THE STATE OF WYOMING

Wyoming Retirement System

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MEMORANDUM

Date: August 10, 2007

To: Senator John Schiffer, Chairman, Management Audit Committee

From: Thomas Mann, Director, Wyoming Retirement System Thomas Mann

Subject: Response to LSO Report, "Wyoming Retirement System: Public Employee Plan"

Please find attached the Wyoming Retirement System's response to the above mentioned report. The board and the staff of the Wyoming Retirement System would like to thank the Legislative Service Office staff for their professionalism and their consideration of the staff and board's schedules. Because of the complexity of the concepts and issues involved in the management of a pension system it is admirable and quite appreciated that the LSO staff took the time and effort to try to fully understand the dynamics of the plan.

Wyoming Retirement System:
Public Employee Plan
Legislative Service Office Report Response

Conclusion: Public Employee Plan benefits and cost provisions still measure up well in comparison to state plans in the region.

Response: AGREE

The basic benefits of the Public Employees Plan are very comparable to the surrounding states. It is most notable that the base benefits (Multiplier and early retirement requirements) are better than any of the regional states contributing to social security. WRS provides these at the lowest contribution rate in the region except for North Dakota, which does not have an automatic COLA built into its program. This is a testament to the prudence by which the Wyoming Retirement Board manages the system.

It is also notable that those states guaranteeing a COLA are struggling with the same issues as Wyoming. Montana has had to reduce its guarantee from 3% to 1 ½% and South Dakota, which guarantees a 3.1% COLA, in 2002 reduced its multiplier for the service of active members from 1.625% per year to 1.55% in an attempt to alleviate funding issues. The Wyoming Retirement System provides a higher benefit at an earlier age to members than the comparator states, although post-retirement increases appear to lag some of those states.

Conclusion: Funding the plan soundly depends upon experience meeting actuarial assumptions about the growth of liabilities and assets.

Response: PARTIALLY AGREE:

The actuarial expectation of a plan is an estimate of the future by the actuary based on prior experience. These are long term assumptions and will show considerable variance over the short term. As was explained, actuarial gains and losses will be realized over time depending on how well the assumptions predict reality. Although policy makers should be aware that actions may affect the actuarial health of the system and to what degree, actuarial considerations should not drive policy. It would be difficult to convince each of the 400+ employers to consider the effects on the system prior to taking care of their own staffing needs.

We do agree that a more robust effort to educate the policy makers on factors that affect the actuarial health of the plans should be implemented and we will undertake that effort. Unfortunately, to accurately measure any individual action and its affect on the actuarial health of the plan takes at least a year of experience to measure. Valuations are done annually on the data from the previous year.

On page 33, paragraph 2 a statement is made that the board was applying a "more specific concept of actuarial soundness" to the WRS plans. This was not a change in policy. Since1981 the plan has operated inside limitations of the total contribution rate of 11.25% and would only support changes that were affordable inside of that rate. The change in 2004 was a request to the Legislature to reword the statute to allow for the awarding of a COLA between 0% and 3% to continue that policy. The existing statute was interpreted as an all or nothing proposition and if it remained the board would have provided no COLAs for the last four years.

The board takes its fiduciary responsibility of prudence very seriously and has adopted actuarial assumptions that reflect the experience of this fund. They also understand actuarial soundness means only providing benefits affordable within the context of the assets and contribution rate available. They feel any other less stringent methodology would diminish the soundness of the system. The UMPERSA statute explicitly holds the board members of this plan personally liable for any breach in fiduciary duty and none of them can be expected to risk their personal assets by violating this precept. Wyoming is the only state in the country up to this point to adopt this statute in its entirety and is now the only board in the state of Wyoming that is held to the personal liability standard.

Recommendation: Together, WRS and the Legislature should determine whether the plan will provide a guaranteed COLA, or continue offering the break-even, non-guaranteed COLA.

Response: AGREE

As a result of the 1996 LSO study on COLAs the Legislature passed the prudent investor rule for WRS investments hoping the further flexibility would increase returns and provide the funding for enhancing the retiree COLA. That strategy worked as long as the equity markets provided the returns to pay for the increased COLA. At no time during that period were there any attempts or any discussion indicating that the COLA would be guaranteed. It was always in the context of being actuarially sound, or affordable inside of the current contribution rate and investment returns.

When funding levels provided a means to increase the maximum allowable COLA to 3%, the goal of the Comprehensive Benefit Plan (CBP) for the Public Employees Plan had been met. Unfortunately expectations are created when an increase remains at a level for a period of time, and the "actuarially sound" requirement is conveniently forgotten. The staff has taken great care, in newsletters, personal letters and direct contact with retiree groups, to explain the funding requirements and the reasons behind the COLA increases being less than expected. Although retirees understand the reasoning, the fact that the state seems to be doing so great economically leaves them convinced there should be money enough to provide a better COLA.

At this time, the only sure way of providing an increase in the COLA would involve a contribution increase or a cash infusion of substantial size. The board intends to approach the legislature with a request to increase contributions in an attempt to improve the allowed retiree COLA. A proposal should be forthcoming by the end of August. At this time the board would argue against a guaranteed COLA because of the unpredictability of actuarial and investment experience. The only guard against the volatility of actuarial experience and investment returns is variable contribution rates. Any discussion on COLA guarantees would have to involve assurances of periodic contribution adjustments when needed.

The statute requiring the board to prepare an annual statement of the required contribution rate which "after approval by the legislature, shall be payable by employers" has been on the books since 1953. The Legislature appears to have raised contribution rates three times between 1953 and 1965, and then increases became somewhat routine during the late 60s and throughout the

1970's. It stopped abruptly with the contribution increase of 1981. Although no formal documentation exists, we assume mutual agreement between the board and the legislature set the rate at a fixed level. The board has worked inside this rate for the last twenty-six years.

It is a noble pursuit to try to "assist retirees in maintaining the purchasing power" of their benefits. It is also an expensive one. We don't believe Social Security, with its funding problems, is the model this board wants to follow. The problems being faced by the board are not unique. As was mentioned, Montana has reduced its "guaranteed" increases by half. The automatic COLAs are the most expensive part of a pension plan and are a large part of the funding issues being experienced around the country. Most private defined benefit plans do not include COLAs.

The board should be applauded for their persistence in providing the highest benefit possible inside the statutory contribution rate. It seems logical to pursue investment returns rather than ask for contribution increases until it's obvious that any meaningful increase will require contribution increases. The last page of this response is a simple illustration of the cold hard fact that the only way this "Puppy" can grow to fit the collar is to be fed by investment returns and contribution increases over time. If the "Puppy" doesn't grow, actuarially sound COLAs are likely to be limited to something less than the maximum of 3%. The board looks forward to a discussion with the legislature on the advantages and disadvantages of providing a "guaranteed" COLA.

Page 61, paragraph 2, discusses the abandonment of the planning process and the ignoring of the Comprehensive Benefit Plan. Although not intentional, the updating of the plan was not pursued because of the funding issues brought on by the poor investment returns of the early 2000s. The goal of the 3% COLA, although reached in 2001, has receded back to the 1% level. It is still the goal of the board to bring the COLA back to the 3% level. That being said, we will revisit the CBP in the next year and update it to match current circumstances.

Recommendation: WRS should develop a proposal for the Legislature to consider, revising WRS agency status and giving it more flexibility to carry out required functions.

Response: AGREE.

W.S. 9-3-403 begins "The responsibility for the administration and operation of the retirement system is vested solely and exclusively in the Wyoming retirement board." In addition, W.S. 9-3-443(a) states "A Trustee or other fiduciary who breaches a duty imposed by this act is personally liable to a retirement system for any losses resulting from the breach…" These two statutes make it very clear that the responsibility for the system and the liability for breaching that responsibility rest solely with the board.

The administrative costs of the system are not covered through the General Fund but are financed through the Retirement Trust Fund. The board is cognizant that administrative expenditures have a direct impact on the ability to pay benefits and have been judicious in their use of pension fund money. Fees for money management firms, consulting firms and advisors have always been foremost is any selection process. Because of the personal liability issues the board should be expected to follow the same judicious path in the staffing and budgeting arena.

The board has proven over the years that it takes its fiduciary responsibilities seriously. That can be demonstrated by the oversight of this program through good and poor investment periods and the continued efficiency and effectiveness of the system. It is the board who understands the needs of the program, and it is the board that is personally liable for a failure of this system. The program is growing and the expertise needs to grow with it.

The concerns are real. To hire a chief investment officer with the experience to manage a $6 billion institutional portfolio will most likely require bringing someone in from outside of Wyoming. Talented computer programming personnel and statistical analysts are expensive and hard to recruit. The need for legal expertise when contracting with multi-national investment firms is also evident. The potential retirement of both the Director and Deputy Director add to the immediacy of this problem. The political reality of getting additional staff through the budgeting process is unpredictable at best and, in the current climate, doubtful. Staffing and the funding of operations should be the board's decision and not dependent on the political winds of the day.

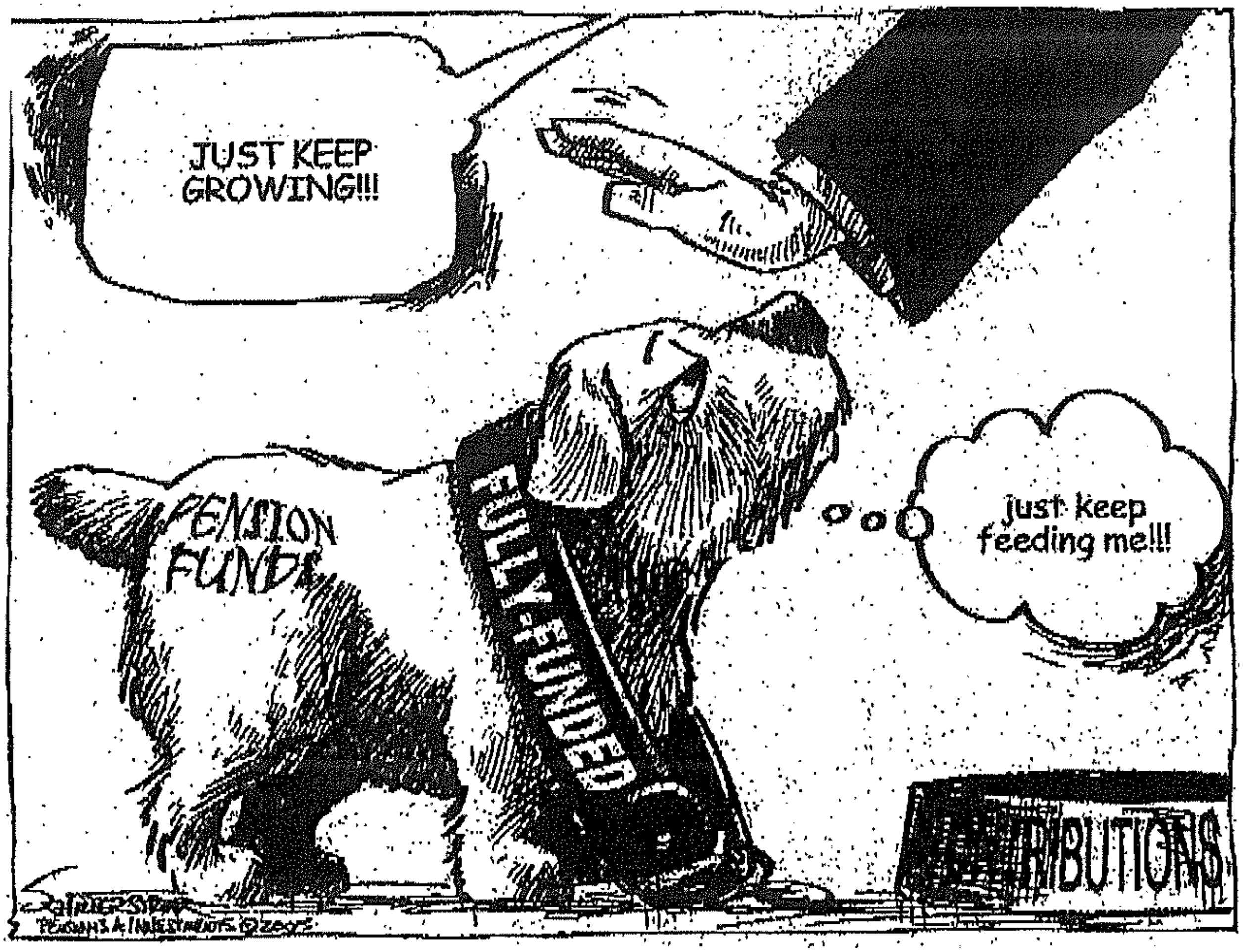
The board fully supports this recommendation, is prepared to develop a proposal, and asks that the committee be willing to sponsor the proposed legislation.

Recommendation: The Legislature should consider designating a committee to have formal oversight and regular interaction with WRS.

Response: AGREE

The current system of using legislative liaisons has worked well and was a great improvement from the haphazard communication between the board and the legislature prior to 1997. The liaisons have provided advice to the board during meetings and have provided expertise on the programs to their legislative bodies. Although the liaison program was not designed to provide a venue of support, they have been a great source for needed sponsorship of board legislative proposals. The time may come when the legislature views that support as not being totally impartial. A standing committee may be perceived as more independent when assessing the needs of the programs and also would expand the board's exposure to more members of the legislature.

If the previous recommendations come to fruition, it will be that much more necessary to keep the legislature informed on the workings of the system to assure proper funding. Most retirement bills involve the allocation of funds and in some manner or another end up in the appropriations committees. The board is of the opinion that the intricate nature of the pension programs is suitable to the expertise required of that committee. Two of the current liaisons are assigned to the Senate Appropriations Committee and because most of the pension bills ultimately are reviewed by the committee, it would be an appropriate starting point to evaluate proposed pension legislation.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