirement, this may prevent you from having a large variable deficiency on your account at the time of retirement.
3. Elect to cancel variable participation unconditionally. If you cancel unconditionally effective January 1, 2012, all WRS contributions beginning January 1, 2012, will be sent to the Core Fund and your variable balance will be moved to the Core Fund. You will receive 2011 Variable interest crediting and either a variable excess or deficiency will be recorded on your account. It is likely that you will have a variable deficiency at cancellation due to current market conditions. If you cancel unconditionally and have a deficiency on your account, you will "lock in" your losses. The deficiency will also increase during any year that there are positive core interest rates and will eventually decrease your monthly formula annuity benefit. **WARNING:** Be sure you fully understand the long term consequences of unconditionally cancelling variable participation.

**Impact of Low or Negative Interest Rates on WRS Benefits**

Low or negative interest rates will affect WRS separation, death and money purchase retirement benefits because they are all based on the total dollar value of your WRS account. Low interest rates will cause the dollar value of your WRS account to grow more slowly and negative interest rates may shrink the overall dollar value of your account. The lower the value of your WRS account, the lower the value of these benefits. A large negative variable interest rate may also create a variable deficiency on your account which will decrease

the value of your formula based annuity calculation if the deficiency is still on your account at the time of retirement.

### **Financial Health of the WRS**

The WRS is solvent, well-funded, has a diversified investment portfolio and is focused on long-term investing. The WRS is also the most fully funded public pension system in the United States and is designed to remain solvent during economic downturns. The payment of all WRS related benefits is also guaranteed by state statute.

### **For Additional Information**

ETF Brochure, [How Participation in the Variable Trust Fund Affects Your WRS Benefits](#)

Variable Excess/Deficiency [Calculator](#)

ETF's [When Should I Retire?](#)

[ETF's Open Letter to Participants and Retirees – November 2011](#)

[ETF Video about Employee Contributions and Investments](#)

State of Wisconsin Investment Board (SWIB) [website](#)

[Historical Investment Returns and Interest Rates](#)