EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE JULY 20, 2011 PENSION BOARD MEETING

1. Call to Order

Chairman Mickey Maier called the meeting to order at 8:35 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present
Linda Bedford (Vice Chair)
Keith Garland
Mickey Maier (Chairman)
Dr. Sarah Peck
David Sikorski

Member Excused
Dean Muller

Others Present
Kimberly Walker, Corporation Counsel
Mark Grady, Acting Deputy Corporation Counsel
Gerald Schroeder, ERS Manager
Marian Ninneman, Operations Manager, ERS
Dale Yerkes, ERS Fiscal Officer
Daniel Gopalan, Fiscal Officer Assistant
Vivian Aikin, ERS Administrative Specialist
Monique Taylor, ERS Clerical Specialist
Ken Loeffel, Retiree
Yvonne Mahoney, Retiree
Bess Frank, Retiree
Sushil Pillai, Joxel Group
Ray Caprio, Marquette Associates, Inc.
Brett Christenson, Marquette Associates, Inc.
Robert Pease, JP Morgan Asset Management
Brian Clarke, IFM
John Busch, Michael Best & Friedrich LLP
Steven Huff, Reinhart Boerner Van Deuren s.c.
Jessica Culotti, Reinhart Boerner Van Deuren s.c.
Wesley Anderson, Reinhart Boerner Van Deuren s.c.
Sara Stellpflug, Reinhart Boerner Van Deuren s.c.
Steve Oyler, Reinhart Boerner Van Deuren s.c.

3. Chairman's Report

The Chairman thanked the Board members for attending, noting that Mr. Muller was absent because of a prescheduled conflict.

The Chairman stated that with the recent elections for the employee and retiree seats, the Board will soon be operating with eight members. Additionally, the County Executive is in process of making appointments for the remaining terms that expired or are close to expiring.

The Chairman noted that there will not be an August Board, Investment Committee, or Audit Committee meeting. Activity will resume in September.

The Chairman then stated that the Board is preparing to issue an RFP for the actuarial services currently provided by Buck Consultants. Volunteers to serve on the RFP evaluation panel in late August would be welcome. Because of the nature of the Board and what is happening in the actuarial service marketplace, there will most likely be very few responses. Dr. Peck indicated she will try to be available, and Ms. Bedford stated that she will get back to the Chairman.

4. Minutes — June 15, 2011 Pension Board Meeting

The Pension Board reviewed the minutes of the June 15, 2011 Pension Board meeting.

The Pension Board unanimously approved the minutes of the June 15, 2011 Pension Board meeting. Motion by Ms. Bedford, seconded by Mr. Sikorski.

5. Reports of ERS Manager and Fiscal Officer

(a) Retirements Granted, June 2011

Ms. Ninneman presented the Retirements Granted Report for June 2011. Forty-one retirements were approved in June, with a total monthly payment amount of $64,321. Of those 41 retirements, 28 were normal retirements, 12 were deferred vested retirements, and 1 was an accidental disability pension. Twenty retirees elected backDROPs in amounts totaling $2,553,872. Of these 20 backDROPs, 9 were under $100,000 and 2 were over $300,000. Most retirees chose the maximum option, so there are no survivor benefits.

Ms. Ninneman also stated that of the 41 retirees, 26 were District Council 48 members, which may be a result of the Budget Repair Bill and employees not knowing how they will be affected.

In response to a question from the Chairman, Ms. Ninneman stated that employees are coming in both for meetings and to actually file retirement papers. Approximately 15 members filed retirement applications for future dates so that by the time they come in for their meetings, their applications will be processed.

(b) <u>ERS Monthly Activities Report, June 2011</u>

Ms. Ninneman presented the Monthly Activities Report for June 2011. ERS had 7,736 retirees at the end of June 2011, with a monthly payout of $15,750,246.

Ms. Ninneman stated that trends are continuing as they have through the first half of the year and ERS can now project certain totals. ERS anticipates approximately 458 retirement applications for 2011 and approximately 650 retirements. Deaths are higher this year due to the aging member population. Open records requests are also higher this year. Legal issues and compliance issues are higher, and ERS anticipates close to 75 for the year. ERS continues to review staff for efficiency improvements and training opportunities because ERS is anticipating 50 retirements per month as the new norm, well over the 20 retirements per month experienced over the last few years.

In response to a question from the Chairman, Ms. Ninneman stated that there is no immediate need for additional pension counselor staff. However, over the next five years ERS is projecting a further increase in the number of retirements and may need to increase staff as a result.

Mr. Schroeder then stated that ERS is expecting a decrease in retirements over the next few months, but that the fourth quarter is expected to be high in anticipation of Ordinance changes for 2012. Additionally, ERS had presented to the Audit Committee a rough draft of long-term projections. Revisions need to be made to the report, but the Retirement Office expects to present it to the full Board in September. The report supports that there are at least five years of over 50 retirements per month, which could extend out to ten years.

The Chairman then noted that this Board meeting is the last formal meeting that Mr. Schroeder will attend prior to his own retirement.

The Chairman thanked Mr. Schroeder, stating that he has been a great leader for ERS and that he will be missed, to which the Board agreed.

(c) Co-Development Progress Report

Sushil Pillai provided an update on the strategy to incorporate the Vitech capability into the ERS environment in order to provide services more quickly.

Mr. Pillai stated that the Vitech environment is an open source architecture broken into categories of complexity levels ranging from easy to expert. Rules and regulatory requirements for the more complex levels are incorporated into the system.

In response to a question from the Chairman, Mr. Pillai stated that open source architecture is based on not just an operation standpoint, but also an application and application development standpoint. The modules used are on an open source architecture or library using Java script.

In response to a question from Dr. Peck, Mr. Pillai stated that a benefit of open source architecture is the ability to download open source tools in order to share the working environment with Vitech. The system is broken into four integrated modules; Letters and Documents, Forms and Reports, Database Development, and Application Development. Making changes to the code is a shared process to ensure effective transition with Vitech. For example, the Application Development module has two components, Product and Development. On the Product side, only the Vitech product team is allowed to make changes. However, on the Development side, both ERS and the Vitech product team can make changes.

Mr. Pillai then stated that complexity levels for modifications are divided into easy, intermediate, advanced, and expert. By 2012, the goal is for ERS to handle all complexity levels. The advanced and expert level changes are expensive for Vitech to make, but ERS could be responsible for them with the proper amount of expertise in the easy and intermediate complexity levels.

Mr. Pillai then discussed the ERS and Vitech relationship. Vitech at any point has complete access to the system so Vitech can monitor it. ERS asked Vitech to be critical of ERS changes to the system to ensure ERS is in line with Vitech protocol and standards. The contract with Vitech states that this is a risk-sharing process, which means when ERS makes a change, Vitech reviews it prior to production to minimize risk. Because ERS is Vitech's client, Vitech has a vested interest in the results.

Mr. Pillai stated that co-development activities will be conducted in three phases. For Phase 1, in 2011, ERS will be responsible for high-volume easy and intermediate tasks. ERS is already beginning to gain knowledge by assuming responsibility for these tasks, and at a significant cost savings. The types of changes in this phase involve anything to do with documents, letters, reports, queries, and datasheets.

Mr. Pillai continued that Phase 2, in 2012, involves more intermediate and advanced changes, and potentially expert level changes, but still high-volume, cost-intensive changes. The types of changes in this phase involve things like rule changes. ERS will be able to make those changes, test them quickly, and then put them into production. By the end of 2012, 80% to 90% of this work will be brought in-house.

Mr. Pillai then stated that Phase 3, in 2013, includes ERS making any major rule changes that are County-specific. This will be reviewed more in-depth in 2013, and anything more complex ERS will defer to Vitech.

In response to a question from Mr. Grady, Mr. Pillai stated that the term "in-house" currently means discussing it with the co-development team, Joxel, which is an intermediate step to bringing it fully in-house. The goal is to ensure that whatever ERS does is high-quality with a quick delivery. If Vitech took six months to a year to make a change, ERS will do it in less time.

In response to a question from the Chairman, Mr. Pillai stated that Vitech, as a software company, has a product, or pension application system, that it uses for all clients. If a client has specific needs, like a certain number of unions or rules, for example, those changes are integrated into a development environment particular to that client.

In response to a statement from the Chairman as to who is allowed to make changes to the basic system that applies to all clients, Mr. Pillai stated that Vitech is open to allowing ERS to make them, which is why the phased-in approach to the more expert changes was created. It allows enough time to build Vitech confidence in ERS as well as ERS expertise in making these types of changes.

Mr. Schroeder then stated that throughout the phases, Vitech will provide oversight services and testing and monitoring services to ensure that ERS is not compromising the overall quality of the data system. The purpose of the co-development project is not only cost reduction, but also performance improvement. The two-month cost analysis Mr. Schroeder provided to the Board is based on actual costs that ERS paid to Vitech in 2010 for various programming involving simple text creation, a document change, and the creation of a new, complex coded document. There is significant cost reduction when comparing what ERS paid to what the co-development team is currently doing. Another key point, however, is that the amount of work being done per hour is increasing. What took Vitech 40 hours to complete, ERS is doing in 20 hours.

In response to a question from the Chairman, Mr. Schroeder confirmed that the comparison involves the same work units, but with more efficiency. With local control and the RFP process, ERS reduced costs by 84% and can control production and changes on a daily basis. Mr. Schroeder then noted as ERS moves through the phases, more comparisons will be provided to the Board.

(d) Fiscal Officer/Cash Flow Report

Mr. Yerkes first introduced Dan Gopalan, the new fiscal officer assistant. Mr. Gopalan stated that he comes from a small CPA firm in Fox Point where he worked for five years, and that he is excited to work for ERS and use his accounting skills to help the Milwaukee County employees and retirees.

Mr. Yerkes next discussed the ERS cash flow report, stating that the cash flow needs remained relatively the same. Cash flow was slightly understated in June and July, but there is plenty of cash in the general account. ERS does not need to liquidate any additional funds until the fourth quarter.

Mr. Yerkes next distributed the June 2011 Portfolio Activity report, noting that American Realty Advisors called in another $10,296,000. ERS placed that amount into real estate and sold $5 million of the REIT investments, with the $5,296,000 balance coming from the bond fund. The total commitment with American Realty Advisors is $30 million, with $6,864,000 unfunded.

Mr. Yerkes then stated that ERS received its first dispersal of $985,000 in June from JPMorgan. Receiving funds from the more difficult to liquidate investments is starting to occur automatically. However, ERS still needs to request funds from IFM on a quarterly basis.

6. Investments

(a) Industry Funds Management (IFM)

Brian Clarke introduced himself as the Executive Director at IFM, noting that he has been involved in infrastructure for over six years.

Mr. Clarke stated that, regarding the comment about ERS still needing to request funds from IFM on a quarterly basis, IFM will now generate a cash yield. Foreign investors are completely opposite in perspective than U.S. investors. They are in a net-cash positive position and prefer to reinvest rather than receive cash back. The U.S. market is different, and so IFM has approved a relatively simple process of indicating whether the cash yield is paid or reinvestment is preferred. This option can be changed on a quarterly basis and the documentation will be provided.

Mr. Clarke provided an update on the ERS portfolio. ERS investments to date have outperformed, which is really due to excellent timing on behalf of ERS. IFM had been in the process of making some fairly interesting investments when ERS made its commitment to IFM, and those investments have significantly outperformed. IFM has realized a 12% annualized return for over 16 years, which is the expectation going forward.

Mr. Clarke then stated that the ERS Fund is currently exposed to eight assets across the U.S. and Europe. IFM is a core infrastructure fund, so IFM looks for very stable, very traditional infrastructure assets and cash-generative investments, only investing in OECD countries, or developed markets. Seven of the eight assets held are regulated assets, which creates a stable return. IFM is currently involved in an exclusive negotiation for another asset in Europe and expects that asset to close by the end of July or early August, and this asset should be in the ERS portfolio shortly. Additionally, IFM is involved in a second exclusive negotiation on another asset, also in Europe. There is more investment opportunity right now in Europe than there is in the U.S., primarily because of the political pressure being placed on regulated assets in Europe to unbundle and sell non-core holdings. This is why IFM purchased 50Hertz, which is one of the four transmission grids in Berlin, Germany.

In response to a question from the Chairman, Mr. Clarke stated that IFM would not necessarily always demand 100% control when purchasing properties, but IFM does demand operational control. For example, IFM will insist on a Board seat. If it is a minority position, IFM will insist on negative control. In some cases, control can be shared. For example, when IFM purchased Dalkia, which is the heating grid in Poland. IFM owns that grid, but the co-investor and operator, which is Dalkia, needed to have control of the asset for legal and technical reasons. IFM exercised its need for management oversight by allowing Dalkia to appoint the CEO. Additionally, IFM might purchase an asset at a minority share and add to the holding over time to eventually become one of the majority owners.

Mr. Clarke then stated that IFM looks hard at portfolio construction. Because IFM is a long-time perpetual fund, there is a wealth of data to look at in underlying holdings and investments. IFM is now taking the second generation of portfolio work, analyzing the individual discreet revenue screens and testing those revenue screens against a series of potential scenarios. Coming out of the global financial crisis, IFM wants to have a better and clearer understanding of how markets can or cannot work against them in certain situations, not just asset by asset, but individual risks per asset by individual revenue screens per asset. IFM will share this information with the Board and with Marquette when the results are available.

In response to a question from Dr. Peck, Mr. Clarke stated that the 23% return is coming primarily from 50Hertz. IFM was fortunate to buy 50Hertz at a time when the regulatory regime in Germany was very much in question and they were just going through the process of unbundling. Most investors did not bid or try to purchase those assets. IFM, however, began a two-year negotiation with the regulator and eventually was able to purchase 50Hertz at a 60% discount of value. ERS just happened to come in at the time IFM made that investment.

In response to a question from the Chairman, Mr. Clarke stated that of the total return, an estimated 10% to 12% comes from positive currency movements. The balance of the return is made up of underlying assets, approximately 30% from cash and the remainder as valuation increases.

In response to a question from Dr. Peck, Mr. Clarke stated that the valuation comes from an independent third party that places values on IFM assets on a quarterly basis. The driver's evaluation generally is even dollar growth and revenue growth, but also market comparison. Risk is modified based on market movement, so how valuations are calculated is modified, as well.

In response to questions from Ms. Bedford, Mr. Clarke stated that though IFM has sold assets over the last 16 years, IFM does not classify itself as a seller of assets. IFM prefers to hold good assets for as long as possible to capture accreted growth and cash generation. IFM does not expect major changes to the ERS portfolio other than the asset negotiations Mr. Clarke mentioned earlier.

Mr. Clarke concluded by stating that a number of IFM's Australian investors who are aware of the asset negotiations are increasing their holdings, so the fund will grow in the upcoming months. ERS may want to consider doing the same. The Chairman then stated that ERS is reviewing its asset allocation over the upcoming months and may consider it.

(b) JPMorgan

Bob Pease introduced himself as a Client Portfolio Manager with the JPMorgan Infrastructure Investments Fund.

Mr. Pease first discussed ERS Fund performance. ERS originally committed $60 million. After a distribution from JPMorgan of just under $1.5 million, current net asset value is $61.4 million. The net of management fees over the last three months is 2.6% and since inception, just over 2.5%. Distributions are increasing. JPMorgan distributed approximately $50 million across the Fund last quarter, which is similar to the previous two quarters, and expectations are that similar amounts will be distributed over the coming quarters. The yield is increasing to approximately 5.5% by year end and JPMorgan should reach its target returns, which is a stated net of 10% to 12%.

Mr. Pease then discussed JPMorgan's strategy and the investment portfolio, which is a core infrastructure strategy investing only in OECD countries. JPMorgan focuses on regulated utilities, contracted power generation, and transportation assets. JPMorgan did not have transportation assets in the portfolio until after the global financial crisis started, which was a benefit to the Fund. Transportation assets tend to have slightly higher economic sensitivity than regulated assets in the infrastructure space.

Mr. Pease stated that there are currently ten investments in the portfolio. Underlying those ten investments are approximately fifty distinct assets, so there is a well-diversified exposure across different subsectors. For example, two water and waste water companies in the U.S. and U.K., and two natural gas distribution networks in the U.S., with an excellent opportunity to add additional natural gas distribution companies. On the regulated side, JPMorgan owns an electricity distribution network in the U.K., a company that effectively owns the wires that deliver electricity to homes. On the power generation side, JPMorgan owns two portfolios of wind farms, one in the U.K. and one in the U.S., and seven natural gas power plants in the U.S. On the transportation side, JPMorgan added two airports in Australia and fifteen ports in Spain. This was a recent acquisition that JPMorgan negotiated for over eighteen months through the financial crisis and was able to purchase at a very good price. There was a definite benefit in seeing how port volumes held up in a very difficult economic environment. JPMorgan is also diversified geographically, both within the U.S. and in Europe. Over time, there will likely be additional investments in continental Europe.

Mr. Pease then stated that from an investment process standpoint, JPMorgan sources transactions in many ways. One is through JPMorgan's global network and the team's substantial network through the industry, a team of thirty people who have worked in the infrastructure space for a long time and who are well-connected. JPMorgan also sources transactions that are going to be available for most infrastructure funds through public auctions. Finally, JPMorgan is increasingly sourcing transactions through existing investments in the portfolio. For example, there are several small natural gas companies that are geographically located near the two natural gas companies that JPMorgan owns. These are companies that may be too small to be acquired by another infrastructure fund. JPMorgan is seeing a number of opportunities in the natural gas space and water space. From a process standpoint, it is like a funnel in that opportunities come in that JPMorgan reviews and screens out over time. As an example, last quarter JPMorgan reviewed approximately thirty-five deals but did not make any investments. However, there is currently quite a bit of deal flow and opportunity in the market.

Mr. Pease stated that the long-term cash flow profile for the JPMorgan Infrastructure Fund performed very steadily over a long period of time, which supports the argument for a long-term strategic allocation to infrastructure. Even during the most recent recession, cash flows dipped down, but held up relatively well compared to many other asset classes and investments. There is more volatility in the transportation sectors, and low economic sensitivity with regulated utilities. JPMorgan believes there is good opportunity right now to deploy capital in the transportation subsectors. The valuations decreased substantially because of the weakness in the global economy and they have not recovered. Volumes, however, have recovered substantially in the subsectors.

In response to a question from Dr. Peck about the JPMorgan Infrastructure Investment Fund report, Mr. Pease stated that the chart on page 10 shows usage in each of the infrastructure subsectors in 2009 compared to the average of 2007 and 2008. Specifically, what happened to usage in the downturn, and then also the recovery of 2010 versus 2009.

Mr. Pease then discussed Fund performance through the global financial crisis compared to other asset classes. While the Fund underperformed target expectations, it mitigated downside volatility in a very tough market, which is what it is meant to do. The Fund outperformed every major asset class except bonds.

Mr. Pease noted that inflation is starting to make its way back into the economy given the amount of monetary stimulus across the globe. Infrastructure is a very practical place to be to help protect investor portfolios against inflation.

In response to a question from Ms. Bedford, Mr. Pease stated that JPMorgan is starting to see more infrastructure opportunities in the U.S. now than a few years ago, although the privatization market in the U.S. is very slow to develop. There are still opportunities in already privately owned infrastructure, like natural gas distribution and the water sector, where there are fewer political hurdles. In 2010, five large cities were looking at privatizing parking assets, which is a little bit less politically sensitive than something like a toll road, so that may be a first step towards increasing privatizations.

Mr. Pease then stated that JPMorgan's view is that both inflation and crude oil prices will increase, which makes natural gas distribution and natural gas power generation more attractive. JPMorgan will continue to pursue opportunities in that space. Additionally, interest rates will most likely increase at some point, and return on equities will increase along with the rates. Infrastructure and the regulated utility space is a good way to hedge against increasing interest rates where that might hurt fixed income portfolios. Long-term, in JPMorgan's view, infrastructure is a good place to be in the spectrum of assets from a returns standpoint. From a capital markets assumption standpoint, it should be part of a diversified portfolio.

Mr. Pease concluded by stating that JPMorgan has good expectations for cash flows in the existing portfolio. Assets are valued at a discount rate of approximately 13%, which is appropriate to the Fund. If the cash flow is delivered, that 13% will be achieved. JPMorgan also anticipates the yield to increase to 5.5% for 2011 and to 6% to 7% over the next few years.

In response to a question from the Chairman, Mr. Pease stated that while JPMorgan strategy and objectives are fairly close to IFM, JPMorgan has more of an exposure to transportation assets. There is more volatility, but also a higher expected return. Additionally, from an asset management standpoint, JPMorgan takes a very active role in the companies it owns and works with the management teams on a daily or weekly basis.

(c) Marquette Associates Report

Ray Caprio and Brett Christenson of Marquette Associates, Inc. distributed the monthly report.

Mr. Caprio first provided an overview of the second quarter market environment. For the broad fixed income benchmark, the fixed income aggregate that both JPMorgan and BNY Mellon manage was up 2.3% for the quarter, with the stock market conversely flat to slightly negative. Yields fell, which put upward pressure on bond market prices, most specifically in the credit market, to which ERS has exposure. The relative performance of the Mortgage and CMBS sectors of the broad benchmark were significant overweights to the Fund. JPMorgan was overweight to agency mortgage backed securities and commercial mortgage backed securities as opposed to corporate bonds. This produced significant returns above the benchmark with lower volatility, and that has and will continue to occur. For the quarter, however, bonds were positive. Currently, they represent 32% of the Fund and the yield is approximately 2.5% between the two managers. Going forward, they will continue to be a drag on the portfolio, so Marquette will look to diversify in other areas to earn a higher rate of return with less risk.

Mr. Caprio continued with the quality breakdown of the corporate bond markets. Year-to-date, there was some risk inversion in the second quarter. Similar to standing equities where small-caps tend to outperform large-caps, junk bonds outperformed high-quality bonds, and that has been the trend for the last few years.

Mr. Caprio then provided an overview of the U.S. equity markets. The Fund has 33% in total equities, including international. Small-cap stocks have performed better than large-cap stocks and it is unknown whether that trend will continue. The Fund is positioned in a way that allows it to be overweight in mid- and small-cap stocks, since historically that has been a good place to be long-term. Median market cap is approximately $5 billion and the Wilshire 5000 is up 0.6%, so there is a significant tilt toward mid-cap stocks overall. Valuation tends to be more on the core and year-to-date growth has performed much better as the U.S. equity managers collectively have been the broad benchmark. It is a combination of the neutral style tilt and the overweight to mid- to small-cap stocks. Although negative for the quarter, year-to-date is positive. In terms of valuation, there have been two or three years of significant volatility, but the Fund is still operating at a significant discount historically.

Mr. Caprio concluded by providing an update on the international markets. The Fund is already well-diversified in international at 20%, with developed markets in Europe, emerging markets, and also small-cap stocks both developed and emerging. It is a heavily bifurcated market in non-U.S. equities. The MSCI ACWI ex U.S. IMI includes 22 emerging countries and 23 non-emerging countries in addition to small-cap. On a percent basis, emerging markets represent about 20% of the index. Marquette uses that as a proxy to develop the diversification of that bucket in the portfolio. The Fund has exposure to all areas that would subsequently be below that benchmark, but collectively year-to-date the international markets have trailed the U.S. markets, although still positive. There have been some differential returns between emerging markets and developed markets. Emerging has been very volatile year-to-date at barely positive, but it is a better place to go long-term, especially with global demand and where the non-U.S. market is going.

Mr. Christensen then discussed the flash report. Total Fund assets as of June were just over $1.8 billion. Fixed income is slightly underweight at 29.5% versus the target of 32%. The Board is aware that because the Plan still has a lot of liquidity, there may be room to drop the fixed income target. Though Marquette is comfortable with the current allocation, the portfolio will be reviewed in September to determine whether it should be rebalanced.

In response to questions from the Chairman about the UBS call, Mr. Christensen stated that the goal was to maintain the REIT allocation to keep the Fund at its target. When UBS calls the $15 million, Marquette wants the REIT allocation as close to that $15 million as possible without too much of an overweight. When American Realty called money, Marquette felt it was best to take a piece of the REIT because of the slight overweight. As the REIT is used up, if American Realty calls their remaining 6% to 6½%, that will most likely come from bonds, and then the remaining allocation in REIT will be for UBS.

Mr. Christensen then stated that total U.S. equity is approximately 23.2% versus a target of 23%. International is slightly overweight at

19.7% versus a target of 18%. Long-short and hedged equity are both in line with their targets. Real estate is slightly underweight, but there is $20 million to be called and real estate should be on target by the end of 2011. Infrastructure is slightly overweight because of appreciation. For private equity, Marquette and the Investment Committee have been considering an evaluation in the coming months to determine if this asset class makes sense long-term.

Mr. Christensen continued that the total Fund composite for the month of June was down slightly, but up 4.5% year-to-date and slightly above the 8% target. Hopefully, positive returns will continue to be realized through the asset classes, but it depends on the direction the market takes. Fixed income returns will provide only a small percentage of return. Marquette feels strongly that ERS will continue to see some very nice returns in real estate and most likely infrastructure. Real estate numbers in the second quarter are coming in at 4% to 4.5%, and Marquette anticipates 2% to 3% for the remaining quarters. Fixed income is up 2.7% year-to-date, and the Fund is outperforming on domestic equity at 6.6% versus 6.1% for the benchmark. Long-term, the Fund has outperformed the Wilshire 5000 on U.S. equity. For international, however, year-to-date is 4.5% versus 4.1% for the benchmark, which is fine. On a one-year basis, international is 30.6%, slightly beating that benchmark. However, the long-term numbers continue to struggle versus that target. GMO, which had been underperforming, has rebounded nicely, but now Barings is underperforming. In terms of rethinking international and moving forward, if the active managers continue to underperform, Marquette recommends switching to a passive strategy. Whether to increase small-cap, what to do with large-cap international, and whether it makes sense to passively manage will probably be part of the rebalance discussion. Real estate has been strong year-to-date, up 7.3%, and will likely be the best performing asset class, but it is difficult to tell where infrastructure will end up because of the volatility with currency. Infrastructure is up 6.9%, and Marquette expects the next few years to work in favor of these funds because the dollar will continue to fall.

In response to a request from Dr. Peck, Mr. Christensen stated that Marquette will add additional information to its report, such as the breakdown of the cash yield versus the exchange.

Mr. Christensen then discussed the Fund Managers. Reinhart year-to-date is up 8.4%. While still underperforming, Reinhart had a decent month in June. GMO large-cap year-to-date is beating the benchmark by 2%. Barings is struggling, especially on a one-year number of 24.8% versus 30.9%, and Marquette will be looking at that more closely. On international small-cap, GMO is up 4% to 4½% over the last year. The Barings emerging market fund is underperforming. This sort of role reversal is why it is important to have the diversification of managers through various asset classes.

In response to a question from the Chairman, Mr. Christensen stated that Barings recently lost another analyst. While Marquette has some concerns about turnover and performance with Barings, at this point it is not necessary to place Barings on alert.

Mr. Christensen continued that for the long-short managers, the outlook is good versus the stock market for the month. Long-short or hedged equity managers typically perform much better in a down market. ABS lost ½% versus 1.8% for the month on the Wilshire 5000. K2 did not hold up as well, down 1½%. Marquette expected those numbers to be better, but believes gains will improve for long-short. In June, the markets were actually down, closer to 5.5% to 6%, before the very end of the month. A strong gain would have been realized versus the markets on long-short because both products were only down approximately 2%.

Mr. Christensen concluded by stating that Marquette has not yet received the American Realty number for the quarter, but Morgan Stanley came in at 3.7%.

7. <u>Investment Committee Report</u>

There was no Investment Committee report because the July 5, 2011 meeting was cancelled.

8. <u>Audit Committee Report</u>

The Chairman reported on the July 7, 2011 Audit Committee meeting. The staff discussed a possible benefit change proposal that would provide death benefits for certain vested deferred members. The consensus of the Committee was that the role of the Pension Board is not to set policy on benefits. Staff should raise any concerns through the appropriate County Executive or County Board channels.

The Audit Committee then discussed the audit and the audit responses. Baker Tilley made recommendations with regard to issues the auditors noticed in the course of the audit. Mr. Schroeder responded to Baker

Tilley, indicating that the controls and monitoring are now in place to address those issues.

The Audit Committee next discussed the employee contribution distribution and collection process. Options will be researched and reported back to the Committee. The contingent benefit forms are still under review.

9. Proposed Ordinance Amendments

Mr. Grady provided the background on the proposed Ordinance amendments. These amendments are part of a series of Ordinance amendments that the County Board has under consideration. There is a requirement in a County Ordinance that states every change in the Pension System will be referred to the Pension Board for comment. The Pension Board is then given up to 30 days to comment if it chooses to do so.

Mr. Grady stated that the most substantive change is to reduce the pension multiplier from 2 to 1.6 for District Council 48 members at the beginning of August and for the Milwaukee Building and Construction Trades Council beginning January 1. These are the last two unions that are not public safety worker unions and that did not have the 1.6 multiplier. As a result of state law, the County now is able to make this change without negotiation.

Mr. Grady then stated that a second change involves raising the normal retirement age from 60 to 64 for new hires for these same two unions. This change has been made either to Ordinance for non-represented employees or through negotiation with all the other unions, and again except for public safety worker unions.

Mr. Grady stated that a third change involves the Rule of 75. While there are no changes to Rule of 75 benefits, Rule of 75 provisions in the union contracts must be added to the Ordinance since the union contracts will not be covering those provisions in the future. A proposal for a minor change to the Rule of 75 by amendment may come up this week in the committees of the County Board. This change will essentially freeze the Rule of 75 benefit for all employees to what they have on that day. In the future, then, if an employee moves from a District Council 48 membership to a non-represented membership, for example, his or her Rule of 75 benefit will not be affected.

Mr. Grady concluded by noting the actuarial report, which provides the savings to the County from a reduction of contributions due to the reduction in the size of the pension benefits.

In response to a question from Mr. Grady, Ms. Ninneman confirmed that there is no new administrative cost to the Ordinance amendments because the computer system can already accommodate the changes.

The Chairman then noted that the Board's responsibility is not to comment on policy but to provide comments on any impact to ERS operations. Typically, the Board adopts a resolution making no formal comment. The Chairman then read the resolution used by the Board in such instances.

The Pension Board unanimously approved the adoption of the following resolution:

> **The Pension Board offers no formal comment regarding the proposed Ordinance amendments to sections 201.24(2.18), (4.1), (5.1) and (5.15) of the Milwaukee County Code of General Ordinances codifying pension provisions for collectively bargained employees, and waives the balance of its 30 day comment period provided for under section 201.24(8.17) of the Milwaukee County Code of General Ordinances. The Employees' Retirement System ("ERS") Manager estimates that implementation of the proposed Ordinance amendments would not result in additional cost to the System. The Pension Board believes that it is in the best interests of ERS for the County Board to adopt Ordinance amendments which clarify the intended operation of the Ordinances in accordance with legal requirements.**

Motion by Dr. Peck, seconded by Ms. Bedford.

10. <u>Administrative Matters</u>

The Pension Board discussed additions and deletions to the Pension Board, Audit Committee, and Investment Committee agendas. The Chairman asked that anyone with future topic suggestions should voice them. Those topics will be discussed at the next agenda planning meeting.

The Chairman encouraged the Board to continue attending the International Foundation courses on investments for the training and education necessary to critically evaluate the investment managers and the reports from Marquette.

11. <u>Disability Matters</u>

Mr. Grady stated that the disability application is not a new application, but a reexamination. Therefore, it does not require any action.

Ms. Ninneman then stated that regarding the income reporting and suspension of benefits disability matter, the member has complied so the matter is moot.

12. Appeal of Election Complaint

The Chairman provided background on the appeal of the election complaint. He stated that Monique Taylor ran as a candidate in the employee election and had concerns about the results. Ms. Taylor documented those concerns and registered a complaint through an e-mail to the Board and various County staff. The Board requested that Mr. Schroeder, under Mr. Grady's supervision, respond to Ms. Taylor's concerns. In a memo, Mr. Schroeder denied Ms. Taylor's complaint, stating that the election was properly conducted and that the results were valid. The Board then asked Ms. Taylor if she wanted to appeal Mr. Schroeder's denial. Ms. Taylor stated that she did.

In response to a question from the Chairman, Ms. Taylor stated that she is asking the Board to void the election results and hold a reelection.

At the Chairman's request, Mr. Schroeder provided an update on the election for the retiree and employee seats. The elections were conducted on July 8 through July 11 using Votenet, the system with which ERS contracts to perform the election. Prior to the election, notices and instructions in the form of e-mail blasts were sent out informing employees that telephone and computer voting would be available. Additionally, ERS supplied Votenet with a list of eligible voters and helped prepare the ballot that is placed into the Votenet system. Throughout the election, ERS also responded to employee telephone calls and inquiries. Votenet tabulated results hourly and provided final results to ERS at the end of the four-day election. The voting turnout was lower than expected for both elections. For the employee election, the voting rate was 6%, or 368 votes, with Rex Queen receiving 230 votes at 62.5% and Monique Taylor receiving 138 votes at 37.5%. For the retiree election, Guy Stuller received 56% of the vote.

Mr. Schroeder then noted that issues occurred with IMSD in terms of the e-mail blasts to the County, but that ERS worked with IMSD to reissue the blasts. In response to a question from Mr. Grady, Mr. Schroeder stated that one e-mail blast issue was resolved within 45 minutes and the other within a few hours, both on the day before the voting period.

In response to a question from Mr. Garland, Mr. Schroeder stated that the Votenet issue was resolved on the day it occurred, which was the first day of the voting period.

Mr. Schroeder then stated an issue with the Votenet system became apparent when members informed ERS that they could not see the ballot in order to vote. ERS immediately held a telephone conference with Votenet and the situation was corrected in a matter of hours. In the interim, ERS answered telephone calls from members and responded to questions about the voting process. Within two hours of these inquiries, ERS designated a telephone number to which members were directed to vote, and paper ballots were completed in those instances. Twenty paper ballots were completed for the retiree election and ten were completed for the employee election. Mr. Schroeder stated that ERS and Votenet responded quickly to the issues and the paper ballot backup system was effective.

Mr. Garland then stated that he received calls on the first day of the voting period asking when the vote was taking place. No e-mail blast was received until later that day. Mr. Schroeder responded that in addition to the blasts that were sent, ERS also sent information to department heads for posting. However, some areas were not included in Lotus Notes so the information was also sent to those departments for posting.

Mr. Schroeder then noted that 60 calls were received over the four-day voting period, 30 of which resulted in paper ballots. The remaining 30 involved guiding members through the voting process or answering their questions.

In response to a question from Ms. Bedford as to whether ERS still needs to pay Votenet despite the issues that occurred, Mr. Schroeder stated that there is a contractual fee ERS pays Votenet for the election services.

In response to a question from Mr. Sikorski, Mr. Schroeder stated that with the employee election, electronic voting totals are consistent with paper ballot voting totals in the past. The volume of votes did not increase. However, the difficulties associated with paper ballot voting prompted ERS to move to an electronic and telephonic voting system.

In response to a question, Mr. Schroeder stated that for the employee election, electronic voting totals were comparable to those in the prior employee election. However, he would need to research the previous retiree election for comparison data because he did not have that information readily available.

The Chairman then invited Ms. Taylor to summarize her election concerns with the Board. Ms. Taylor distributed a packet of information in response to the memo received from Mr. Schroeder. She stated that Mr. Schroeder's memo indicates that the processes in which the employee election was conducted compared to the February 2011 election were contradictory, and that her complaints to ERS management were not taken seriously. She reported that Mr. Schroeder had stated that in the electronic voting system, the primary contact is an ERS IT Systems staff person with the highest level of security clearance for control purposes and that ERS Management provides only operational support. However, the primary contact person Mr. Schroeder referred to is a V3 consultant, not an ERS employee. Additionally, the operational support was actually a hands-on process administered by a benefits analyst, who typically would not have the level of security required for this type of support.

The Chairman then requested, in light of the fact that Mr. Schroeder's memo recognizes the issues that occurred during the election and states that the issues were resolved, that Ms. Taylor respond to the specific areas of Mr. Schroeder's memo with which she disagrees. Ms. Taylor stated that the instructions sent out by Ms. Ninneman the day before the election were sent to all department heads. She reported that Ms. Ninneman indicated that she had received instructions from Ed White of IMSD on how to send instructions because mass mailings could no longer be sent using IMSD. However, Ms. Taylor received several calls from employees on voting day indicating that they had not received instructions and did not know how to vote. Further investigation by Ms. Taylor confirmed Mr. White did not recall having spoken with Ms. Ninneman about processing mass mailings and that an e-mail sent by Mr. White stated others would be able to send mass mailings in the future. Ms. Taylor stated that when informing ERS management that employees were not receiving their voting instructions, she felt she was not taken seriously. Ms. Taylor then informed Ms. Ninneman that if the instructions were not sent, she would file a formal complaint. Voting instructions were then sent out later that afternoon.

In response to a question from the Chairman, Ms. Taylor stated that there is a possibility that a large group of employees did not get the opportunity to vote because of the issues that occurred. One employee told Ms. Taylor that when the employee called to place her vote via the telephone, the system informed her she had already voted. When this same employee accessed the website to vote, the website also indicated that she had already voted. The employee called ERS and was transferred to a benefits analyst, who in turn transferred her to the Pension Information Systems Specialist, who cast the vote for the employee.

In response to a question from the Chairman, Ms. Taylor stated that the Pension Information Systems Specialist was able to cast the employee's vote for the employee on the website using the ballot the employee herself was unable to access. The employee did receive confirmation of her vote, but was never informed of an in-person, paper ballot option.

Ms. Taylor continued that there are probably a number of employees who experienced the same issues but who have not come forward. Ms. Taylor stated that she believes casting a paper ballot over the phone is a direct violation of ERS Rules. Ms. Taylor also stated that exactly how many paper ballots came in over the phone is unknown. There is only the figure provided by Mr. Schroeder and Ms. Ninneman.

Ms. Taylor concluded by stating that the current method used to reach employees is through word-of-mouth and IMSD sending voting instructions and other notices. Because the instructions and notices were sent out during the middle of the day on the first day of voting instead of the day before the voting period, there was less time for employees to read the instructions, remind themselves to vote, and discuss the elections. Additionally, sending the voting instructions to department heads is ineffectual as the department heads will more than likely not post the instructions.

The Chairman then asked those ERS employees who were present whether they were notified of the election. Messrs. Sikorski, Yerkes, Gopalan, and Loeffel and Ms. Aikin all received their voting information and could cast a vote. However, Mr. Sikorski also stated that a large number of employees do not have access to Lotus Notes and they rely on the department heads to relay important information to them. Because this does not always happen, it is possible that many such employees did not know the election was happening.

Ms. Taylor then stated that one employee in Corporation Counsel's office who does have a Lotus Notes account did not receive voting instructions. Ms. Taylor stated that it is obvious that ERS was able to reach some employees, but not all.

In response to a question from the Chairman, Mr. Schroeder stated that he did not personally look for verification that the information distributed electronically was actually sent. Once ERS received inquiries that messages were not received, ERS consulted with IMSD to verify the message went out to all Lotus Notes clients. A backup procedure involved sending the message to department heads for those employees without computer access.

Ms. Taylor then stated that Mr. Schroeder indicated he spoke with IMSD the day before the voting instructions were sent. Ms. Taylor continued by stating that nobody in IMSD can verify that conversation. If there had been a conversation, Mr. Schroeder would have been informed that Lotus Notes is not designed for mass mailings and that it would not reach the number of people necessary.

Ms. Bedford stated that it appears the voting system is not working well, to which Ms. Taylor added that the voting system can also be easily manipulated. In response to the Chairman's request for additional information on Ms. Taylor's statement, Ms. Taylor stated that the system can be easily manipulated because anyone can access it and cast any amount of votes if they have Social Security numbers and birth dates of voters.

In response to a question from the Chairman, Mr. Schroeder indicated that is not true.

Mr. Grady then stated that his understanding of the contract with Votenet includes a requirement that everyone have a unique identifier and that once a vote is cast using that identifier, another vote cannot be cast.

In response to a question from Mr. Grady, Ms. Taylor confirmed that an employee with access to the Social Security numbers and birth dates of other employees could cast ballots for those employees. Ms. Taylor stated that she is not claiming that happened, but is stating that it is possible. The Pension Information Systems Specialist did cast votes for the people who called in.

In response to a question from the Chairman, Ms. Taylor agreed that part of the process of casting paper ballots for employees involved those individual employees receiving confirmation e-mails of their votes.

In response to a question from Mr. Garland, Ms. Ninneman indicated that there are copies of the paper ballots. Typically, paper ballots are used for absentee voting. The employee returns the paper ballot in a sealed envelope and the envelope is opened and the vote reported on the last day of the voting period. With the Votenet issue in this election, the typical paper ballot was given to a non-ERS employee and employee calls were routed to that non-ERS employee. This employee, the new Pension Information Systems Specialist, entered the votes into the Votenet system as an administrator and on behalf the employee, received the confirmation of those votes through the Votenet system, and then e-mailed the confirmation to the employee whose vote she had cast.

In response to a question from Mr. Garland, Ms. Ninneman stated that a person with an administrator role could access Votenet and cast votes for employees if that person had employee Social Security numbers and birth dates. Ms. Ninneman also stated that a Votenet report could be run to show the entries for all votes cast.

Mr. Garland then stated that if a report indicates that only 30 administrative votes were cast, representing the 30 paper ballots, then it would be easy to dispel the allegation that votes not on a paper ballot were entered into the system.

In response to a request for confirmation from the Chairman, Ms. Taylor stated that she is alleging that someone abused administrator votes by using administrator privileges to cast votes for other employees. Ballots were cast by employees on behalf of employees and that should have never happened. A paper ballot is a paper ballot and should not have been entered into Votenet.

In response to a question from the Chairman, Ms. Taylor stated that the outcome of the election was affected in such a way that it negatively impacted her because a different process was used from that of previous elections.

In response to a question from Dr. Peck, Ms. Ninneman confirmed that all votes go through the Votenet system to get tallied whether they are telephonic, electronic, or paper, and that Votenet has a record of which employees voted and for whom. Dr. Peck noted that it would be possible to determine whether paper ballots were properly cast by the people alleged to have cast them.

Ms. Ninneman then stated that while ERS does not typically use paper ballots, for this election they were necessary to implement an emergency process in order to collect votes in an orderly manner, to have them taken in by a non-ERS employee, and to follow up with a confirmation.

The Chairman noted that he did not know of any reason Mr. Schroeder or Ms. Ninneman would have to skew the election results and asked Mr. Schroeder, Ms. Ninneman, and Ms. Taylor to respond to the question of vested interest in the outcome of the election. Mr. Schroeder stated that he did not have a vested interest other than to run a legitimate election and secure that all ballots are cast and counted. Ms. Ninneman agreed, stating that ERS elections are run according to the Rules and the required timeline was adhered to. The Rules require an e-mail blast with the candidates and their bios, and that was sent. The subsequent e-mail blast was strictly a PR move to help employees and remind them of the importance of voting. Ms. Ninneman stated that she would like each candidate to win and serve the Board to the best of his or her ability, but that she has no vested interest in who that successful candidate may be.

Ms. Taylor then stated that the question is really whether Mr. Schroeder and Ms. Ninneman would admit they had a vested interest if that were the case. Ms. Taylor also stated that several events that have taken place in terms of management have caused low employee morale, and that ERS employees do not trust management.

Mr. Loeffel noted that, as an observer of the discussion, there appears to be a question of integrity, or perceived non-integrity, and that perhaps the Board could use this as a learning experience for future elections.

In response to a question from the Chairman, Ms. Ninneman stated that the cost to run a Votenet election is $3,000 to $4,000.

Ms. Bedford moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(g), with regard to items 12, 13, and 14 for the purpose of the Board receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation. At the conclusion of the closed session, the Board may reconvene in open session to take whatever actions it may deem necessary concerning these matters.

The Pension Board voted by roll call vote 5-0 to enter into closed session to discuss agenda item 12, 13, and 14. Motion by Ms. Bedford, seconded by Dr. Peck.

The Board excused all Retirement Office employees for the discussion of the employee election appeal.

In open session, the Board discussed a motion to approve the election results subject to a non-ERS independent verification of the Votenet system. Results of both the employee election and the retiree election need to be reviewed because of the alleged issue with the integrity of the voting process.

The Chairman then requested that Mr. Grady find an independent party to verify the voting results under the auspices of Corporation Counsel's office.

The Pension Board unanimously approved the election results subject to a non-ERS independent verification of the Votenet results. Motion by Mr. Sikorski, seconded by Dr. Peck.

In response to questions from Mr. Grady with respect to notifying the candidates in both elections, the Chairman stated that the Board is approving and accepting the election results, but also verifying that election results are consistent with the Votenet totals. If a review does not disclose significant problems, the Board anticipates that Guy Stuller and Rex Queen will attend the September meeting as members of the Board. However, if a review does reveal a problem, the Board will call a special meeting in August to discuss the matter.

The Chairman then informed Ms. Taylor that the Board understands that there may have been issues with the election, but that these issues were addressed. The process will most likely be reviewed going forward, but for this employee election the Board is going to respect the vote of the employees.

13. Pending Litigation

(a) *Mark Ryan, et al. v. Pension Board*

The Pension Board took no action on this item.

(b) *Travelers Casualty v. ERS & Mercer*

The Pension Board took no action on this item.

(c) *ERS v. Lynne Marks*

The Pension Board took no action on this item.

(d) *Christine Mielcarek v. ERS*

The Pension Board took no action on this item.

(e) *Lucky Crowley v. ERS*

The Pension Board took no action on this item.

(f) *Renee Booker v. ERS*

The Pension Board took no action on this item.

14. Report on Compliance Review

The Pension Board took no action on this item.

15. Adjournment

The meeting adjourned at 11:40 a.m.

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