

# EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

## MINUTES OF THE JUNE 20, 2012 PENSION BOARD MEETING

1. Call to Order

Chairman Mickey Maier called the meeting to order at 8:30 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present

Mickey Maier (Chairman)

Dean Muller

Dr. Sarah Peck

Dave Sikorski

Patricia Van Kampen

Member Excused

Others Present

Mark Grady, Deputy Corporation Counsel

Matt Hanchek, Employee Benefits Administrator

Dale Yerkes, ERS Fiscal Officer

Vivian Aikin, ERS

Melissa Brown, JPMorgan Asset Management

Steve Weddle, JPMorgan Asset Management

Hillary Ripley, IFM

Ray Caprio, Marquette Associates, Inc.

Larry Langer, Buck Consultants

Marilyn Mayr, Prior Pension Board Member and Retiree

Yvonne Mahoney, Retiree

Steven Huff, Reinhart Boerner Van Deuren s.c.

3. Chairman's Report

The Chairman stated that the Pension Board typically does not meet in August, depending on workload.

Since it is critical for everyone to be present at the Board meetings, members should inform Ms. Ninneman if there are attendance concerns for the July meeting.

4. Minutes—May Pension Board Meeting

The Pension Board reviewed the minutes of the May 16, 2012 Pension Board meeting.

**The Pension Board unanimously approved the minutes of the May 16, 2012 Pension Board meeting. Motion by Mr. Sikorski, seconded by Ms. Van Kampen.**

5. Reports of ERS Manager and Fiscal Officer

(a) Retirements Granted, May 2012

Mr. Hanchek presented the Retirements Granted Report for May 2012. Twenty-five retirements from ERS were approved in May, with a total monthly payment amount of \$34,780. Of those 25 ERS retirements, 11 were normal retirements, 10 were deferred, and 4 were disability retirements. Nine members retired under the Rule of 75. Additionally, 11 retirees chose the maximum option, and 6 retirees chose Option 3. Twelve of the retirees were District Council 48 members. Five retirees elected backDROPs in amounts totaling \$992,872.

(b) ERS Monthly Activities Report, May 2012

Mr. Hanchek presented the Monthly Activities Report for May 2012. Combined, ERS and OBRA had 7,900 retirees at the end of May, with a monthly payout of \$12,790,108.

Mr. Hanchek then stated that ERS held only 19 appointments in the month of May—18 normal retirements and 1 early retirement—and retirement volume continues to taper off. Additionally, the OBRA project is complete so there will be no more OBRA cash-outs.

In response to a question from the Chairman, Mr. Hanchek stated that ERS is on target for approximately 300 total retirement appointments for the year.

(c) Fiscal Officer

Mr. Yerkes first discussed the ERS cash flow report. May cash flow came from the Mellon Capital Bond Fund. Additionally, lump sum payments are reduced by about \$3 million per year because the previous forecast was too high.

Mr. Yerkes then discussed third quarter funding needs. The initial third quarter funding request was for \$5 million in July, \$15 million in August, and \$15 million in September. However, Mr. Caprio since noted Marquette wants to withdraw the funds from infrastructure and real estate. Because these investment classes allow withdrawals only once per quarter, the third quarter funding request is now for a lump-sum of \$35 million.

In response to a question from the Chairman, Mr. Yerkes stated that ERS expects to fund some pension cash flow out of infrastructure and real estate distributions. That money will be coming in September, and ERS might receive an amount other than the \$15 million originally forecasted. ERS will determine amounts needed for July and August, but \$35 million is what is required for the entire quarter.

In response to a question from Dr. Peck, Mr. Yerkes stated that funds should come from infrastructure and real estate because there is an overweight in both asset classes.

**The Pension Board unanimously approved the liquidation of assets to fund cash flow of \$35 million for July 2012, August 2012, and September 2012. The amount should be withdrawn from investments designated by Marquette. Motion by Mr. Sikorski, seconded by Dr. Peck.**

Mr. Yerkes next discussed the portfolio activity report, noting not all information was available at the time the report was distributed, but that there was no unusual activity.

Mr. Yerkes concluded by updating the Board on the annual report. ERS is behind by one month because the OBRA actuarial report was delayed and because of scheduling conflicts with the auditors. The auditors are expected to present at the July Pension Board meeting.

In response to a question from the Chairman, Mr. Yerkes confirmed that the outstanding item for the annual report is the finalized OBRA contribution. Additionally, ERS does not expect any negative information on the overall report.

6. January 1, 2012 OBRA Actuarial Valuation Results

Larry Langer from Buck Consultants distributed and discussed a summary of actuarial results for OBRA.

Mr. Langer first stated that there were many changes in OBRA over the past year. In November 2011 and February 2012, about \$1.4 million worth of cash-outs occurred for nearly 8,200 participants, representing a significant change in the funded status of the OBRA system. The impact on the liability was a fairly substantial decrease from \$5.5 million to \$2.5 million. Contributions of over \$2 million were made to pay for the cash-outs, with the remainder used to bolster the funded status. In 2011, the funded status was \$.25 on the dollar, and in 2012 it is \$.50 on the dollar. When the funded status of the plan is higher, contributions fall as a result. The ongoing cost to members is approximately \$180,000, if paying for the benefits accrued, compared to about \$600,000 in administrative expenses, and the remainder is unfunded liability. Administrative expenses are currently amortized over a 10-year period and not paid all at once. The contribution is lower because the contribution variance, or the additional contribution amount included this year, is amortized over a 5-year period. With the experience review later this year, Buck Consultants will have a recommendation as to how to ensure contributions going in are enough to pay administrative expenses and benefits accrued, as well as how to reduce the unfunded liability.

In response to questions from the Chairman and Mr. Grady, Mr. Yerkes stated that expenses include a \$15,000 actuary fee charged to OBRA and legal fees charged directly to OBRA. Everything else is either part of the administrative fee based on actual dedicated staff head count. Capital expenses that are part of depreciation are also allocated as a percentage of the head count based on employee time spent times the total administrative expense.

Mr. Langer then noted that OBRA is a separate plan from ERS, so there is also a separate valuation report. Buck Consultants could combine the two valuation reports actuarially to eliminate redundancy and cost if, from a legal standpoint, the plans were considered a combined plan.

Mr. Grady then stated that the plans were not considered a combined plan from a legal standpoint. The assets are comingled for investment purposes, but otherwise the plans are separate. Mr. Langer responded that Buck Consultants will review the

feasibility of combining the actuarial reports for the separate plans going forward.

Mr. Langer then discussed the contribution request to the County. The budget amount for 2013 is \$360,000, and the actual for 2012 is \$446,452.

Mr. Grady stated that the County actually budgeted much more than the \$446,452 for 2012, so there is an over-contribution on the County's part. This is due to the changes in demographics and liabilities, which ultimately affected the payouts.

**The Pension Board unanimously approved the OBRA contribution request to the County Executive in the amount of \$360,000. Motion by Mr. Sikorski, seconded by Dr. Peck.**

Mr. Grady stated that the full OBRA actuarial report could be requested from ERS staff if any Pension Board member would like to review the findings in more detail.

Mr. Langer next discussed the experience review that will take place in November. Buck Consultants will provide a report based on various assumptions along with recommendations based both on those assumptions and other information. It might be prudent for all or some of the Board or a committee to review the report ahead of time because one of the recommendations is related to OBRA administrative expenses.

The Chairman stated that this discussion should coincide with the discussion on asset allocation and adjusting the actuarial rate of return set by the Pension Board. The actuarial rate of return is an important factor, and how to best interact with the actuary in order to determine this rate is also important.

Mr. Langer then stated that the actuarial rate of return is currently at 8%. The rate is reviewed every 5 years and should be considered from a long-term perspective. Standard practice is to use the period over which the investment returns will occur. With open plans like ERS and OBRA, a 30- to 40-year timeframe would make sense.

Mr. Grady added that Marquette will be looking at a 10-year capital market projection as opposed to a 30-40 year timeframe. Rate recommendations do not necessarily need to be based on different timeframes, though it may be difficult for an actuary to consider that difference when making a recommendation.

Mr. Langer stated that a 10-year projection is more for allocation purposes while a 30-year projection is more in line with what an actuary needs. When Buck Consultants receives the asset allocation, the allocation is shared with investment consultants in order to project that out to the extent necessary to reconcile the difference between Marquette's and Buck Consultant's number.

In response to questions from Dr. Peck, Mr. Langer stated that when assets do not have a 30-year history in the portfolio, they are correlated into other asset classes that do have that history. It is understandable that a 10-year return gross of fees at 6.9% with an 8% actuarial rate of return can be unsettling.

Mr. Grady then stated that recently the return of the Fund has been trending up over many years of the prior decade as the market recovers. He also noted that the Fund asset allocation is also much different now.

Most of the other experience assumptions are driven primarily by data already included in the demographics, unlike the investment return assumption.

Mr. Langer agreed that looking at past performance to determine whether adjustments to the investment return assumption need to be made is prudent, but more critical is looking into the future. Investment return is in part driven by economic factors outside of the workforce. For example, there are very few groups in the country large enough to have created an individual mortality table and, like with Milwaukee County, Buck uses a standard mortality table to adjust for more or fewer deaths. The remaining factors are almost explicitly County-specific. Buck reviews things like retirements, terminations, and disabilities because they vary so much from group to group.

In response to a question from Mr. Muller, Mr. Langer confirmed that Buck will return in November with a report that will require action from the Board. The assumptions and methods used in the report include the impact of smoothing on a 5-year, 10-year, and 15-year basis.

In response to a question from Mr. Grady, Mr. Langer stated that Buck would be ready to attend the October Investment Committee meeting to discuss the investment return assumption. Mr. Caprio stated Marquette could be ready by September. There are many scenarios that can be run to show how to meet rate of return. For

example, with bonds at 2%, it would be difficult to reach an 8% rate of return, so one scenario would involve increasing the risk in the portfolio investments, and another would involve waiting out the situation for the new few years.

## 7. Investments

### (a) JPMorgan Asset Management

Melissa Brown and Steve Weddle of JPMorgan Asset Management distributed a booklet containing information on the investments managed by JPMorgan for ERS. Ms. Brown introduced herself as a Vice President of JPMorgan. Ms. Brown then introduced Mr. Weddle as Managing Director with the infrastructure team.

Mr. Weddle first provided an investment summary. The total ERS commitment drawn down as of October 2010 was \$60 million. After distributions to ERS, the net asset value as of March 31, 2012 is approximately \$61.2 million. The gross of management fees for one year is 8.69%, and 8.22% since inception. Overall, the fund has performed well according to Mr. Weddle. Cash yields, a big portion of the overall investment strategy, are being generated.

Mr. Weddle stated that JPMorgan's overall strategy includes core plus infrastructure, with a focus on the global market and including North America, Western Europe, and Australia. The target return for these existing mature assets is 10% to 12% net IRR with a significant portion of that coming from yield. Fund structure is an open-ended perpetual life fund where money is always accepted and liquidity on a semi-annual basis is allowed. The fund is U.S. dollar denominated. JPMorgan primarily looks at regulated assets, transportation assets, and contracted assets. The fund seeks current income as well as inflation in value of assets. In terms of portfolio design, 40% to 60% is in North America, 40% to 60% in Europe, and 0% to 20% in other OECD countries. On a subsector basis, there are targets of 40% to 60% in transportation, 40% to 60% in regulated utilities, and approximately 0% to 20% in power generation assets.

Mr. Weddle then stated that since JPMorgan began investing in 2007, from the subsector standpoint, asset allocation has included regulated assets of approximately 50% in water and wastewater, natural gas distribution, and electricity distribution; a 29% allocation in transportation including private sea ports and airports; and a 21% allocation in contracted power. JPMorgan is slightly underweight in

transportation and that will be a focus going forward; JPMorgan pursued an airport transaction in Edinburgh and also bid on Pittsburgh parking but both attempts were unsuccessful because JPMorgan is disciplined in terms of purchase threshold. In terms of geographical diversification, North America represents approximately 30% of the portfolio and includes assets like wind energy and regulated and water utilities. The U.K. represents at 41% with assets in water, regulated electricity distribution, and contracted power. In Continental Europe at 15%, JPMorgan owns sea ports in Spain. In Australia at 13%, JPMorgan owns two airports. The fund is well-diversified and fairly consistent with the initial targets set in 2007.

In response to a question from the Chairman, Mr. Weddle stated that Pittsburgh parking involved municipal parking. In terms of location, it had strong, monopolistic characteristics where other parking was not readily available in the area.

Mr. Weddle then provided an overview of the current portfolio. The ten investments made from 2007 through 2011 include regulated assets in water, regulated assets in energy, transportation, and contracted power generation. Regulated assets in water include Southwest Water, located in California, Texas, and Alabama, and which serves 1 million customers with water as well as wastewater. Southern Water Systems, acquired in 2007 and which makes up approximately 18% of the overall portfolio, serves customers with water and wastewater in southeast England. Regulated assets in energy include Summit Utilities and Southern Missouri Natural Gas, which involves gas distribution primarily in Colorado and Missouri. The two companies merged in January of this year, resulting in an increase in operating efficiencies. Also in the energy sector is Electricity North West located in the U.K. Electricity North West was purchased in December of 2007 and represents about 15.9% of the overall portfolio. Transportation assets are doing well and include Noatum Ports, the largest gateway in Spain. These assets were acquired in December of 2010, but due diligence has been performed for the last 18 months so JPMorgan could monitor volume. So far, performance is positive despite events in Spain. New Queensland Airports was acquired in January 2009, and includes two airports. Contracted power assets include Southwest Generation located in California, Colorado, Nevada, and New Mexico; Coastal Winds located in Texas and New York; and Zephyr Wind, acquired in 2007 and based in the U.K. The ten assets in the portfolio represent annualized revenues of \$2.6 billion, annualized

EBITDA of \$1.5 billion, and 7,600 employees. Again, the portfolio is well-diversified.

In response to a question from Ms. Van Kampen, Mr. Weddle stated that regulated utilities tend not to fluctuate as much because they are typically long-term contracts and have an inflation pricing mechanism. Transportation assets have a bit more economic sensitivity in terms of market downturns.

In response to a question from the Chairman about how sensitive the ports are to market slowdown in Spain or Europe, Mr. Weddle stated that imports to Spain are slower. However, exports and other traffic volume have been fairly stable.

In response to a question from Mr. Muller, Mr. Weddle stated that ERS owns \$60 million out of this \$3 billion portfolio, or roughly 2%.

Mr. Weddle then discussed portfolio performance. As of March 31, 2012, the 12-month gross is 9.2% and the 12-months cash yield is 6%, with about 49% of investors reinvesting into the fund. With a net asset value of \$3 billion and a gross asset value of \$7.3 billion, the portfolio is moderately and effectively leveraged. Most of the maturities on the debt have also been extended, and JPMorgan believes the portfolio is managed in a very prudent, proper way. In comparison to other asset classes in terms of IIF performance, the annual yield is 6%, and 9.2% on a total return basis, compared to lower annual yields in world equities, Barclays fixed income, real estate, and REITS. IIF outperformed most major asset classes with less volatility.

In response to a question from Dr. Peck regarding the value of insurance relative to the value of assets in relation to a catastrophic event, Mr. Weddle stated that all assets carry some form of catastrophe insurance. The amount of coverage is close to the overall value of the asset itself.

In response to a question from the Chairman about managing risk, Mr. Weddle stated that regulatory risk is considered any time an asset is brought into the portfolio. JPMorgan reviews regulator and case studies in terms of process and rate hikes, how long that process takes, and to what extent a full vetting is provided once requested. JPMorgan also considers the overall level of usage over extended periods of time because of the maturity of the assets; the overall pricing in the contiguous area because that will drive what can be

done in terms of rate increases; requirements as they relate to the operating capital expenditure; whether capital investment is required in terms of to what extent it would be included in a risk case; and how all of these factors affect the overall composition of the portfolio.

In response to a question from Mr. Muller regarding renegotiated debt rates and how far they could be extended, Mr. Weddle confirmed that it varies from project to project. There was total leverage in the portfolio at the end of the first quarter with a 7.3% gross asset value and a 59% loan-to-value ratio. Debt allocation was 54% fixed rate, 15% floating rate, and 31% index-linked. Moving into 2020 to 2029 and 2030 to 2060, the largest percentage of debt is out beyond those periods, whether fixed rate, floating, or index. Effectively, most of the debt financing that has a maturity is 2020 or beyond, and that is very important. As debt is coming due, particularly because of the low rate environment, JPMorgan refinances it as well as extends it out.

In response to a question from Mr. Muller, Mr. Weddle stated that the distinction between floating and index is that floating rate is beyond the basis of looking at, for example, LIBOR plus a spread. Index is related to a CPI, plus some spread.

In response to a question from Dr. Peck about exit strategy, Mr. Weddle stated that with an open-end structure and the type of assets JPMorgan acquires, assets are held long term. As operating and financial efficiencies are built in and capital structure is set, assets should be kept as long as possible, provided the asset is performing. If an investor or buyer wants to purchase the asset at a value higher than what JPMorgan places on it, JPMorgan would potentially sell.

In response to a question from Mr. Caprio, Mr. Weddle confirmed that the fund distribution forecasts listed in the report would likely change if JPMorgan made additional investments. Yield increases with a projected portfolio average of 7% to 8% going into 2014 and 2015 because of operating efficiencies. The forecast is fairly consistent with the targets of the overall portfolio, and is based on the ten investments discussed earlier. JPMorgan is confident the forecast is accurate.

In response to questions from the Chairman, Mr. Weddle stated that infrastructure assets are not readily available. They are quasi-monopolistic, so higher margins are used along with leverage. There

is a greater volume of these assets available on a selected basis, however, in Australia, Canada, or Europe than in the U.S. market. As operating margin decreases, capital expenditures are made. JPMorgan looks for different efficiencies both in terms of operations and capital structure.

Mr. Weddle then discussed JPMorgan's three-stage investment process; investment strategy, pre-ownership, and post-acquisition. JPMorgan continually identifies, assesses, categorizes, manages, and monitors risk throughout this process. In the investment strategy phase, things like geography, subsector, deal type, and pricing are reviewed. In the pre-ownership phase, the acquisitions team and the asset management team work together to ensure the deal sourcing is in line with strategy. Due diligence is performed through valuation, negotiation, financing, and execution. In the post-acquisition phase, the asset management team sets up the overall management of the portfolio assets and monitors performance. Board-level decisions are also made in this phase.

Mr. Weddle continued by stating that in terms of infrastructure and opportunities and considering GDP growth over the last 50 years, growth rates over the next decade will not be what they have been historically. JPMorgan will look for monopolistic situations, and situations where there are regulated utilities and long-term contracted assets to ensure cash flow. From an inflation standpoint, this is not such a big concern right now, but central banks will start to tighten as stimulus programs strengthen the economy. Inflation will occur in the more intermediate to longer term. As this happens, infrastructure assets with an embedded inflation and pricing mechanism become attractive assets to hold. Natural gas, for example, experienced a shift in terms of what was historically seen in the price differential with oil. Over the last 10-year period, that price differential was 10 to 1. However, with shale gas finds and fracturing and the cheaper method with which natural gas can be extracted, that relationship is shifting. Now, oil increased slightly and natural gas dropped substantially, changing that differential to 30 to 1. Overall, natural gas and distribution is going to be attractive, as potentially will natural gas distribution in terms of the U.S. exporting to other countries.

Mr. Weddle then discussed return on equity for gas and electric utilities, both driven primarily over the last 30 years. This correlates to what is seen with utility bond yields and natural gas and treasuries. Essentially, return on equity is at a spread over the bond

yields. JPMorgan anticipates an increase in bond yields over the next decade and, with that, an increase in return on equity.

Mr. Weddle then stated that improved economic activity suggests adding transportation assets. The number of passengers getting on planes and the number of railcar containers being used since the recessionary period has increased substantially. However, prices have not rebounded as quickly, so this is a good entry point into transportation assets. Additionally, the water sector is a very significant area for consolidation because there are essentially 50,000 independent water systems, which are very small and contiguous. Compared to, for example, the U.K. where there are perhaps 30 different water systems, that is an opportunity for improved efficiency and therefore an attractive area in which to invest.

Mr. Weddle concluded by stating that in terms of the portfolio and market outlook, JPMorgan expects lower GDP growth, deleveraging and higher inflation, and that shale gas will result in lower gas and electricity prices. Additionally, an increase in potential for return on equity and a consolidation in the U.S. water sector are expected. Going forward, transportation assets will be a major priority for the fund, as well as a focus on industry fundamentals like natural gas, water, and wastewater.

In response to questions from Mr. Muller, Mr. Weddle stated that of the total return, yield is approximately two-thirds with appreciation making up the remainder. With a 10% to 12% net, roughly 7% is yield. Additionally, JPMorgan has an internal independent valuation team that assesses the assets on a quarterly basis using outside firms to stress test the underlying discount factors and key assumptions. PricewaterhouseCoopers, the auditor, performs an independent valuation as well. The infrastructure managers use a discounted cash flow basis for valuation of the assets, which is a recognized standard.

In response to a question from Mr. Muller on JPMorgan's report, Mr. Caprio stated that the NCREIF ODCE U.S. Real Estate index is the commercial real estate benchmark. The objective in using this index was to reduce the volatility of real estate, so the return expectation for commercial open-ended is less than REITS but with half the volatility.

(b) IFM

Hillary Ripley of IFM distributed a booklet containing information on the investments managed by IFM for ERS. Ms. Ripley then introduced herself as Vice President of IFM and a member of the investor relations team.

Ms. Ripley first provided an overview of the firm. IFM is one of the world's largest investors in infrastructure with approximately \$10 billion in assets across Europe and the United States since 2004, and Australia since IFM's inception. IFM also invests in other equities, resulting in an additional \$25 billion of assets under management. The firm is owned and was founded by 32 major Australian pension funds, a unique ownership structure that results in a strong alignment of interests between the fund and management team, and the underlying investors. IFM is a core infrastructure fund of mature assets with monopolistic characteristics that exhibit a history of cash yields. The fund targets a 10% return net of fees with as little volatility as possible through geographic, sector, vintage year, and regulator diversification.

In response to a question from the Chairman, Ms. Ripley stated that any leverage in the fund exists at the asset level.

Ms. Ripley then discussed the portfolio assets. There are currently eight assets in the fund; three in the U.S., three in the U.K., and two in continental Europe. In the U.S., Colonial Pipeline is the largest refined petroleum product pipeline, transporting about 17% of demand for refined product. Duquesne Light is a Pittsburgh-based company in the regulated power and distribution markets. Essential Power is a portfolio of non-regulated, primarily gas-fired and hydroelectric plants, supplying upwards of 1,700 megawatts to the northeast. In the United Kingdom, Arqiva is a leading owner and operator of communications infrastructure, both broadcast and wireless. Wales West Utilities, a gas pipeline company, has about 35,000 kilometers in pipe and is one of the regulated monopolies in Great Britain. The Anglian Water Group is the fourth largest regulated water and wastewater company in England. In Europe, Dalkia is a district heating and cogeneration company. 50Hertz, in Germany, is one of the four transmission system operators. IFM is proud of its asset collection and believes diversification will increase as more assets are added to the fund. To date, IFM has three regions, five sectors, six regulators, and seven vintage years.

In response to a question from Dr. Peck, Ms. Ripley stated that the negative return from Arqiva stemmed from refinancing in a market where refinancing is not easy to accomplish and which had to be incorporated into the capital evaluation.

Ms. Ripley then discussed the ERS Fund performance. IFM drew down capital at the end of May 2010 for a \$60 million investment. The value of the investment at the end of March 2012 was \$74 million, which amounts to a 15% increase since inception. If March 31 capital distributions of \$3.3 million are added, that amounts to another 5.5% for a total of just over 20%, which is very close to the 10% annual return target. IFM was able to accomplish this during the recession period, which is a challenging market for the types of assets in which IFM is invested.

Ms. Ripley next discussed overall fund performance. Since 2006, asset performance has been fairly consistent and in most cases, gradual positive growth was realized. An exception to this is 50Hertz. In 2011, regulators were evaluating 50Hertz and making a pricing decision, so there is a slight dip in performance, though it ultimately served the investment well in terms of operational performance. With asset valuations, accomplishments in 2011 include Dalkia, which operationally outperformed the acquisition scenarios that the IFM investment team put in place when the acquisition was made. Anglian Water Group also did very well, and continues to do so in 2012. With Arqiva, 2011 was the year in which IFM assessed the refinancing and that resulted in negative performance because all of that risk was incorporated into the valuation. This remains the case for the first quarter of this year, and IFM is comfortable with the extent to which the risk was incorporated. Additionally, the non-dollar assets all confronted currency appreciation headwinds. IFM eliminated the currency exposure in the portfolio. Overall, in terms of performance returns since inception, IFM slightly outperformed its target.

In response to a question from Ms. Van Kampen, Ms. Ripley stated that the difference between the operating performance of the assets versus the cash distributions each of the companies make can be significant. It is a management judgment to the extent that the valuation is partly based on cash distributions and partly based on capital yield, but there is not necessarily a direct link. The fact that the fund demonstrates strong performance is a testament to the strength of IFM's investment process and management.

In response to questions from the Chairman, Ms. Ripley stated that the part of the return attributed to currency is difficult to quantify. Without being able to verify the exact amount, Ms. Ripley estimated 2.4% of the overall year. IFM does not hedge currency risk because to do so would be to make decisions on behalf of the underlying investors who may not want hedging. Additionally, hedging against currency fluctuations is a derivative of hedging against inflation. They are not directly aligned, but they are related. If every currency to which the fund was exposed was hedged, some of that inflation hedging would be eliminated.

Ms. Ripley concluded with an overview of year-to-date performance. The fund finished strong in the first quarter at 4.1%. In terms of the analysis done on the returns each period, IFM looks at how much is driven by distributions, how much by change in asset value, and how much by FX movements because these items can actually benefit the fund. Assets drive performance, notably 50Hertz with a very strong quarter that will have a direct impact on pricing going forward. There were distributions from Wales and West Utilities and from other assets, as well. Finally, as an added note, IFM's cash yield policy changed this year. Investors now have a 90-day notice option twice per year to either take investments out of the fund or reinvest them.

In response to a question from the Chairman, Ms. Ripley stated that IFM has a significant amount of capital committed. ERS is drawn completely, but there are commitments in the fund. IFM has enough capital for any of the deals at which it is currently looking.

In response to a question from Mr. Sikorski about regulated versus non-regulated investments, Ms. Ripley stated that IFM does not require that regulations be involved in the businesses invested in, but monopolistic industries are usually regulated, anyway.

(c) Marquette Associates Report

Ray Caprio of Marquette Associates distributed and discussed the first quarter report and the May 2012 monthly report.

Mr. Caprio first discussed the first quarter report. At the end of March, the ERS Fund was up 6½% net of fees and ranked in the 48th percentile relative to the other public pension funds in this universe, which includes over 100 plans ranging in size. The ERS Fund is just above median. Marquette's goal is to keep the Fund at median to slightly above median. The focus since inception has

been risk; making sure the return is risk-adjusted and that rank is consistent on the return side, but also on the risk side. In 2011, the Fund was ranked in the 53rd percentile, but the risk rank was in the top quartile. The goal here was to shift a sizeable piece of the Fund away from volatile markets like stocks and bonds and move it into infrastructure, real estate, and private equity to produce more stable income-generating returns with less correlation in the stock market. The Fund performed well over the last 3 years and total returns were 14%, so good decisions were made. Contributors included fixed income, up 9.6%, and U.S. equities, up 24.7%, and international, up 16.7%. Real estate was also up 31.8% now that the commercial real estate has been in the portfolio for about 1½ years. The REITs were up significantly over the last 3 years and over the last 10 years they were up 9.3%, but again the focus was to reduce volatility. REITs are stocks and are highly correlated to stock markets, so diversification benefits from the stable income that comes with commercial real estate are not realized. Moving forward, Marquette expects better long-term returns in commercial real estate, but with half the volatility.

In response to questions from Ms. Van Kampen as to why the ERS return is below the policy benchmark, Mr. Caprio stated that there are no listed benchmarks for some of the asset classes currently in the Fund. For instance, infrastructure does not have a listed benchmark that can be used as a component and policy benchmark. Therefore, Marquette includes that allocation as a fixed income investment in the policy. Another example, and one that led to the underperformance of the policy mix, is hedged equity funds. These funds are included in the long-only equity allocation of the policy benchmark, the Wilshire 5000. As a result of equities outperforming the hedge funds over the last 3 years, the policy mix has exceeded actual ERS returns. Marquette will run a more specific policy mix moving forward.

Mr. Caprio stated that the total Fund can be evaluated based on a number of components, such as Sharpe ratio and tracking error, in order to evaluate the Fund's investments on a risk-adjusted basis.

Mr. Caprio then discussed the May 2012 flash report. Asset values through the end of May were \$1.68 billion. Real estate and infrastructure are overweight, and Marquette will continue to use those funds to pay benefits in order to maintain balance in the portfolio. Otherwise, the Fund is fully funded for the different allocations put in place over the last two years. Marquette will replace the iShares mid-cap growth under the U.S. Equity portfolio

in the next few weeks. Private equity has also been a focus for the last 6 months in terms of finding the best approach to fulfill that allocation. Marquette will soon make commitments to the Adams Street 2012 fund, which is having its final close in the next three weeks, and to Siguler Guff, a small-mid buyout allocation. The contracts are finished for that transaction and they will be calling money shortly. The goal is to reach the 6% target within the next few years.

Mr. Caprio continued by stating that another focus will be on manager performance, similar to what was done for mid-cap growth. AQR has been in the fund for 5 years and they are under by 10 basis points gross of fees and closer to 50 basis points net of fees. This manager might need to be reviewed in order to avoid detracting from the total fund performance. Also relating to international, various emerging markets are starting to trail a bit based on stock selection. With fundamental managers that pick stocks, some can be slightly more quantitative than others, but it comes down to stock selection. In the next few Investment Committee meetings, this should be the focus behind determining whether these managers should be reevaluated.

Mr. Caprio then stated that for the month of May, there was a drawdown in the stock market, which was the main contributor to the -4.2%. The Fund is still positive to date by about 2%, and the longer track record returns are strong. The 10-year rate of return is at 6½%, and while the actuarial rate of return is 8%, there has been a lot of discussion on whether that rate is sustainable. A lot of it is driven by bond yields. The 10-year Treasury at 1.6% or 1.7% falling from about 3% over the last 2 years has helped bonds by providing better returns. However, moving forward the yield is not there, and it will continue to be a drag on performance. In a higher interest rate environment, it will become a bigger piece of the portfolio and provide a 4% or 5% return, but currently it is not yielding much. This is why Marquette prefers real estate and infrastructure; the yields are much more attractive at 6% and 7%, and very sustainable. Additionally, the timing is right for investing, particularly in real estate. Real estate returns are not quite at pre-crises levels, but certainly moving in that direction slowly. If a real estate manager returns 16% over the next 3 years, that manager will be back to where they were in 2005. That is where the yield is moving, and the direction in which Marquette wants to go.

Mr. Caprio concluded by stating that hedge funds, which had not performed as well, did reduce volatility quite a bit, but for the last

two years returned just slightly over 2%, well below the stock market. This somewhat detracted from overall performance because that allocation was taken from stocks, specifically the U.S. equity portfolio. However, managers are starting to report more favorable news. What the managers consider to be fundamentals are coming back to the market, which allows the managers to do a better job of picking stocks. May was a decent month for hedge funds in that markets were down, so hedge funds did protect to a small extent. Real estate and infrastructure are valued quarterly, so returns will not be seen until the end of the second quarter. At that time, the picture will be much clearer on how the Fund actually performed.

Dr. Peck then stated that an item could be added to the Investment Committee agenda to discuss active versus passive management and review how the portfolio is allocated.

Mr. Caprio noted that asset allocation will be revisited this year with the actuary. Different models will be reviewed again, as well as return expectations, because the bond market has been so volatile. This drives a lot of the expectations for asset return and full return, and ensuring that a portfolio return of around 8% can be achieved over the next 10 years.

#### 8. Investment Committee Report

Dr. Peck reported on the June 4, 2012 Investment Committee meeting.

Dr. Peck first noted an error in the minutes of the June 4, 2012 Investment Committee meeting. The recommendation was to retain Northern Trust as the international index manager, not State Street Global Advisors. The recommendation was based on a lower fee, data liquidity, and familiarity with the firm. Performance was similar between the managers and therefore not as relevant.

**The Pension Board voted 4-1, with Dr. Peck, Ms. Van Kampen, and Messrs. Sikorski and Maier approving and Mr. Muller dissenting, to move to Northern Trust as the international index investment fund. Motion by Ms. Van Kampen, seconded by Dr. Peck. The motion failed to pass because it lacked the necessary five votes as required by Ordinance section 201.24 (8.5).**

Mr. Muller stated that his dissent is due to the concept of indexing, and that Marquette did not look for a manager that outperformed the index.

After general Board discussion, Mr. Muller stated that he would be willing to change his vote if Marquette performs a search for an active manager that outperformed the index. An RFP could then be sent to these individual active managers if the Investment Committee determines that it would be worthwhile to seek an active manager.

**The Pension Board unanimously approved moving from GMO to Northern Trust as the international index investment fund, with the proviso that Marquette researches an international active manager that outperformed the index, and presents the findings to the Investment Committee. Motion by Dr. Peck, seconded by Ms. Van Kampen.**

In response to a question from Mr. Grady, Mr. Hanchek indicated that the minutes from the June 4, 2012 Investment Committee meeting will be corrected and reposted.

9. Audit Committee Report

The Chairman reported on the June 5, 2012 Audit Committee meeting.

The Chairman noted that Mr. Garland will be relocating to another state. Additionally, Ms. Taylor is no longer an employee of Milwaukee County. Since both are therefore no longer members of the Pension Board, some items on the Audit Committee agenda are either moot or can be deferred.

The Audit Committee first discussed the retiree election that is in process using the current Votenet procedure. The discussion involved proposed changes to the retiree and employee election process. The Chairman requested that a specific proposal be drafted to include cost comparison and process changes. Ms. Taylor volunteered to lead the project; however, until someone volunteers

to replace her on this project, the current Votenet procedure will be used.

The Audit Committee next discussed forms and letters. Ms. Ninneman requested guidance on which changes to the ERS forms and letters needed Board approval. The Audit Committee agreed that unless there is something that affects the policy of the Board, such as ERS Rule- or Ordinance-related matters, changes which are administrative can be handled by ERS staff.

The Audit Committee then discussed Option 7 and the fee assessed to members for calculating this benefit, currently \$50. An internal audit issue was raised, and ERS requested an amendment to Pension Board Rule 1035(a) allowing ERS to recoup all costs associated with calculating this benefit option. Mr. Grady prepared the amendment.

Dr. Peck suggested that going forward the members should be advised of the fee at the time of the request. The Chairman also suggested advising the member upfront of the likelihood of an Option 7 retirement request being approved.

**The Pension Board unanimously approved amending Rule 1035 to include all costs related to an Option 7 benefit calculation, attached to these minutes as Exhibit A, effective June 20, 2012. Motion by Dr. Peck, seconded by Mr. Sikorski.**

The Audit Committee next discussed the Certified Employee Benefits Specialist (CEBS) Designation and whether courses unrelated to pensions should be included as eligible Pension Board educational courses. Ms. Taylor proposed the matter and Mr. Garland wanted to discuss it at the Board level. However, since both are no longer Pension Board members, the issue is moot.

The Audit Committee next discussed how to calculate the number of pay periods for final average salary and the inclusion of an adjustment for leap years. The Audit Committee agreed that an adjustment should be made as recommended by the audit. Mr. Grady drafted a Board Rule to clarify the periods to be used in the calculation, which will be presented to the Pension Board for review.

The Audit Committee then reviewed and approved a new form on the PSO option.

The Audit Committee next discussed calculations relating to Option 6 when a backDROP is elected; specifically, when the 120-month

period begins. The Committee agreed that the 10 years of guaranteed payments should begin on the member's retirement date rather than on the member's backDROP date, but that it should be actuarially adjusted to reflect the backDROP selection and period. A rule was drafted and will be presented to the Pension Board for review.

The Audit Committee next discussed the check register. Ms. Taylor asked for clarification on the process ERS follows when purchasing goods and services like office furniture. The Chairman explained that the Board approves a budget and ERS then administers that budget. The check register is presented to the Board on a quarterly basis for review and questions.

The Audit Committee concluded with a discussion on the open staff positions at ERS. At Ms. Taylor's request for an update, Ms. Ninneman stated that there had been no changes to staff and she did not anticipate filling any of the vacant positions in 2012.

Mr. Hanchek then noted that ERS is experiencing some backlog, but that it is related to recent clerical staff vacancies and not from lack of budgeted staff. ERS is in the process of recruiting for the clerical staff vacancies.

10. Administrative Matters

The Chairman first addressed the open Vice Chairman position on the Pension Board, stating that there are two major functions of this role. The first is to run the Pension Board meeting when the Chairman is absent. The second is to attend the agenda setting meeting with the Chairman and ERS staff. Anyone interested in this leadership position on the Board or who would like to nominate someone should come forward.

The Chairman then addressed the special employee elections. The Board must authorize an election process for the positions previously held by Ms. Taylor and Mr. Garland.

Mr. Grady stated that the current rule provides for an automatic election if someone leaves at a normal end of term. However, if someone leaves mid-term, the Board has to authorize a special election because the current rule also allows an option to let the position sit vacant for a mid-term departure.

In response to a question, Mr. Grady stated that the remaining term for Mr. Garland is 1½ years, and the remaining term for Ms. Taylor is 2½ years.

Mr. Grady continued by stating that if the Board authorizes the elections, the elections will be conducted under the current Votenet rules, which include telephone and computer voting, but not paper. Additionally, in order to determine whether a primary in each seat must be held, it would be prudent to ask the candidates to declare the term for which they are running.

The Chairman then stated that other options have been considered over the years when two seats were open. For example, after candidates file nomination papers and the election is held, the longest term could be given to the candidate receiving the most number of votes and the shorter term could be given to the candidate with the second-most number of votes.

Mr. Grady stated that this option could avoid a primary election, provided for in existing rules for a normal election when there are more than two candidates. There is no provision for this when there are two elections at one time, however.

After general discussion by the Board about whether to hold one or two elections and whether to allow employees one or two votes, Mr. Muller and Ms. Van Kampen concurred with the earlier option to hold one election, to allow employees one vote, and to give the longer term to the candidate with the most number of votes and the shorter term to the candidate with the second-most number of votes.

Mr. Grady then stated that an issue to consider is that if there are more than two candidates, a winner could be elected without a majority vote, which employees might object to.

Mr. Sikorski then stated that more election votes were cast before the Votenet system was introduced.

Dr. Peck suggested that ERS explore other ways of getting election information to employees in order to improve turnout and promote things like security and the use of the telephone to cast a vote. The Chairman then suggested that education about the election be part of the motion relating to a special election.

Mr. Grady stated that part of the problem lies with advertising. Notice of an election has been primarily sent through e-mail since not even direct deposit slips are sent via U.S. mail to employees'

homes, anymore, so one question is how to reach those employees who are not at their computers or do not have computers at work. Some sort of public posting might be a prudent option.

In response to a question from Ms. Van Kampen, Mr. Grady stated that an election most likely would not be held until September or October if a special election was approved today.

Mr. Sikorski then stated that he will not vote in favor of a special election unless in-person voting at polling places is provided in the voting process.

In response to a question from Mr. Grady, Mr. Hanchek stated that a notice with a unique identifier and login information for Votenet was mailed to employee home addresses and that same process would be followed for any special election.

Mr. Muller then questioned why the same process used to sign up for employee health benefits, which receives 100% participation, does not work for an election. The issue he-stated is how this incentive problem can be corrected.

The Board then discussed potential ways to increase voter turnout.

**The Pension Board voted 4-1, with Dr. Peck, Ms. Van Kampen, and Messrs. Muller and Maier approving and Mr. Sikorski dissenting, to authorize, pursuant to Rule 1020, a special election to fill both employee seats. Because of the dual vacancies, there will be one election with one vote per employee, with the candidate with highest vote count receiving the longest partial term, and the candidate with the second-highest vote count receiving the shorter partial term. In the event of a tie, the tie will be broken in accordance with State statute as described in Rule 1020. Motion by Mr. Muller, seconded by Mrs. Van Kampen. The motion failed to pass because it lacked the necessary five votes as required by Ordinance section 201.24 (8.5).**

In response to a question, Mr. Grady stated that a new retiree member will join the Board after the election in process. Additionally, a sheriff's deputy member could be designated as early as next month.

The Pension Board then discussed additions and deletions to the Pension Board, Audit Committee, and Investment Committee topic lists. The Chairman stated that the GMO item is removed from the

Investment Committee agenda and an active versus passive international item is added.

Dr. Peck then suggested that a discussion of AQR and Barings also be added to the Investment Committee agenda.

In response to a question from Mr. Muller, the Chairman stated that the proxy voting reports received by ERS should be kept on file at ERS. Marquette should ensure that reports are received.

The Chairman moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(f), with regard to items 11 and 12 for considering the financial, medical, social, or personal histories of specific persons which, if discussed in public, would be likely to have a substantial adverse effect upon the reputation of any person referred to in such histories, and that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(g), with regard to items 11 and 12 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 items 11 and 12. Motion by the Mr. Muller, seconded by Ms. Van Kampen.**

11. Pending Litigation

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

The Pension Board took no action on this item.

(b) Renee Booker v. ERS

The Pension Board took no action on this item.

(c) Jo Ann Schulz v. ERS

The Pension Board took no action on this item.

(d) Stoker v. ERS

The Pension Board took no action on this item.

12. Report on Compliance Review

Returning to open session, the Board discussed proposed Rule 1045 regarding the calculation of final average salary.

**The Pension Board unanimously approved the adoption of Rule 1045 attached to these minutes as Exhibit B, effective June 20, 2012. Motion by Mr. Sikorski, seconded by Ms. Van Kampen.**

The Board then discussed proposed Rule 1046 regarding the calculation of Option 6 benefits when the individual elects a backDROP.

**The Pension Board unanimously approved the adoption of Rule 1046 attached to these minutes as Exhibit C, effective June 20, 2012. Motion by Dr. Peck, seconded by Mr. Sikorski.**

13. Adjournment

The meeting adjourned at 12:00 p.m.

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

## EXHIBIT A

### AMENDMENT TO THE RULES OF THE PENSION BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

#### RECITALS

1. Section 201.24(8.1) of the General Ordinances of Milwaukee County (the "Ordinances") provides that the Pension Board of the Employees' Retirement System of the County of Milwaukee (the "Pension Board") is responsible for the general administration and operation of the Employees' Retirement System of the County of Milwaukee ("ERS").
2. Ordinance section 201.24(8.6) allows the Pension Board to establish rules for the administration of ERS.
3. ERS Rule 1013(1)(d) allows a member to apply to the Pension Board to receive his or her benefit in any other form, but the member must pay all costs incurred by the system to evaluate such form of benefit.
4. ERS Rule 1035 describes the requirements to apply for an Option 7 form of benefit under Rule 1013. Rule 1035(c) requires a member to pay \$50 towards the cost of calculating an Option 7 form of benefit.
5. The Pension Board believes it is appropriate to amend Rule 1035 to clarify that the member is required to pay all costs associated with calculating an Option 7 form of benefit.

#### RESOLUTION

Pursuant to Ordinance section 201.24(8.6), the Pension Board hereby amends Rule 1035 to read as follows:

#### **1035. Option 7 Benefit Requests.**

The following procedures shall govern the Pension Board's review of applications for Option 7 benefits:

(a) **Option 7 Benefit Defined.** For purposes of this Rule 1035, "Option 7 benefit" refers to a retirement benefit that is in a form permitted by Ordinance section 201.24(7.2) and Rule 1013(a)(4), that is the actuarial equivalent of the benefit otherwise payable, that is not provided for by Ordinance section 201.24(7.1) or Rule 1013(a)(1), (2) or (3) and that is not a lump sum distribution as that term is defined in Rule 1021.

(b) **Eligibility to Apply for an Option 7 Benefit.** A member shall be eligible to apply for an Option 7 benefit pursuant to Ordinance section 201.24(7.2) and Rule 1013(a)(4) if the member is eligible for a Normal Pension, an Early Pension, or a Deferred Vested Pension pursuant to Ordinance sections 201.24(5.1), (5.2) and (5.5), respectively. An Option 7 benefit shall not be an available option for the distribution of any disability pension offered through ERS.

(c) **Member Application.** An eligible member shall apply for an Option 7 benefit by making an application on the form approved by the Pension Board. As required by Rule 1013(a)(4), the member shall be required to pay the System ~~\$50~~ for all costs related to the calculation of an Option 7 benefit.

(d) **Member Signature.** The application shall be personally signed by the member. Applications signed by a guardian, conservator or other representative of an incapacitated member shall not be valid.

(e) **Spousal Consent.** If the member is married at the time the application is made, the member's spouse must sign the application, giving the spouse's written consent to the receipt of an Option 7 benefit. This requirement shall be waived if the member documents the inability to obtain the spouse's signature for one of the following reasons only:

(1) The spouse is incompetent and a copy of the court order appointing the spouse's guardian is submitted with the application. The guardian's signature shall be required on the application in lieu of the spouse's signature.

(2) The member certifies, on a form provided by the Pension Board, that the member does not now know and has not known the whereabouts of the spouse for at least the 180 days immediately prior to the date the application is signed.

(f) **Pension Board Discretion.** The determination of whether to approve an application for an Option 7 benefit is solely within the discretion of the Pension Board as set forth in Ordinance section 201.24(7.2) and Rule 1013(a)(4). Consistent with Rule 1013, the decision of the Pension Board regarding any application shall be final and binding, unless it is found to be arbitrary and capricious by a court. In making this determination, the Pension Board will weigh

three competing interests: (1) the individual applicant's interests in receiving a distribution in the form of the applicant's choice; (2) the individual applicant's interests in receiving a distribution in a form that the individual has the capacity and fiscal responsibility to manage, even if that is not the form of the applicant's choice; and (3) the interests of the System members as a group in not having plan assets depleted by adverse selection. If it chooses, the Pension Board may delegate any or all of its responsibilities in making the Option 7 benefit determination to a committee. Each decision of this committee shall be effective on the date specified by the committee once ratified by the Pension Board.

(g) **Minimum Percentage of Option 7 Benefits.** The Pension Board will generally deny Option 7 benefit requests that provide for a survivorship benefit of less than 25 percent. However, the Pension Board reserves the right to exercise its discretion in approving any Option 7 benefit.

(h) **Submission of Evidence.** In order to have sufficient information to make its determination, the Pension Board shall require that the applicant submit evidence of the following: (i) a bona fide retirement purpose for the application and benefit form requested; and (ii) the applicant's good health. In addition, the Pension Board may require that the applicant submit evidence of any or all of the following: (i) the applicant's fiscal responsibility; and/or (ii) the absence of undue influence in the applicant's decision to elect an Option 7 benefit.

(1) **Bona Fide Retirement Purpose.** Any member applying for an Option 7 benefit must submit evidence of a bona fide retirement purpose for the application and the particular benefit form requested. On its own, eligibility of a beneficiary for retiree health benefits shall not be considered a valid reason to approve an Option 7 benefit request. The member shall also explain why an Option 7 benefit is necessary and none of the other optional forms of benefit provided by ERS is sufficient to meet his or her retirement needs.

(2) **Good Health.** Any member applying for an Option 7 benefit must submit evidence that he or she is in good health. "Good health," as used in Ordinance section 201.24(7.2), is defined as a state of physical and mental well being. Good health includes the capacity to make rational decisions. Good health also includes the absence of diseases or conditions that, from a medical standpoint, may result in a significant shortening of life expectancy. In submitting evidence of good health, the following procedures shall be followed:

(A) **Medical History and Evaluation.** The member shall be required to undergo an examination by a physician. This physician could be either the member's regular attending physician, if the member has one, or a Medical Board physician. As part of the exam, the member and the physician shall complete a Medical History and Evaluation of the patient, including the

physician's opinion of whether the applicant is in "good health" as defined above. The attending physician's opinion of whether the applicant is in "good health" is merely a factor to be considered by the Pension Board, and is not determinative of the Pension Board's ultimate decision of whether to grant the Option 7 benefit request. The cost of this initial examination and completion of the Medical History and Evaluation shall be borne by the member.

(B) *Review by Medical Board.* The Medical History and Evaluation, if required, shall be returned to the attention of the Secretary of the Pension Board. The Secretary of the Pension Board shall, in turn, forward the Medical History and Evaluation to the Medical Board pursuant to Ordinance section 201.24(8.12) for review. If, after review, the Medical Board believes that the Medical History and Evaluation is complete and sufficient on its face, it shall return the document with this opinion to the Secretary of the Pension Board.

If, however, after review of the Medical History and Evaluation submitted by the member, the Medical Board believes that confirming or additional information is necessary, then the member shall be required to undergo a subsequent medical examination conducted by the Medical Board. The costs of such examination shall be borne by the System.

(C) *Authorization to Disclose.* In advance of the subsequent medical examination, the applicant shall be required to execute an authorization to disclose any and all information and records which relate to the applicant's medical condition to the Medical Board and the Pension Board. This authorization shall apply to medical information and records for the five years preceding the date of the application and any records accumulated during the application period and as a result of the application itself.

(D) *Copies of Medical Records.* Upon receipt of the authorization to disclose records, the Medical Board may request copies of the member's medical records. The cost of obtaining such medical records shall be borne by the System.

(E) *Subsequent Medical Examination.* The Medical Board shall conduct the subsequent medical examination of the applicant. If the applicant fails to attend an appointment for the subsequent medical examination without canceling the appointment in time to avoid any cancellation fee, the applicant shall be responsible to pay such fee. If an applicant cancels more than one appointment for an independent medical examination, the Pension Board may, within its discretion, determine that the member is not acting in good faith, and may cancel the member's application for an Option 7 benefit.

(F) *Medical Board's Opinion and Evaluation.* Following the subsequent medical examination, the Medical Board shall provide a Medical Opinion and Evaluation in a format determined by the Medical Board and the Pension Board. The Medical Opinion and Evaluation shall include the Medical Board's opinion of whether the applicant is in "good health" and the reasons underlying the opinion. The Medical Board's opinion of whether the applicant is in "good health" is merely a factor to be considered by the Pension Board, and is not determinative of the Pension Board's ultimate decision of whether to grant the Option 7 benefit request.

(G) *Specialists and Second Opinions.* Within its discretion, the Medical Board may determine that it is appropriate for the applicant to undergo further medical examination by a specialist and/or for an additional opinion. The costs of any such examination(s) shall be borne by the System. The physician or specialist conducting such examination shall also prepare a Medical Opinion and Evaluation as discussed in subparagraph (F) above.

(H) *Confidentiality of Medical Records and Reports.* Any medical records or information obtained in the application process shall be released only to members of the Medical Board and the Pension Board for the purpose of evaluating the member's request for an Option 7 benefit. Such records shall be handled, accessed and stored in accordance with applicable medical confidentiality standards. Such records shall not be considered "open records" available to the general public.

(I) *Actuarial Estimates.* Upon receipt of the member's application for an Option 7 benefit, the Secretary of the Pension Board shall contact the actuary and request a copy of a report showing the value of the applicant's requested benefit in comparison to a ten year certain annuity. The Pension Board shall review this information and take it into consideration in evaluating the possible shortening of an applicant's life expectancy if an applicant cannot demonstrate "good health."

(J) *Other Evidence.* If, in the Pension Board's discretion, more information is necessary to determine the health status of the applicant, then the Pension Board may require the submission of additional medical information as it may specify for the Pension Board's review.

(3) *Fiscal Responsibility.* Depending on the benefit form requested, the applicant may be required to prove to the satisfaction of the Pension Board that he or she is fiscally responsible enough to manage the Option 7 benefit to cover the member's financial needs throughout the period of retirement. If the Pension Board determines that such evidence is necessary, the following procedures shall be followed:

(A) *Declaration of Financial Responsibility.* The applicant shall execute a Declaration of Financial Solvency stating: (1) whether he or she has ever filed for personal bankruptcy or financial reorganization under either state or federal law, and if so, when; (2) that he or she is currently financially solvent (i.e., that personal assets at least equal personal liabilities); (3) that he or she has no plans to file for personal bankruptcy or financial reorganization under either state or federal law in the foreseeable future; (4) that he or she has an investment plan ready to be implemented upon receipt of the Option 7 benefit; and (5) that he or she understands the consequences of electing to receive benefits in the form requested.

(B) *Credit Report.* The applicant shall execute an authorization on a form provided by the Pension Board to allow the Pension Board to obtain a report on the member's credit history. The System shall bear the cost of obtaining such credit report, if the Pension Board deems it necessary to do so.

(C) *Other Evidence.* If, in the Pension Board's discretion, more information is necessary to determine the fiscal responsibility of the applicant, then the Pension Board may require the submission of additional financial information as it may specify for the Pension Board's review.

(4) *Absence of Undue Influence.* Depending on the form of benefit requested, the applicant may be required to prove to the satisfaction of the Pension Board that the applicant is not under undue influence in making the application to receive an Option 7 benefit. The Pension Board may require that the applicant submit to a personal interview with the Board or its designees. The Pension Board may also require the applicant to provide such other information as it deems necessary for the Pension Board's review as to the issue of undue influence.

(i) **Pension Board Determination.**

(1) *Scheduling the Review.* The member's request for an Option 7 benefit shall be placed on the agenda for a regular business meeting of the Pension Board scheduled following the date upon which the Pension Board has received all of the following necessary items for review which are complete in all respects: (a) the Application for Option 7 Benefit; (b) evidence of a bona fide retirement purpose and good health; (c) any evidence of fiscal responsibility or absence of undue influence as determined to be necessary by the Pension Board; and (d) any additional information the Pension Board has requested in connection with the application.

(2) *Member Attendance.* The member shall be invited to attend the meeting at which the member's request for an Option 7 benefit is to be

reviewed. The member should be prepared to respond to questions placed by the Pension Board about the evidence required for the Option 7 benefit application.

(3) ***Standards of Proof.*** The Pension Board's determination is made on a case-by-case basis in weighing the evidence presented as it affects the competing interests which must be considered by the Pension Board as outlined in subparagraph (f) of these procedures. No one piece of evidence is likely to determine whether an Option 7 benefit request will be granted or denied. In any individual case, some evidence may weigh in favor of granting the request, whereas others may weigh against it. In reviewing the application and supporting materials presented by a member, the Pension Board need only find that a preponderance of the evidence supports each requirement in order to justify granting an Option 7 benefit request or fails to support any requirement in order to justify denying an Option 7 benefit request. The determination of the Pension Board in granting or denying an Option 7 benefit request shall be final and binding, unless it is found to be arbitrary and capricious by a court.

(4) ***Decision and Record.*** The Pension Board shall take the information presented at the business meeting under advisement. If the Pension Board does not render a written decision granting the Option 7 benefit within 60 days following the meeting, it shall be deemed denied. The Pension Board shall keep a written record of its evaluation along with the application record.

(j) **Invalidation of Application.**

(1) ***Incomplete Application Void.*** If any of the documents necessary to the Option 7 benefit application procedure as described in this rule are not received by the Pension Board within 180 days following the date the application for an Option 7 benefit is received by the Pension Board, the application shall be canceled and void. If the member still wishes to request an Option 7 benefit, a new application must be filed and the process begun anew.

(2) ***Material Omissions or Misrepresentations.*** If it comes to the attention of the Pension Board that the member may have made omissions or misrepresentations in the application process which are material to the decision on granting an Option 7 benefit request, the Pension Board has the discretion to cancel the member's application. The Pension Board also has the discretion to refuse a new application from such member.

(3) ***Death Prior to Pension Board Approval.*** If the member's death occurs prior to the time the Option 7 benefit request has been approved by the Board, the Option 7 benefit application shall be canceled and void. No benefits shall be payable on account of the member's death, except such death

and/or survivor benefits as may be available based on the member's status, pursuant to one or more parts of Ordinance section 201.24.

(4) ***Withdrawal of Application.*** A member may cancel his or her Option 7 benefit request by submitting such cancellation in writing to the Pension Board. The member may begin a new application process subsequent to withdrawal of an application.

Amended effective June 20, 2012.

## EXHIBIT B

### AMENDMENT TO THE RULES OF THE PENSION BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

#### RECITALS

1. Section 201.24(8.1) of the General Ordinances of Milwaukee County (the "Ordinances") provides that the Pension Board of the Employees' Retirement System of the County of Milwaukee (the "Pension Board") is responsible for the general administration and operation of the Employees' Retirement System of the County of Milwaukee ("ERS").

2. Ordinance section 201.24(8.6) allows the Pension Board to establish rules for the administration of ERS.

3. Section 201.24(2.8) of the Ordinances provides definitions for the "final average salary" of members. The Ordinance generally provides for the utilization of either three (3) or five (5) consecutive years during which the member's compensation was the highest.

4. The Retirement Office has developed an administrative practice for many years of utilizing consecutive bi-weekly pay periods to constitute the appropriate number of years under the Ordinance. The Office has utilized 78 (26 two week pay periods times three) consecutive pay periods to represent three years under the Ordinance and 130.5 (26 two week pay periods times five, plus 0.5) pay periods to represent five years under the Ordinance. The extra 0.5 pay period was included to account for the possibility of a leap year occurring during the five year period. However, a recent audit questioned the utilization of 130.5 pay periods rather than 130.

5. The Pension Board believes it is appropriate to adopt the following rule to clarify and to document the procedure for calculating final average salary.

#### RESOLUTION

1. Pursuant to Ordinance section 201.24(8.6), the Pension Board hereby creates and adopts Rule 1045 to read as follows:

#### **1045. Calculation of Final Average Salary under Section 2.8.**

(1) For the purpose of calculating final average salary under §201.24(2.8), whenever a member's final average salary means "the average annual earnable compensation for the three (3) consecutive years of service during which the member's earnable compensation was the highest," the member's final average salary shall be calculated based on the member's earned compensation during the seventy-eight (78) consecutive pay periods during which the member's earned compensation was the highest.

(2) For the purpose of calculating final average salary under §201.24(2.8), whenever a member's final average salary means "the average annual earnable compensation for the five (5) consecutive years of service during which the member's earnable compensation was the highest," the member's final average salary shall be calculated based on the member's earned compensation during the one hundred and thirty (130) consecutive pay periods during which the member's earned compensation was the highest.

Adopted on June 20, 2012.

## EXHIBIT C

### AMENDMENT TO THE RULES OF THE PENSION BOARD OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

#### RECITALS

1. Section 201.24(8.1) of the General Ordinances of Milwaukee County (the "Ordinances") provides that the Pension Board of the Employees' Retirement System of the County of Milwaukee (the "Pension Board") is responsible for the general administration and operation of the Employees' Retirement System of the County of Milwaukee ("ERS").
2. Ordinance section 201.24(8.6) allows the Pension Board to establish rules for the administration of ERS.
3. Upon retirement, members may elect an Option 6 form of benefit under ERS Rule 1013, which provides a ten-year certain form of benefit. In addition, eligible members may elect a backDROP under Ordinance section 201.24(5.16).
4. The Ordinances and Rules do not indicate the date on which the ten year period commences for a member electing an Option 6 form of benefit with a backDROP. The Ordinances and Rules also do not specify how this type of benefit should be actuarially adjusted to account for the backDROP period.
5. The Pension Board believes that it is appropriate to adopt a Rule documenting its interpretation of how to apply an Option 6 form of benefit to members who elect a backDROP.

#### RESOLUTIONS

1. The Pension Board interprets the Ordinances and Rules to provide that a member electing an Option 6 benefit with a backDROP will receive ten years of payments from the date of retirement with a monthly benefit actuarially adjusted to the backDROP date to ensure the individual receives an appropriately actuarially equivalent benefit. The actuarially adjusted benefit will be applied for the backDROP period and the monthly benefit payments.
2. Effective June 20, 2012, pursuant to Ordinance section 201.24(8.6), the Pension Board hereby adopts Rule 1046 to read as follows:

#### **1046. Calculation of Option 6 Benefits with a BackDROP**

Effective June 20, 2012, a member electing an Option 6 form of benefit under Rule 1013 who also elects a backDROP under Ordinance section 201.24(5.16) shall have his or her benefit calculated as follows: The ten-year certain period will commence on the individual's retirement date. The amount of the member's monthly benefit for the backDROP payment and monthly payment purposes will equal an actuarially adjusted certain benefit for the number of years in the backDROP period plus ten, creating an actuarially equivalent benefit which guarantees ten years of payments after the individual's retirement date.

Adopted on June 20, 2012.