



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 4, 2001

Joint Committee on Finance

Paper #415

Additional Resources for Act 11 Implementation Costs (ETF)

CURRENT LAW

A biennial appropriation [s. 20.515(1)(v)] exists under the Department of Employee Trust Funds (ETF) to support the costs associated with implementing major retirement benefit improvements contained in 1999 Wisconsin Act 11. The appropriation is currently funded at \$1,575,700 SEG in 1999-00 and \$1,639,800 SEG in 2000-01 and supports 19.0 SEG two-year project positions. The 2000-01 funding amounts reflect the impact of a \$1,055,700 SEG supplementation by this Committee on April 24, 2001. The appropriation will be repealed on July 1, 2001.

GOVERNOR

No provision.

DISCUSSION POINTS

1. On April 27, 2001, the Department of Employee Trust Funds (ETF) submitted a biennial budget amendment request to the Committee seeking: (a) an extension of the sunset date of the s. 20.515(1)(v) biennial appropriation until July 1, 2003; and (b) additional funding of \$4,763,800 SEG in 2001-02 and \$453,700 SEG in 2002-03 and authorization for 20.0 SEG, two-year project positions to implement the provisions of Act 11, once the Wisconsin Supreme Court rules on the legality of various provisions of the legislation.

2. During the fall of 1999, the Legislature enacted 1999 Assembly Bill 495, which made a number of significant changes to the benefits available under the Wisconsin Retirement System (WRS) and to the manner by which the WRS would be funded. Funding was also provided

in the 1999-01 state budget under a new biennial appropriation in ETF for 75% of the total funding that the agency had initially identified that it might need to implement this legislation. The expectation was that ETF would request additional funding from this Committee under s. 13.10 procedures, once the full scope of the agency's implementation requirements was better known and any court challenges were resolved.

3. The retirement legislation was published on December 29, 1999, as 1999 Wisconsin Act 11. It would have become effective the following day; however, on the same day that the Act was published, the Wisconsin Supreme Court granted an injunction barring its implementation until the Court heard arguments on and issued an opinion in, the matter of *Wisconsin Professional Police Association, Inc., et al. v. Lightbourn, et al.*, which challenged a number of the principal provisions of the legislation. Although implementation of any of the new rights and benefits created by Act 11 was enjoined, the Court did authorize ETF to take "such contingent and preparatory measures toward implementation of the Legislation as they may deem appropriate in their discretion and consistent with their fiduciary and other duties and responsibilities for administering the public employee trust fund."

4. On October 4, 2000, the Court heard oral arguments on the case. At this writing, the Court has not yet issued its opinion on the matter.

5. Act 11 contained the following major benefit improvements and WRS funding modifications. Many of these provisions, if upheld by the Court, are expected to have important workload consequences for the Department.

- The formula factor used for retirement annuity calculations was increased by 0.165% for each WRS participant category for service earned before January 1, 2000. Current law factors continue to apply for service earned from January 1, 2000. Participants must be actively employed on or after January 1, 2000, for the provision to apply.

- Participation in the Variable Trust was reopened to participating active employees on or after January 1, 2001.

- The current formula benefit maximum of 65% of final average earnings was increased to 70% for general category participants and for elected and state executive category employees.

- A one-time \$4.0 billion distribution was made from unrecognized investment earnings in the Fixed Trust's Transaction Amortization Account (TAA) for distribution to the employee, employer and annuity reserves. Of the amounts distributed to the employer reserve, the first \$200 million will be used to establish a credit account for each employer to pay unfunded liabilities of the employer and then to pay employer-required contributions.

- The 5.0% annual interest crediting cap was eliminated for WRS participants hired after 1981 and interest crediting at the effective rate of earnings was restored for participants actively employed on the general effective date of Act 11.

- Death benefits for participants under age 55 (under age 50 for protective service participants) would include both the employee-required contributions and the matching employer contributions. Additionally, death benefit payments could be made to any beneficiary who is a person or a trust.

- The TAA was frozen and eliminated over a 5-year period and replaced with a new Market Recognition Account designed to flow changes in investment results into the WRS more rapidly than had been the case with the TAA.

- The underlying actuarial assumptions governing the funding needs of the WRS were changed. The Fixed Trust's assumption of long-term across-the-board salary increases for the purpose of valuing liabilities of the WRS of 4.8% (or 3.2% less than the current 8.0% long term investment earnings assumption) was reduced to 4.6% (or 3.4% less than the current 8.0% long term investment earnings assumption).

6. Consistent with the Supreme Court's injunction, which authorized the Department to continue making contingent preparations for the implementation of 1999 Wisconsin Act 11, ETF has been engaged since early in calendar year 2000 with an extensive effort to reprogram several hundred computer program modules, draft redesigned forms and brochures, and revise a variety of operational procedures in anticipation of the Court's ruling.

7. While a majority of the reprogramming effort has been completed, the agency indicates that there are significant components for which contract programmers will still be required, and many of the revised systems must be tested before they can be placed into service.

8. The Department anticipates that when the Court issues its ruling, and assuming that most of the provisions of Act 11 would be upheld, the agency will be required to undertake the following activities:

- First, it must make retroactive interest crediting adjustments to those active participants first hired before 1982 to reflect the impact of any accelerated distributions from the TAA authorized by the Court. In addition, if authorized by the Court, effective rate interest crediting would have to be applied to post 1981 active participants, retroactive to 1999 account year balances. It is anticipated that these types of adjustments would affect approximately 190,000 participant accounts.

- Second, an estimated 100,000 annuitant accounts will require multiple adjustments to correctly reflect the retirement dividend that would have been payable for 2000 and 2001, to the extent that Act 11 is ruled constitutional. Previously, retirement dividends for these years had been computed and distributed based on the current law flow of investment earnings into the WRS annuity reserve and did not reflect any extraordinary transfers from the TAA or the impact of

replacing the TAA with a new Market Recognition Account.

- Third, the accounts of approximately 16,200 participants who have retired since January 1, 2000, will require multiple recalculations to correct the cumulative impact of benefit underpayments. When these individuals initially retired, their annuity had to be calculated on current law provisions and could not factor in the impact of any Act 11 provisions, to the extent authorized by the Court.

- Finally, approximately 350 annuitants are leaving the retirement system roles each month because of death and the Department will be required to separately recalculate the adjustments that would have been payable to these individuals up to the time of their death due to the impact of any Act 11 provisions, to the extent authorized by the Court. The Department will have to make the necessary correction payments either to the decedent's beneficiary or to their estate.

9. Once the Court renders a decision, the Department anticipates an on-going need for project staffing during the next biennium to manage an increased volume of Act 11-generated Call Center inquiries, additional pre-retirement counseling workload and other activities such as an increased volume of estimated benefit calculations and inquiries about reopening participation in the Variable Trust.

10. The Department has developed the following proposed budget for its projected Act 11 implementation costs during each fiscal year of the next biennium, assuming that the Supreme Court acts to uphold most of the provisions of the legislation.

**Requested Additional Funding for
Act 11 Implementation Costs during the 2001-03 Biennium**

<u>Cost Category</u>	<u>Request for 2001-02</u>	<u>Request for 2002-03</u>
ETF Staff Costs		
20.0 FTE Project Positions, Staff Overtime and Extra Hours	\$740,100	\$320,400
Supplies and Services Costs		
DOA Information Technology Charges	866,100	70,600
Programming, Applications Development and Data Entry Contractual Services	2,752,400	4,600
Printing Revised Forms and Brochures	95,000	5,000
Postage for Retirement Packets and Employer Bulletins	230,000	10,000
Actuarial Services	30,000	\$0
Private Space Rental	32,200	26,300
Office Supplies	<u>18,000</u>	<u>16,800</u>
Total	\$4,763,800	453,700

11. The principal unknowns ultimately affecting the actual amount of the Department's funding needs in the next biennium are: (a) when the Supreme Court will act on Act 11; (b) and how it will rule when it does issue its opinion. There is no way of knowing how or when the Court will act on this matter, although a determination is likely before the Court ends its current term in June.

12. The Department believes that many of the Act 11 benefit improvement provisions will likely be upheld by the Court, and the agency would need to move in an expeditious manner to implement those provisions once the Court does rule. From the standpoint of the Department, this view argues that the most prudent course is to make the entire amount of the required supplement immediately available to the agency so that it has maximum flexibility in responding to the Court's decision. If the Committee finds this view persuasive, it could extend the current July 1, 2001, sunset on the agency's s. 20.515(1)(v) appropriation until July 1, 2003, and provide \$4,763,800 SEG in 2001-02 and \$453,700 SEG in 2002-03 and 20.0 SEG two-year project positions to implement the provisions of Act 11, once the Wisconsin Supreme Court rules on the legality of various provisions of the legislation.

13. The Committee might view it as more prudent to wait until the full nature and extent of the Court's ruling are known before providing the agency with the levels of funding it has requested for Act 11 implementation. Under this alternative, the Committee could act to extend the current July 1, 2001 sunset on the agency's s. 20.515(1)(v) appropriation until July 1, 2003. The Committee could also appropriate at this time approximately one-third (\$1,600,000 SEG) of the total funding initially requested for the 2001-02 fiscal year and authorize 20.0 SEG two-year project positions. This level of funding should be sufficient to support the agency's initial Act 11 implementation efforts.

14. These funds would be budgeted in unallotted reserve for release to ETF by DOA, based on when the Supreme Court's Act 11 decision is handed down, its workload impact on the Department and ETF's actual need for the funds. Under DOA's ordinary procedures governing agency operations if the state budget is not in place by July 1, 2001, if the budget bill advances with an extension of the sunset date on ETF's Act 11 implementation appropriation, DOA would normally authorize ETF to continue expending at the appropriation's base level.

15. To the extent that ETF would ultimately need more than the \$1,600,000 SEG initially provided under this alternative, it could return to this Committee under s. 13.10 for a further supplementation once the full extent of its funding requirements for the remainder of the biennium were known.

ALTERNATIVES TO BASE

1. Extend the sunset date of the s. 20.515(1)(v) biennial appropriation until July 1, 2003, provide \$4,763,800 SEG in 2001-02 and \$453,700 SEG in 2002-03 and authorize 20.0 SEG two-year project positions to implement the provisions of Act 11, once the Wisconsin Supreme

Court rules on the legality of various provisions of the legislation. *[This alternative would adopt ETF's April 27, 2001, biennial budget amendment request in its entirety.]*

Alternative 1	SEG
2001-03 FUNDING (Change to Base)	\$5,217,500
<i>[Change to Bill]</i>	<i>\$5,217,500]</i>
2002-03 POSITIONS (Change to Base)	20.00
<i>[Change to Bill]</i>	<i>20.00]</i>

2. Extend the sunset date of the s. 20.515(1)(v) biennial appropriation until July 1, 2003, provide \$1,600,000 SEG in 2001-02 and authorize 20.0 SEG two-year project positions to implement the provisions of Act 11, once the Wisconsin Supreme Court rules on the legality of various provisions of the legislation. Budget these funds in unallotted reserve for release to ETF by DOA, based on when the Supreme Court's Act 11 decision is handed down, the decision's workload impact on the Department and ETF's actual need for the funds.

Alternative 2	SEG
2001-03 FUNDING (Change to Base)	\$1,600,000
<i>[Change to Bill]</i>	<i>\$1,600,000]</i>
2002-03 POSITIONS (Change to Base)	20.00
<i>[Change to Bill]</i>	<i>20.00]</i>

3. Maintain current law.

Prepared by: Tony Mason