
Should I Join the Variable Trust?

University of Wisconsin System
Administration - July 2001

This presentation is intended:

- To explain the role of the Variable Fund in Wisconsin Retirement System benefits
- To give you information about your opportunity to elect to participate in the Variable Fund

Your UW pension

- Like nearly all permanent employees of state and local government in Wisconsin, UW employees participate in the Wisconsin Retirement System (WRS)
- Through the WRS, retirement assets are accumulated to distribute to you when you retire, die, or leave WRS-covered employment.

Your WRS account

- The University contributes 10% of salary (differs for executives, protectives, a few others)
- Your account shares in WRS investment returns
- Your benefits are partly or wholly based on your account balance

How are WRS assets managed?

- The State of Wisconsin Investment Board (SWIB) manages state and local government moneys in Wisconsin
- The WRS has two Funds: the Fixed and the Variable
- Both Funds are managed by SWIB
- SWIB's web-site:
<http://www.swib.state.wi.us/>

Your WRS account earnings

If you were hired before 1982:

- Your account earns interest at the actual rate credited to the WRS Fixed Fund
- If you chose to be in the Variable Fund before 1981, up to 50% of your account earns at the Variable rate

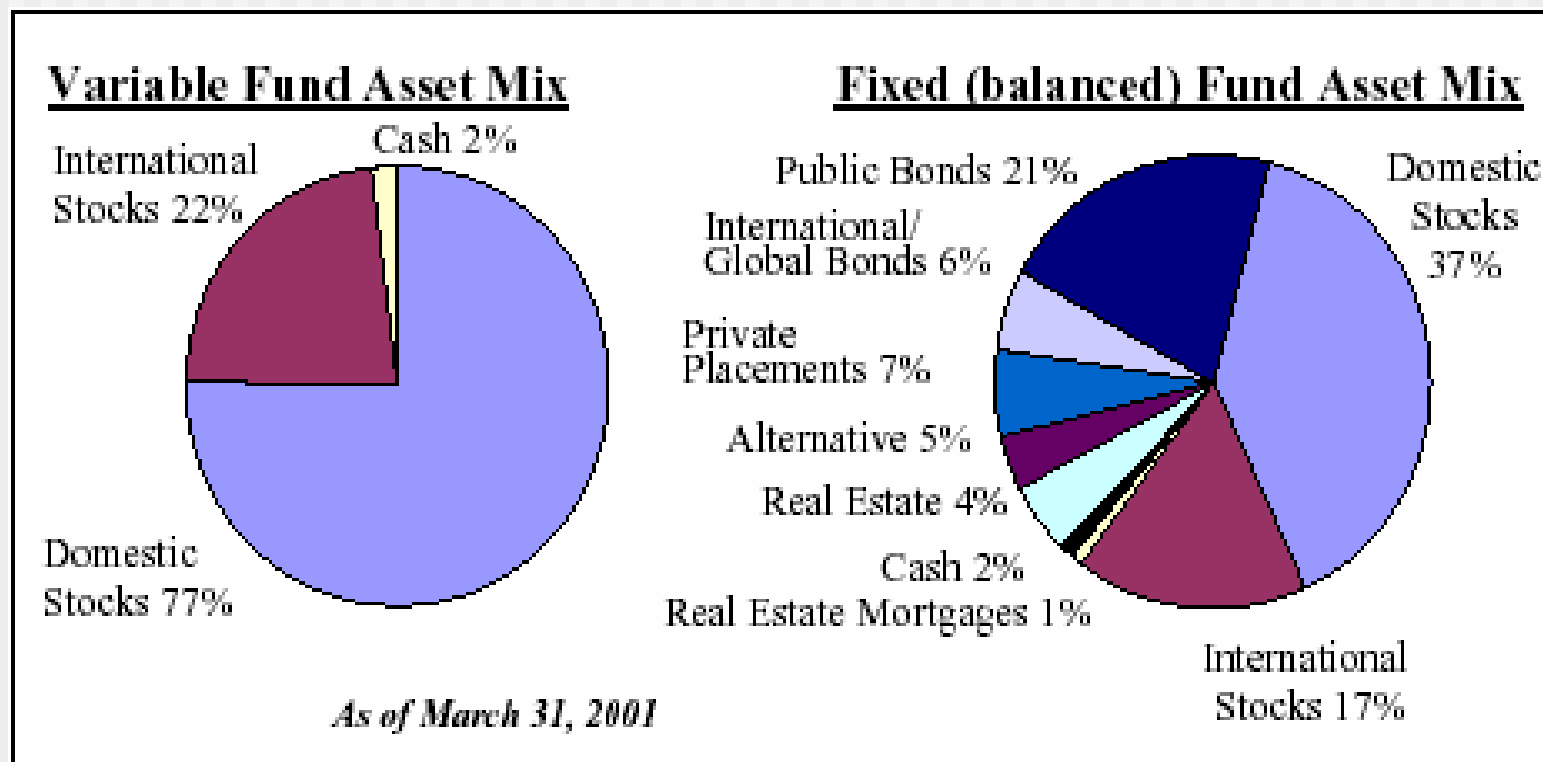
If you were hired after 1981:

- Your account earned a guaranteed 5% annually until 1999.
- New legislation (Act 11) gave you the actual Fixed rate starting in 1999
- . . . And the option of Variable starting in 2001

About the Funds

- As of 12/31/2002, 58% of Fixed assets were invested in exactly the same domestic and international stock portfolios as Variable assets
- The Fixed Fund also invests in bonds, real estate and loans to companies. These “fixed” investments are intended to give more stability to the Fixed Fund.
- The Variable Fund was closed to new participants between 1980 and 2001.

How are WRS assets invested?



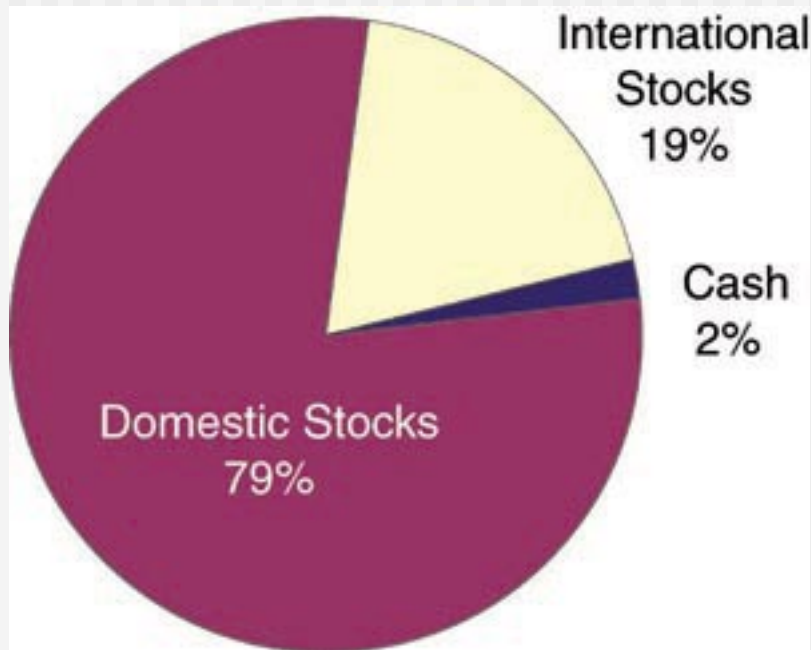
\$7.3 bill. as of 12/31/00

\$54.8 bill. as of 12/31/00

Source: State of Wisconsin Investment Board

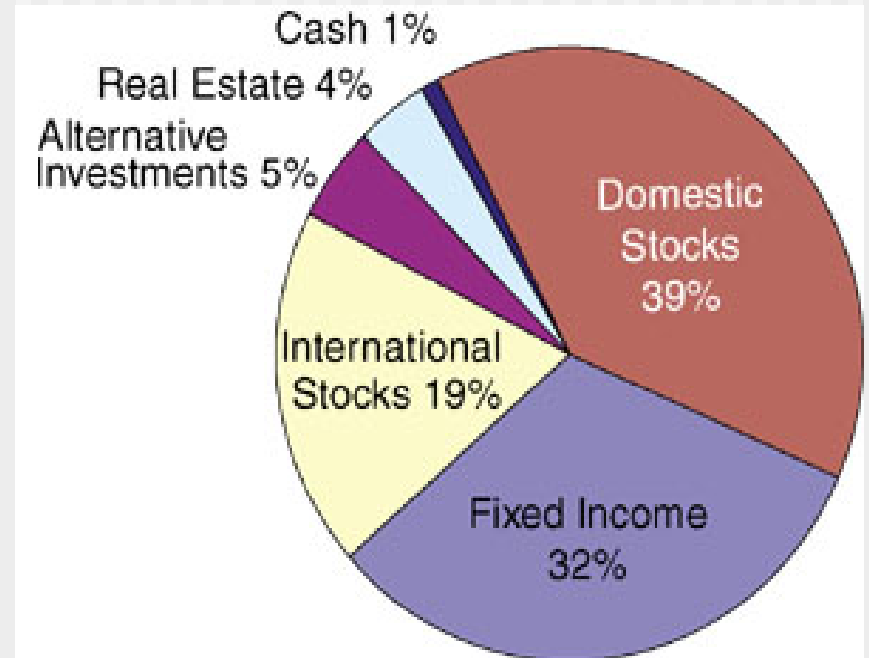
How are WRS assets invested?

Variable Fund Asset Mix



\$4.7 billion

Fixed (Balanced) Fund Asset Mix



\$46.3 billion

As of December 31, 2002

Source: State of Wisconsin Investment Board

Should I elect Variable?

Just answer this basic question: How do you want to invest your **FUTURE** WRS contributions (usually 10% of salary)?

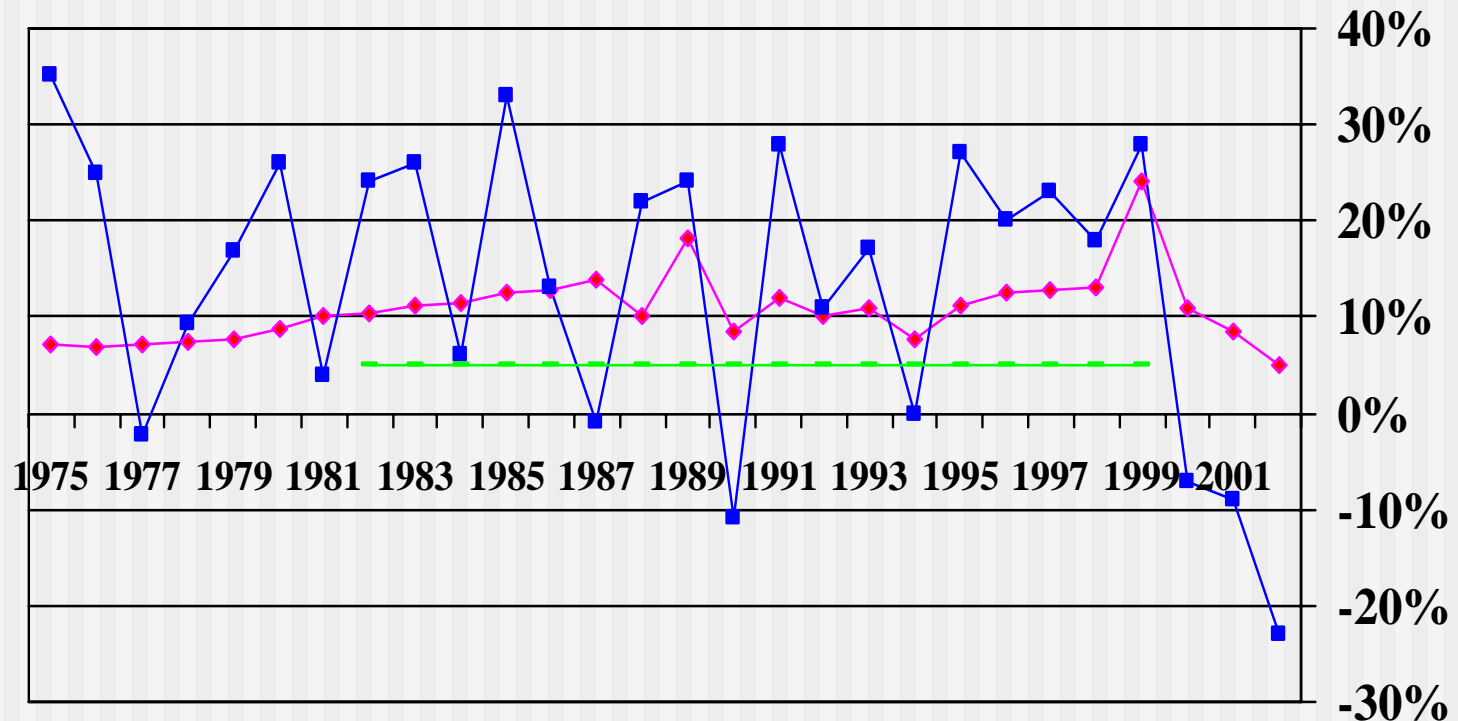
- All in the Fixed, a fund that is about 55-60% stocks and 40-45% bonds, loans, and other fixed investments, OR
- Half in the Fixed and half in the Variable, a fund that is 98% stocks, including about 20% international stocks?

Will I earn more in the Variable?

Maybe, but remember:

- Choosing Variable only affects the way one-half of your **FUTURE** contributions are invested
- The Variable Fund can be very volatile, as the next slide shows

WRS Returns, 1975-2002



◆ Fixed ■ Variable - - - 5% cap

Fixed vs. Variable returns

- From 1975 to 2002, the Fixed Fund averaged 10.8% per year (including extraordinary dividend distributions in 1989 and 1999). The Variable Fund averaged 13.7%
- The Fixed Fund had a “smoothing mechanism.” High returns raised the Fixed rate by a relatively small annual amount for several years; a bad year lowered it by a small amount over several years
- Under new legislation (1999 Act 11) the Fixed Fund still has a smoothing mechanism, but it is less powerful than before
- The Variable Fund has no smoothing mechanism: participants get the full market return each year

Can I lose money in the Variable?

Yes! The Variable Fund had negative returns for three years in a row, 2000-2002.

- If your WRS pension is money-purchase*, your annuity will directly reflect any investment losses (Fixed as well as Variable).
- If your WRS pension is formula*, you profit from Variable participation only if the Variable Fund out-performs the Fixed Fund over time, giving you a "Variable Excess."
If the Fixed Fund out-performs the Variable Fund over time, you will have a "Variable Deficiency" that lowers your formula benefit

*See slide 22 for a definition.

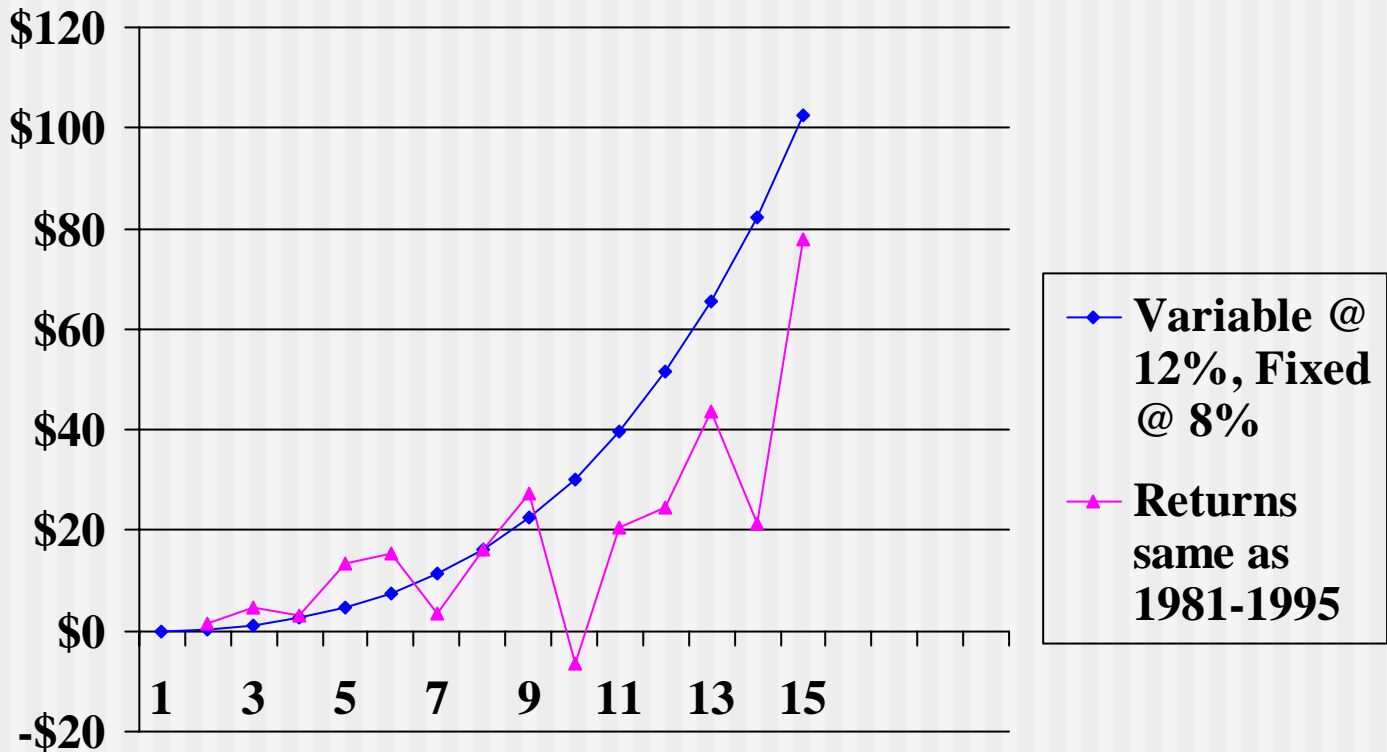
How much more could I earn with Variable?

The next slide shows two scenarios.

Assume that:

- Your salary is \$30,000 per year and you get a 2% raise each year
- You are age 45 or older now, and you will retire at age 60
- The Fixed Fund earns a steady 8% and the Variable a steady 12% (blue line) OR
- Fixed and Variable returns are the same as in the years 1981-1995 (pink line)

Hypothetical additional monthly benefit at age 60 due to Variable participation



Years of Work before Age 60 (retirement)

Conclusions:

- In both scenarios, the extra benefit is fairly insignificant until you've contributed to the Variable for about 10 years
- Under the assumptions used here, if you invest in the Variable for 15 years, your additional benefit could be \$80 to \$100 per month.
- BUT you could also experience a loss, as shown in year 10.

Cautions

- It is *unlikely* that the Fixed and Variable will have steady, stable returns every year
- Although stocks have outperformed bonds historically, there are no certainties, especially in the short run
- Past experience is *no guarantee* of future performance

Three complications . . .

Act 11 makes important changes to the Fixed Fund that may affect your decision:

1. If you were restricted to a guaranteed 5% interest rate, you will now receive the actual Fixed earnings rate on your Fixed account
2. Accumulated gains to the Fixed Fund as of 1999 will be paid out to Fixed accounts over five years (2000-2004). During these years, the Fixed return is expected to be 2% to 4% higher than it would be otherwise.

Three complications, cont.

3. As a result of accounting changes in Act 11, Fixed gains or losses will be distributed faster than in the past. Both good and bad years will be felt more immediately.

Result: The difference between Fixed and Variable returns may be less significant to you, and have less impact on your benefits, than in the past.

To summarize,

- The Variable Fund is likely to be more volatile than the Fixed Fund
- The greater the difference between the Fixed return and the Variable return, the greater your reward for electing the Variable
- When the Fixed Fund out-performs the Variable, Variable Excess balances drop
- If you have less than ten years until retirement, choosing the Variable may not make much difference to you

Your WRS retirement benefit

Your basic benefit* is the larger of:

- Your years of service, times your final average earnings, times a **formula** factor, or
- Your total “employee-required” account, plus a 100% match from the employer account, times a **money-purchase** factor based on your age

*Your basic benefit is reduced if you retire early or select an annuity that includes a guaranteed death benefit.

How does being in the Variable affect my money purchase benefit?

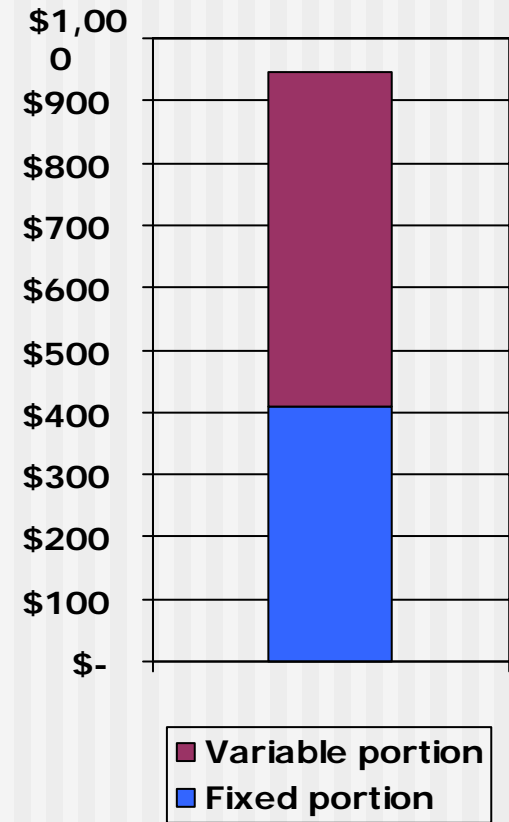
Example:

Fixed
Account =
\$65,000

Variable
Account =
\$85,000

M.P. factor =
.0063

- In a money-purchase benefit, the extra money you earned by being in the Variable is included in the money-purchase calculation



How does being in the Variable affect my formula benefit?

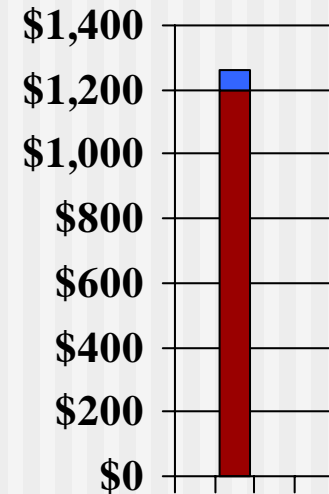
Example:

Formula benefit = \$1200/mo

Variable Excess = \$10,000

M.P. factor = .0063

- In a formula benefit, your "Variable Excess" --the extra money you earned by being in the Variable as compared to the Fixed--is added to your formula annuity as a money-purchase annuity



■ Variable Add-on
■ Formula Benefit

What happens to my Variable investment after I retire?

- Your annuity will have two parts:
 - The Fixed part will receive dividends from the Fixed Fund (if fund gains are high enough)
 - The Variable part will increase or decrease annually to reflect Variable Fund gains or losses
- The relative size of the two parts will vary from year to year

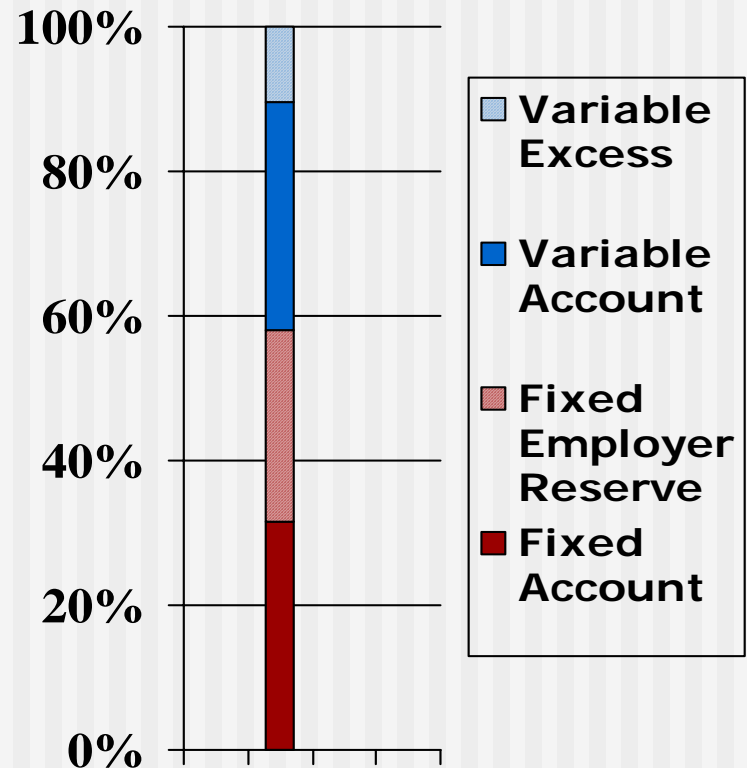
How much of my annuity will be in Variable?

- In a **money purchase** annuity, the Variable portion is proportional to the amount of your total account that is in Variable
- If you receive a **formula** annuity, it is worth more, by definition, than your WRS account. The extra funding comes from the employer reserve and is 100% Fixed. Therefore your Variable annuity will probably start out at less than 50% of the total.

Allocation of a formula benefit between Fixed and Variable

Example:

- Fixed Account Total = \$75,000
- Variable Account Total = \$100,000
- Total benefit = \$1,042.50 formula + \$157.50 from Variable Excess
- Value of total benefit at age 60 = \$238,095
- Shortfall in value of formula benefit is made up from Fixed employer reserve



How do I elect Variable participation?

- Active employees have one opportunity to elect Variable participation by filing a form with the Department of Employee Trust Funds
- You can do this any time. There is no 'window' of opportunity or deadline
- Use 'Election to Participate in the Variable Fund' (Form number ET-2356) - at etf.wi.gov

What happens when I elect Variable?

Starting January 1 of the year after you file your election:

- 50% of your **FUTURE** contributions are invested in the Variable Fund
- Your prior account balance and 50% of future contributions stay in the Fixed Fund
- Fixed and Variable earnings/losses are posted at the **end** of each year based on the **January 1** balance.

When will I see the results of my Variable election?

If you elect Variable effective January 1, 2004,

- You will earn the Variable return on your Variable balance starting January 1, 2005
- You will first see Variable earnings on the statement you receive in **May, 2006**
- Variable returns in 2003 and 2004 will not affect you

Can I get OUT of the Variable?

- Yes. You can cancel at any time, before or after retirement, by filing a cancellation notice (Form ET-2313) with the Department of Employee Trust Funds
- The Variable cancellation is effective on January 1 of the year after the form is received by DETF.
- The cancellation, when received by DETF, cannot be withdrawn.

What happens to my account if I cancel?

You may elect to:

- Leave your Variable balance in the Variable Fund, or
- Transfer the balance to the Fixed Fund, or
- Conditionally transfer the balance to the Fixed. This means that it is moved the next time your year-end total Variable investment breaks even compared to Fixed

Will I lose my Variable Excess/Deficiency if I cancel?

No.

- If you move your Variable account to the Fixed Fund, your Variable Excess/Deficiency will be tracked separately and will grow at the Fixed rate. A deficiency, if any, will *increase* over time!
- If you do not move your Variable account to the Fixed Fund, your Variable account will continue to gain or lose at the Variable rate.

Can I cancel Variable, then rejoin?

If you elect participation in the Variable Fund and later cancel, you cannot get back in unless:

- You cease all WRS covered employment AND
- Take a separation benefit that closes your account and forfeits all WRS service AND
- Later return to WRS covered employment

For additional information:

- [Department of Employee Trust Funds](#)
 - May and September 2000 issues of *Trust Fund News*
 - Form 4930, "How participation in the variable trust affects your WRS benefit"
- Investment information from the [State of Wisconsin Investment Board](#)
- DETF Telephone Message Center:
1-800-991-5540, codes 10125 and 10130

Variable Fund Investment....

If you decide to participate, view it as a long term investment.

Prepared by the UWSA Office of Staff Benefits. Last updated April 3, 2003