



May 3, 2011

Honorable Robert Cowles, Co-Chair  
Joint Legislative Audit Committee  
Room 118 South, State Capitol  
Madison, WI 53702

Honorable Samantha Kerkman, Co-Chair  
Joint Legislative Audit Committee  
Room 315 North, State Capitol  
Madison, WI 53702

Re: Audit Report #10-14, State of Wisconsin Investment Board (SWIB)

Dear Senator Cowles and Representative Kerkman:

This letter is a follow-up to the audit.

To design a funding plan for the Wisconsin Retirement System (WRS), there are various assumptions made by the actuarial firm that performs the annual valuations. Two key assumptions are the assumed rate of investment return and the assumed across-the-board growth in employee wages. Collectively they are called "economic assumptions," and while the ultimate cost of the pension plan is determined by what actually transpires over the years rather than the assumptions, the assumptions do significantly affect current required contributions.

In the fall of 2010, SWIB recommended to the Employee Trust Funds (ETF) Board that the two assumptions be reviewed. Our belief was that economic circumstances justified lowering both investment return and wage expectations for the longer term. Before the review, assumptions were for a long term 7.8% annualized investment return and 4.0% across-the-board wage growth. The Legislative Audit Bureau agreed with the need for a review and recommended that SWIB and ETF report the outcome to the Legislature.

Both agencies worked closely with the WRS actuary in analyzing expectations. The actuary conducted an extensive review and analysis of the current assumptions in light of economic expectations for inflation and financial market returns. Ultimately, the actuary recommended revised assumptions of 7.2% for investment return and 3.2% for wage growth. In March 2011, the ETF Board agreed with the actuary's recommendation to use those assumptions in future actuarial valuations of the WRS.

The assumption changes have minimal or no impact on future required contributions. However, using the revised return assumption, we believe, provides a more realistic expectation given likely economic circumstances. Likewise, salary growth is likely to be subdued for some time. In the end, the effect should be more stability in contribution requirements.

The actuary is required by law to conduct a review of all economic and non-economic assumptions used in developing the funding plan for the WRS. The review is conducted every three years. The next scheduled review will occur in December 2012.

Sincerely,



Keith Bozarth, Executive Director  
State of WI Investment Board



Dave Stella, Secretary  
Dept. of Employee Trust Funds

cc: Joint Legislative Audit Committee Members  
Jan Mueller, Legislative Audit Bureau