EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE FEBRUARY 9, 2011 ANNUAL PENSION BOARD MEETING

1. Call to Order

   Chairman Mickey Maier called the meeting to order at 9:35 a.m. in the Grand Ballroom of the Italian Community Center, 631 East Chicago Street, Milwaukee, Wisconsin, 53202.

2. Roll Call

   Members Present:
   Linda Bedford (Vice Chair)
   Donald Cohen
   Keith Garland
   Mickey Maier (Chairman)
   Jeffrey Mawicke
   Dr. Sarah Peck
   Don Weber

   Members Excused:
   David Sikorski
   Guy Stuller

   Others Present:
   Mark Grady, Principal Assistant Corporation Counsel
   Marvin Pratt, County Executive
   Gerald J. Schroeder, ERS Manager
   Monique Taylor, ERS Clerical Specialist
   Marian Ninneman, Certified Employee Benefit Specialist
   Roger Kerkenbush, Assistant Fiscal Officer
   Steven Huff, Reinhart Boerner Van Deuren s.c.
   Robert J. Maurer, Robeco Boston Partners
   John Forelli, Robeco Boston Partners
   Brett Christenson, Marquette Associates, Inc.
   Ray Caprio, Marquette Associates, Inc.
   Larry Langer, Buck Consultants
   Matt Janes, Prior ERS Manager
   Marilyn Mayr, Prior Pension Board Member
   Cliff VanBeek, Prior Pension Board Member
   Esther Hussey, Prior Pension Board Member
   Bruce Richardson, Prior Pension Board Member
   Milwaukee County Retirees and other attendees

3. Remarks of Interim County Executive

Marian Ninneman introduced the members of the Pension Board and legal counsel.

Ms. Ninneman then introduced newly sworn County Executive Marvin Pratt, former Mayor of Milwaukee, and provided an overview of his career in public service and the military.

Mr. Pratt noted that he previously served on the City of Milwaukee Pension Board and understands the Board's fiduciary responsibility to the retirees. He stated that despite the challenges Milwaukee County faces and the fact that since 2008, at least 20 states have rolled back pension benefits or are seriously considering it, ERS is 85% funded and committed to the protection of its retirees. Mr. Pratt then noted that 70% of retirees received a monthly pension amount of $2,000 or less and 35% received $1,000 or less. With an annual average social security benefit of $1,700, that is a maximum of $3,700 for 70% of the retirees. Mr. Pratt indicated he hopes new County leadership continues to support the needs of the retirees.

4. Remarks of Pension Board Chairman

Ms. Ninneman introduced Pension Board Chairman Mickey Maier. The Chairman discussed the handout noting the accomplishments of the Pension Board. The Pension Board strives to invest the over $1.8 billion in Plan assets prudently to achieve the actuarial rate of return of 8% over a long period of time while taking on as little risk as possible. With the help of Marquette Associates, ERS has changed its asset allocation in order to broaden and diversify the assets in the Fund. As a result, the Fund had very positive rates of return in 2010.

The Chairman then discussed two responsibilities of the Pension Board. The first is ensuring that those entitled to receive ERS benefits do receive them, and that those not entitled do not receive them. The second is ensuring that the Board follows the rules established by the Internal Revenue Code and by County Ordinances. For these reasons, legal counsel is included in Board meetings.

5. Remarks of Interim Benefits Director

Ms. Ninneman introduced Gerry Schroeder, the Interim Benefits Director. Mr. Schroeder stated that, in response to frequently asked questions, pension checks will continue to be received, the ERS Fund is secure, and Milwaukee County is not on the verge of bankruptcy.

Mr. Schroeder then provided a profile of an ERS retiree. According to demographic information, the current ERS retiree population is approximately 60% female. Regarding age, 34% of the retirees are over 75 years old and 49% are between ages 61 and 75. Nearly 54% are single. Concerning the pension type, 72% selected a normal retirement.

Regarding pension options, 47% chose the maximum benefit option and 22% chose Option 3, which provides a reduced pension amount to the retiree while living and the same amount to a designated beneficiary upon death of the retiree. Relating to pension amounts, 41% have a monthly pension of $1000 to $2000 and 35% have a monthly pension amount less than $1,000. Approximately 87% of retirees live in Wisconsin, of which nearly 64% live in Milwaukee County. The most popular out-of-state retirement residences for ERS retirees are Arizona, Florida, Texas, California, and Nevada.

Mr. Schroeder then noted that administrative accomplishments for 2010 include the transition to electronic files, offsite storage, record formatting, file material protection, and the implementation of a fire suppression system. Additionally, the Trustee manual was updated, an employee retirement handbook was created, and ERS is now 100% direct deposit. Customer service accomplishments include a monthly ERS newsletter, community presentations, updated pension statements, and community resource guides. V3 system accomplishments include new releases and updates, programmed Ordinance amendments, and the generation of Form 1099s and pension statements. Operational accomplishments include customized group training, Pension Counselor Certification, and the adoption of a notarization process and an exit survey process for all retirees.

Mr. Schroeder then indicated that for quality assurance purposes, internal audits with random record sampling are being performed on the V3 system. Additionally, ERS developed a three-year fiscal strategic plan, in which fiscal operations will check payments and implement controls recommended by auditors, and a five-year V3 strategic plan that includes upgrades and enhancements to grow the system. ERS paid $12 million for the V3 system and wants to appropriately maintain it.

Mr. Schroeder then stated that 2011 goals include the development of an operational strategic plan, internal ERS audits, a three-level review of outgoing payments, the implementation of video conferencing, and the development of customized individual training.

6. <u>ERS Fund Results, Asset Allocation Strategy, and Update</u>

Ms. Ninneman introduced Brett Christenson of Marquette Associates, the Investment Consultant for ERS. Mr. Christenson stated that total assets at the end of 2010 were approximately $1.9 billion, of which 30–32% were in fixed income, or bonds. This asset class is an anchor of the portfolio because it provides stability to the Fund. U.S. equity at 23% of the assets, and international equity at 18%, are targeted to the stock market. Long/short equity at 10% is a more conservative way of investing in the stock market. This asset class is less volatile and protects money when the market is down. Real estate and infrastructure asset classes invest in pipelines, utilities, roads, bridges, and ports. These portfolios, at 14% of the asset class, are real assets owned by the Fund across the U.S. and globally. Private equity, at 3%, is an illiquid asset class. An initiative for 2011 is to continue to fund the real estate and private equity portfolios up to their targets because they are underweight by approximately 2% and 1½%, respectively.

Mr. Christenson then discussed the Pension Fund versus its peer group. The ERS Fund is invested similarly to other public pension funds across the U.S. However, it is more conservatively invested in U.S. equity. This portfolio is underweight to the stock market, which reduces risk and volatility. These assets are invested in other areas, such as infrastructure or long/short equity, to help diversify assets without compromising return. Marquette plans to keep risk low in the investment portfolio and is targeting an 8% rate of return over a long term.

Mr. Christenson stated that with a 2010 preliminary return of 12.2% and a 2009 return of 18.6%, it has been a strong two years of return for the Fund. In 2009, the Fund received proceeds of $400 million from pension obligation bonds of the County, and Marquette proposed an investment plan for the money in early 2009. The timing of the bond proceeds had a positive impact on the Fund and on the County. While 2008 was a very detrimental year to pension funds across the country and though the Fund lost 22.3% that year, 2009 was a strong year for returns. The Fund is expected to perform better than its peer group because it is conservatively invested.

Mr. Christenson then noted that the Fund is highly diversified with 17 different managers and over 25 different investment products. In 2010, a major initiative of the Board in terms of the investments was to diversify and reduce risk in the real estate portfolio. A structured, public search was performed to find more managers. The Pension Board considered any manager that fit the profile of the search. For this search, over 20 RFPs were received from real estate managers. The Board reduced that list to 6 managers and then interviewed them. Three new managers were hired, Morgan Stanley, American Realty, and UBS.

Mr. Christenson then provided a 2011 market preview. Marquette expects the economy to continue to grow and unemployment to remain at 9%, with the hope that it will decrease. For the time being, inflation is very contained and Marquette does not expect to see much inflation in 2011. In terms of fixed income, or the bond market, the bond portfolio of the Fund is currently yielding approximately 3½%, which is low. However, Marquette expects that interest rates will begin to increase back to historical levels closer to 5½– 6% over the next few years. In the U.S. equity portfolio, the stock market over the last two years is up over 45% and though it may seem like the market is overvalued, stocks are actually fairly priced according to Marquette. The value of the S&P 500 stocks is still below its long term average so the general consensus is that, despite the strong run in the stock market, the market may see good returns in 2011. Emerging markets in the international market, to which the Fund has exposure, have also had strong returns recently. Though it may seem the market is overpriced, the emerging markets have very low debt, compared to the developed countries like Japan, Europe, and even the U.S., so they are cutting back on spending which slows their economies. They also have much higher growth prospects going forward than a lot of the larger developed countries do, so there is potential for growth in this area.

Mr. Christenson continued that long/short equity is a conservative asset class. This market has skilled fundamental stock pickers that will add value in 2011. Strong companies with low debt, strong prospects for earnings, and low competition are the best stocks to invest in going forward. The real estate market is currently bifurcated. However, the real estate managers in the Fund use less than 40% debt in properties and they invest in trophy assets such as high-quality office buildings in major metropolitan areas. Marquette believes that these properties will continue to have strong returns in 2011. The real estate portfolio for the Fund was up almost 15% in 2010 and there will be room for growth in 2011. The private equity allocation to the Fund is small, but as the economy emerges from the credit crisis, companies that are invested here will continue to increase their values, which should benefit the Plan.

Mr. Christenson concluded by saying that the infrastructure asset class has a good yield of 8%. It is structured to generate a lot of income and is invested in assets such as utilities, pipelines, and roads and bridges that earn money from tolls. The Fund has a 7% allocation in this class to combat inflation and to provide yield in the meantime in a low yield environment.

7. Report of Buck Consultants, Actuary of ERS

Ms. Ninneman introduced Larry Langer of Buck Consultants, the actuary for ERS. Mr. Langer provided an overview of the actuarial valuation process and of the 2009 Plan Year, and a preview of the 2010 Plan Year.

Mr. Langer stated that actuaries develop an annual actuarial valuation for the Board that recommends the contribution amounts needed to ensure sufficient funds for member retirement. The Board then passes this information to the County Executive for approval and budget purposes. The actuarial valuation process includes collecting information from all ERS members to project the types of benefits that will be paid on their behalf. Additionally, actuarial, demographic, and funding assumptions are made. For example, rate of return over a very long period of time, or when people might retire, or the types of benefits that will need to be paid. This information, plus any known changes, is placed in a modeling system and an actuarial valuation report is produced. The current report indicates that approximately $2.4 billion is the total obligation to be paid off over time for memberships as of 2010, which Buck Consultants splits into small, affordable amounts for the County. The report also indicates that there are nearly 5,000 active members and approximately 7,400 retired members.

Mr. Langer reported that the 2009 rate of return was 20.4% for market assets and 3.9% for actuarial assets. Factors that helped stabilize the Fund include that projections and liabilities behaved as expected and plan amendments occurred, such as the multiplier for active members decreasing from 2% per year of service to 1.6%, and the retirement age increasing to age 64.

Mr. Langer further reported that the 2010 rate of return was 12% for market assets and 5% for actuarial assets. Liabilities are expected to be on target. Plan amendments added in 2010 include member contributions for non-represented and elected members.

Mr. Langer stated that the market value of assets is just under $1.9 billion. The actuarial value of assets is the smoothed, or average, value of assets, which is what Buck Consultants uses because it helps limit the amount of contribution volatility within the Plan and is more steady at just over $1.9 billion. In 2009, the actuarial value greatly increased due to the $400 million proceeds from pension obligation bonds. ERS had dropped to just under $1.2 billion before the money went in. After, it rose to just under $1.9 billion with investment returns over two years, so the timing for the pension obligation bond proceeds was excellent.

Mr. Langer then discussed actuarial accrued liability, which is the amount of money needed to pay benefits to all ERS members. The actuarial accrued liability as of January 2010 was just over $2 billion, which is the portion of the total $2.4 billion obligation that is allocated to past service. As of January 2011, it increased to just over $2.1 billion and it is anticipated that it will further increase as members accrue more benefits. That number is compared to the market value of assets available. As of 2010, approximately $0.87 on the dollar was available to pay for the benefits accrued today. That number has grown to 89% in the past year because of the increase to a 12% rate of return on assets, as opposed to 8%. The nationwide average for other retirement systems is 70–75%. There are sufficient funds to pay retirees.

Mr. Langer provided a history of the contributions that went into the Fund, not including the pension obligation bond proceeds and a 2010 contribution of approximately $30 million. He stated that if the Fund were ever 100% funded, cost of benefits accruing on a year-to-year basis for active members would be approximately $20 million per year. Mr. Langer then stated that contributions over the next thirty years are projected to increase. However, the 2010 provision changes will lower the contributions by $2 million less than what they otherwise would have been. These amounts do not include payment of the pension obligation bond proceeds.

Mr. Langer then commented that the County generally has been meeting its contribution obligation. Over the past 15 years, County contributions exceeded obligations by $400 million. While the proceeds from the pension obligation bonds is most of this excess, the County is generally meeting its obligations even without it.

Mr. Langer then stated that actuarial objectives for the 2011 Plan Year include determining actual contributions for 2011 and budgeting contributions for the 2012 Plan Year.

In response to question about whether the County has repaid the money it borrowed from the Fund, Mr. Langer stated that, in broad terms, County contributions have been more than sufficient, even without the pension obligation bond. The proceeds from the pension obligation bonds have more than offset the money that the County borrowed.

In response to a question from a retiree about the death of her husband and benefit amounts actually received, Mr. Schroeder suggested the retiree meet with him after the meeting so he could obtain the necessary information to research the situation.

8. <u>Remarks of Boston Partners</u>

Ms. Ninneman introduced Robert Maurer and John Forelli of Robeco Boston Partners, the fund managers for the large cap value equity fund.

Mr. Maurer provided some background on Robeco Boston Partners and its investment philosophy. Robeco Boston Partners is a value manager with a three-circle philosophy—valuation, business fundamentals, and catalyst for change. In valuation, the price to be paid for the fund shares is reviewed. In business fundamentals, the type of business bought for that price is considered. With catalyst, an analysis of what will unlock the value in the security is performed.

Mr. Maurer then discussed the 2010 large cap value fund return of 13.75%. The fund met its benchmark, which is the Russell 1000 Value, for 2010. The fund also met its benchmark over the past three years. The three-year number is actually a negative number; the fund was down 1%, but the market was down 4.4% . However, Robeco strives to protect funds on the downside. Overall, the return is approximately 10% per year, which is above the benchmark and the actuarial assumption.

Mr. Forelli reported that in 2011, the market and the ERS portfolio are off to a strong start. The portfolio is up about 6.6%, compared to about 5.3% in the market. Robeco tries to reduce the volatility of returns and seek consistent performance over time. Since Robeco has been managing this ERS fund, it has beaten the market 64% of the time in down markets and 56% of the time in up markets, which places Robeco in the top 5% of large cap value managers in the U.S. Over the last ten years, the portfolio exceeded the market return with less risk than the market as a whole. Each stock in the portfolio is measured on a daily basis and companies with consistent earnings that beat expectations are searched for.

Mr. Forelli stated that in the portfolio today are big investments in finance, health care, and technology. He anticipates GDP in the range of 3–4% in the United States in 2011. In November 2010, that number was closer to 2%. Going forward, Robeco expects an accelerating economy, an increase in capital spending, and an increase in manufacturing. Parts of the economy are doing better and the stock market has responded over the last two years. At the same time, unit labor costs are staying down, so currently there may not be a concern about inflation, although that is most likely one of the biggest risks going forward. Another risk is that the Federal Reserve is due to stop its bond purchasing at the end of June 2011. Investors could question whether the recovery seen today was lead by the Federal Reserve and whether it might stop when the Federal Reserve stops buying bonds. However, Robeco believes that the economy is really in the beginning stages of self-sustaining recovery.

In response to a question about the U.S. dollar and the price of gold, Mr. Forelli stated that the U.S. dollar has been the store value and the international currency since World War II. Mr. Forelli advised not turning U.S. dollars into gold because gold is a commodity that fluctuates in price, and its volatility is not necessarily good for retirees.

9. Questions and Answers

Ms. Ninneman called for questions and answers from those assembled.

In response to a question about the U.S. government debt and how it will affect the pension fund, Mr. Christenson stated the likely scenario is that inflation would occur in the economy as the government struggles to pay down that debt. Marquette, in conjunction with the Board, looked at a number of inflation scenarios and assets are diversified enough to hopefully perform in as many different scenarios going forward, regardless of whether inflation occurs or the stock market is strong.

In response to a question about the deferred compensation plan and Great West as its administrator, Mr. Grady stated that the deferred compensation plan does not fall under the responsibility of the Board. Mr. Grady noted that there is a five-member board that oversees the deferred compensation plan with representatives from County Board staff, corporation counsel, and administrative services, but that this Pension Board does not have anything to do with it. Mr. Grady asked the retiree to approach him after the meeting to discuss it further.

In response to a question about whether Scott Walker plans to do anything to affect pensions within the state of Wisconsin, Mr. Grady stated that Scott Walker has already discussed proposing changes to the state retirement system and employees' benefits.

In response to a question about the location of the Pension Board meetings, Ms. Ninneman stated that the monthly Pension Board meetings will continue to be held at the Marcus Center.

In response to a question about what the investors receive in terms of fees, Mr. Christenson stated that in the quarterly reports that Marquette provides to the Board, all fees are fully disclosed. In general, the fees that ERS pays to managers are well below industry standard, approximately ½% per year. The Fund is large enough that many managers are willing to reduce their fees. The 12.2% return is gross of fees, so after compensating for fees, the return for the year will likely be closer to 12%.

A retiree thanked the Board for a good program, but asked that the slides be easier to read. The retiree also stated that postponing the annual meeting by a month or two to accommodate the potential for bad weather would be helpful. The Chairman stated that the annual meeting occurs in February because the Board is trying to get results from the previous year out as soon as possible. However, the Board can discuss the possibility of changing the date.

A retiree commended the Board for its work, commenting that the Board is affecting the families and children of members, which is appreciated. The Chairman stated that the Pension Board takes its responsibilities very seriously.

In response to a question about the bank error in February of 2010, the Chairman stated that a bank error occurred where Wells Fargo Bank made erroneous deposits, but the errors were quickly corrected.

10. Adjournment

The meeting adjourned at 11:30 a.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board