EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE JULY 18, 2012 PENSION BOARD MEETING

1. Call to Order

   Chairman Mickey Maier called the meeting to order at 8:40 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present	Member Excused
Norb Gedemer	Dean Muller
Mickey Maier (Chairman)	
Dr. Sarah Peck	
Dave Sikorski	
Patricia Van Kampen	

Others Present
Marian Ninneman, CEBS, CRC, ERS Manager
Mark Grady, Deputy Corporation Counsel
Matthew Hanchek, Employee Benefits Administrator
Jerry Heer, Director of Audits, Milwaukee County
Dale Yerkes, ERS Fiscal Officer
Vivian Aikin, ERS
Mark Sullivan, BNY Mellon
Mark Keleher, BNY Mellon
Patricia Smith, BNY Mellon
Darlene Middleman, Baker Tilly Virchow Krause, LLP
Jessica Jochman, Baker Tilly Virchow Krause, LLP
Ray Caprio, Marquette Associates, Inc.
Brett Christenson, Marquette Associates, Inc.
Marilyn Mayr, Prior Pension Board Member and Retiree
Yvonne Mahoney, Retiree
Donna Destefano, Retiree
Steven Huff, Reinhart Boerner Van Deuren s.c.
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*

3. Chairman's Report

The Chairman first introduced and welcomed new member Norb Gedemer as the DSA representative to the Pension Board. Mr. Gedemer stated that he is currently a bailiff with the Milwaukee County Sheriff's Department, and he serves as treasurer for the Deputy Sheriffs' Association and as a board member for the Health Care Trust.

The Chairman then noted that the James Tietjen appeal originally on the agenda was removed because Mr. Tietjen decided to delay the appeal.

4. Minutes—June Pension Board Meeting

The Pension Board reviewed the minutes of the June 20, 2012 Pension Board meeting.

The Pension Board unanimously approved the minutes of the June 20, 2012 Pension Board meeting. Motion by Ms. Van Kampen, seconded by Mr. Sikorski.

5. Reports of ERS Manager and Fiscal Officer

(a) Retirements Granted, June 2012

Ms. Ninneman presented the Retirements Granted Report for June 2012. Twenty-two retirements from ERS were approved in June, with a total monthly payment amount of $45,559. Of those 22 ERS retirements, 15 were normal retirements, 4 were deferred, and 3 were disability retirements. Eleven members retired under the Rule of 75. Additionally, 7 retirees chose the maximum option, and 8 retirees chose Option 3. Seven of the retirees were District Council 48 members. Eight retirees elected backDROPs in amounts totaling $1,424,714.

ERS continues to experience a lighter retirement volume.

Ms. Ninneman then noted the retirement of Lee Holloway, former chairman of the Milwaukee County Board of Supervisors, and Robert Shupe, an ERS staff member with the County for 34 years.

(b) ERS Monthly Activities Report, June 2012

Ms. Ninneman presented the Monthly Activities Report for June 2012. Combined, ERS and OBRA had 7,916 retirees at the end of June, with a monthly payout of $13,338,733.

Ms. Ninneman then noted that, while ERS does have a more mature retiree population, the number of retiree deaths is nearly 300 year-to-date. This mid-year total is already what the end-of-year total had been in the past few years.

(c) Second Quarter Co-Development Report

Ms. Ninneman discussed the second quarter co-development report. ERS has realized significant savings of $328,000 year-to-date by using the co-development team rather than Vitech to make system changes. A new testing tool is being implemented, which will allow the co-development team to perform regression testing when a modification is moved into production, and the team is also now handling work flow modifications. ERS should see additional savings moving into the third and fourth quarters.

Ms. Ninneman then stated that the co-development team has been operating for two years and is already meeting goals set for later phases of the project.

(d) Second Quarter Individual Retirement Session Survey Responses

Ms. Ninneman discussed the second quarter individual retirement session survey responses. Items of note include that the retirement schedule was light for the second quarter, the retiree survey was changed, and all comments received were positive. Retirees noted that retirement information should be available to employees at the beginning of or by mid-career, which indicates members are more interested in the retirement process and in saving for retirement. ERS plans to address the retiree suggestion with documentation and education on the benefits of a Milwaukee County pension.

In response to a question from the Chairman, Ms. Ninneman stated that ERS does intend to integrate with the 457 Plan with Great West.

(e) Election Promotion

Ms. Ninneman discussed promoting the retiree and member elections. Ms. Ninneman met with seasonal, new, and long-term employees and learned that employee interest in the elections is low because they have little knowledge of election candidates and Pension Board responsibilities. In response, ERS will have staff available at the kiosks located at the parks, the Zoo, DPW, and the airport to walk employees through the voting process and answer questions. Additionally, the voting period will be extended. The end result is that votes can still be cast electronically, but with guidance from ERS staff.

Ms. Ninneman then stated that ERS is developing an educational process for its employees to promote the value of ERS, primarily because there is more interest now due to employee contributions, but also because it will help the election process in the long run. Some of the changes ERS is making include promotional materials like posters and flyers being delivered in person to department heads with an explanation of the importance of the election. Additionally, to simplify the process, rather than using Social Security numbers to vote, employees can use the same identification number as is used for benefits open enrollment. Finally, the candidates will be asked to promote themselves and be more visible throughout the election process.

In response to a question from the Chairman, Ms. Ninneman stated that employee access to a computer did not come up as an issue when speaking with ERS employees.

The Chairman suggested that the candidates create a one-page promotional flyer to include a picture and a link to a YouTube video created by the candidate. Ms. Ninneman agreed.

Mr. Sikorski then stated that it would be beneficial to reiterate to the department heads the need to post the promotional materials so employees without access to computers can view them.

Mr. Grady then suggested that it would also be beneficial to work through Human Resources to get the promotional materials posted sooner.

(f) <u>Fiscal Officer</u>

Mr. Yerkes first discussed the portfolio activity report, noting that June funding of $5 million came from the Mellon Capital Bond Fund. Additionally, the ETF was sold and Geneva Capital was purchased. At the end of June, Geneva began managing money, but did not actually make trades until July 6. The JPMorgan transition team was used for the purchase to save costs on commissions.

In response to a question from Mr. Yerkes, the Chairman stated that the Board appreciates receiving this information in advance.

Mr. Yerkes then discussed the cash flow report, noting that there are no significant changes from the previous month. Real estate and infrastructure are relatively new investments and since it takes 3 to 6 months to get money out of those investments, it is important to plan ahead and request funds before the start of the quarter. Additionally, Mr. Caprio approved taking $15 million out of Morgan Stanley real estate and $10 million out of IFM infrastructure. Morgan Stanley will send ERS the funds on the last business day of September. IFM could send ERS the funds the first week in October.

Mr. Yerkes concluded with a discussion of the second quarter check register.

In response to a question from the Chairman, Ms. Ninneman stated that the Assima Inc. STT line item is the license renewal for ERS training software, which was previously known as Kaplan.

6. <u>Baker Tilly 2011 Annual Audit Results</u>

Darlene Middleman from Baker Tilly Virchow Krause distributed and discussed the 2011 Annual Report to the Pension Board. Ms. Middleman introduced herself as senior manager and then introduced Jessica Jochman as manager of the engagement, stating that both have been with the engagement since Baker Tilly has been with the firm.

Ms. Middleman first provided background on the audit process. Prior to an audit, Baker Tilly meets with the Audit Committee to discuss required communications, which include the timing of the audit, any audit concerns, and areas of the Plan on which Baker Tilly should spend more time. A formal letter outlining this process was issued to the Audit Committee in January of 2012, and the meeting took place in February. There were no concerns on behalf of the Audit Committee, so Baker Tilly performed its normal risk assessment audit by reviewing potentially risky areas and designing an updated approach to those areas.

In response to a question from the Chairman, Ms. Middleman confirmed that there were no significant changes in Baker Tilly's approach this year versus previous years.

Ms. Middleman continued by stating that auditing standards require that certain communications are also necessary after the audit takes place, and a formal letter outlining this process was issued today to the members of the Audit Committee. The letter states that the objective of the financial statement audit is to express an opinion on the financial statement, and that opinion is derived in accordance with generally accepted accounting principles in the U.S. The standards require that Baker Tilly plan and perform its audit to obtain reasonable rather than absolute assurance on the financial statement, which is why only sample transactions are tested as opposed to all transactions. The standards also require that Baker Tilly determine there are no material misstatements, and that the audit does not relieve management, the Board, or the Audit Committee of their responsibilities.

Ms. Middleman then stated that part of the audit includes reviewing and understanding the internal controls of the Pension System. During its preliminary field work, Baker Tilly looks at significant cycles in the Pension System to determine whether those controls are in place and implemented properly. Baker Tilly does not test these controls, but seeks to understand them in order to form a risk assessment for the audit. Baker Tilly then identifies control deficiencies, or a design or operation of internal control that will most likely be caught in the normal course of business in a timely manner. Most plans have control deficiencies, but these are typically not significant issues. Baker Tilly also identifies material weaknesses, or a design or operation of internal control that could potentially evade management or staff and result in a material misstatement on the financial statements. Finally, Baker Tilly identifies significant deficiencies, which is an issue critical enough to be brought to the attention of those charged with governance, but that is not a control deficiency or material weakness. Baker Tilly did not identify any material weaknesses in internal controls in the 2011 audit. However, other observations were documented to management and are currently awaiting a response.

Ms. Middleman then noted that management is responsible for the selection and use of accounting principles. In terms of significant findings, this year there were no new accounting policies adopted and no changes to existing policies. Additionally, there were no unusual or significant transactions in the Plan that required attention.

Ms. Middleman continued by stating that accounting estimates are prepared by management based on past experience and future expectations. Baker Tilly did not encounter any significant difficulties working with management during the 2011 audit. Baker Tilly is also required to accumulate all known and monthly misstatements identified during the audit, and has identified one entry for a benefit payment that was not posted on the financial statement. During testing, Baker Tilly found errors in some ERS calculations. Though not material, Baker Tilly wanted to draw attention to it.

In response to a question from the Chairman, Ms. Middleman stated that Baker Tilly could not reveal the threshold amount that is considered to be material.

Ms. Middleman then stated that Baker Tilly had no disagreements with management and has no knowledge that management consulted any other accounting firm for opinions on the financial statements. Once the final 2011 audit report is available, management will be asked to sign a management representation letter, stating that what was presented to Baker Tilly during the audit was true and accurate, that management is not aware of any fraud, and that management agreed with the actuarial calculation. This final report will then be brought before the Board. Overall, Baker Tilly had no significant issues to communicate.

In response to a question from the Chairman, Ms. Middleman stated that the final 2011 audit report would not alter the numbers appearing in the draft report. There may be small cosmetic and wording changes, but the numbers in the draft report are final.

Ms. Middleman then stated that in addition to a letter from the Pension Board drafted by management, the report contains independent auditor reports, management discussion and analysis, and basic Fund financial statements, which include a statement of Plan net assets as well as changes in Plan net assets. Required supplemental information not part of the basic financial statement but required under the governmental accounting standards are also included in the draft report. The remaining information included in the report concerns 10-year historical trend information and statistics.

Ms. Middleman then noted that the annual report includes last year's independent auditor letter. However, it will be replaced with the new letter when it is finalized.

Ms. Middleman also noted that this year the report includes significant Plan participant contributions as opposed to last year. Also, a new accounting standard, GASB 67, which goes into effect next year, will require expanded supplemental explanation and disclosure schedules.

In response to a question from the Chairman, Mr. Yerkes and Ms. Middleman stated that the next steps include finalizing the report and performing last checks to verify all suggested changes have been made. Once complete, an attorney opinion will be requested to verify there are no contingencies to be recorded, and then the final report will be issued.

In response to a question from Mr. Yerkes, the Chairman stated that approving the annual report is not on the Board agenda for this meeting. The Chairman then requested that the Board review the report and provide comments to Mr. Yerkes for inclusion, if necessary, in the final report.

7. Investments

(a) BNY Mellon

Mark Sullivan, Patricia Smith, and Mark Keleher of BNY Mellon distributed a booklet containing information on the custody services provided by BNY Mellon for ERS.

Mr. Sullivan introduced himself as a relationship executive from the BNY Mellon Boston office. Mr. Sullivan first reported on annual compliance with the Most Favored Nation clause, which dictates that Milwaukee County will receive the lowest fees of all BNY Mellon comparable clients between $1 billion and $1.5 billion. Out of those clients, BNY Mellon identifies those that are similar to ERS in structure, account totals, and so on. Overall, 5 clients all had lower fees, but they also had lower complexity than ERS and were eliminated from discussion within the clause. The $50,000 annual fee for ERS stands because there are no other BNY Mellon clients that are comparable.

In response to a question from Dr. Peck, Mr. Sullivan stated that 2 of the 5 clients are public pension funds. While the names cannot be disclosed, the clients are cities in the U.S., and Mr. Sullivan will include a client type category in future reports.

In response to a question from Ms. Van Kampen, Mr. Sullivan stated that BNY Mellon has never had an account similar to ERS, but that the Most Favored Nation clause would apply if a client with similar account structure and asset allocations is found. ERS would then receive a rebate for the difference in fees. However, $50,000 is still a competitive fee.

In response to a question from the Chairman, Mr. Sullivan stated that BNY Mellon has not looked at comparable clients between $1.5 billion and $2 billion because at the time the clause was written, ERS around $1.4 billion in assets.

Mr. Sullivan next provided an overview of BNY Mellon. BNY Mellon is the 11th largest global asset manager and has strong credit ratings. Second quarter earnings show BNY Mellon now at $.39 per share, down from $.52 this same quarter last year because of a large litigation charge related to FX issues. BNY Mellon assets have grown, but the current operating environment of low interest rates and increased expenses mitigates some of the per-share growth.

Ms. Smith then introduced herself as the dedicated client service officer for securities lending, stating that she has been involved with securities lending at BNY Mellon since 1990, with ERS joining in 1993. Ms. Smith invited the Board to contact her directly with securities lending questions, as well as to visit any BNY Mellon office in Pittsburgh, New York, Toronto, London, or Hong Kong.

Ms. Smith stated that many changes have occurred in the industry since the 2008 crisis. One of the largest changes is a demand for transparency, and BNY Mellon's response to that is to turn monthly reports into daily reports. As a result, a robust set of reports are available at any time for clients to review the securities lending program. BNY Mellon is also open to daily discussions and market updates, and anything else that provides clients with the most current information. Another significant change is an emphasis on the intrinsic value of lending. Aside from low interest rates, the reason behind this change is the deleveraging of hedge funds. BNY Mellon recommends that ERS review guidelines to potentially turn a conservative investment into an intrinsic value type of product. A third change in the marketplace is the shift from cash collateral to non-cash collateral, especially to any of the treasuries. The industry has a ratio of 60% non-cash to 40% cash, with ERS at around 90% non-cash to 10% cash. Another significant change requiring attention is a huge shift in the regulatory environment, and it is unknown what impact that shift will have.

In response to questions from Dr. Peck, Ms. Smith stated that the move from cash to non-cash collateral has to do with the way cash collateral investment is reinvested into the market and the investment term.

Ms. Smith next reiterated that BNY Mellon is a top-rated global custodian. The merging of BNY and Mellon proved to be valuable, especially in terms of the expertise on each side. The cash investment strategy, or CIS, is responsible for all BNY Mellon cash and short-duration, fixed income businesses. Under that umbrella are assets under management of about $483 billion, so BNY Mellon is very significant in the marketplace. BNY Mellon has one lending platform, which is Charles River, and a consolidated credit research team that underwrites all issue orders.

Ms. Smith then discussed the reinvestment portfolio summary, noting that the daily reports are available in ERS's Workbench tool. The summary provides information on yield, asset class, prime quality, maturity schedule, and top issuers for the ERISA pool and the Pooled Employees pool. These are the legacy term investments that remain in the classification of June 2009. The summary shows that ERS has a little over $50 million out on loan, $27 million in the ERISA pool and the remainder as non-cash.

In response to a question from the Chairman, Ms. Smith stated that ERS is still under water with Sigma, which settled litigation on July 6. Pool participants will receive an allocation, and notice of that allocation should be sent in late July or early August, with an anticipated December distribution. There is a chance of recovery, but it would not be substantial.

In response to a question from the Chairman, Ms. Smith confirmed that a good strategy for ERS would be to wind out of Sigma based on securities lending income. Mr. Caprio also stated that based on the current income of $100,000, that process could take 2 to 3 years.

Ms. Smith next discussed the risk management structure. There are three categories of risk: credit (borrower) risk, market (reinvestment) risk, and business and operational risk. For each category, BNY Mellon has controls in place to mitigate risk. For example, on the credit side, there is a risk that a borrower may not return the security. On the operational side, there is a risk of negligence or misconduct on behalf of BNY Mellon. In either situation, BNY Mellon has remedies in place, as outlined in the Securities Lending Authorization Agreement, and controls in place to mitigate negative results.

Ms. Smith then discussed BNY Mellon reports. The daily and monthly reports summarize performance through June 30 and contain information on earnings, asset class, earnings per asset class, year-to-date information, volumes and spreads, and average rebate rates derived from lending to certain classes. The executive summary report provides a list of the top 10 daily earning securities and month-to-date totals. The portfolio holdings report shows the holdings under ERISA.

In response to a question from Dr. Peck, Ms. Smith stated that she would provide login information for the Workbench to Mr. Yerkes so that these reports could be accessed. Ms. Smith will also provide any relevant white papers available.

Mark Keleher then introduced himself as the CEO of Beta and Transition Management, one of BNY Mellon's asset management subsidiary firms.

Mr. Keleher first discussed the questions raised relating to FX transactions and the overlays that are typically run. In 2009, BNY Mellon was hired by ERS to convert idle cash to equity and bonds for the domestic equity and plan asset allocation accounts. The domestic equity account is benchmarked to the S&P 500 and is performing well. Since inception on April 1, 2009, the account returned over 81%. The plan asset allocation account is benchmarked at 18% MSCI EAFE, 43% Barclays Aggregate, and 39% S&P 500. This account has also performed well, returning about 44%. The disparity between the two returns is due to the Barclays Aggregate not performing as well in the after-market. There is also one closed overlay related to the Pension Obligation Bond, benchmarked at 20% MSCI EAFE, 44% Barclays Aggregate, and 38% S&P 500, at approximately $20 million with a 38% return over the period.

Mr. Keleher continued by stating that the accounts can be set up to overlay internationally, benchmarked to MSCI EAFE, in a number of different ways. When this was done between 2009 and 2010, the accounts were large enough to use baskets of futures and local currency forwards to replicate performance of the MSCI EAFE. In 2010, the accounts were small enough that the liquidity provided by the local contracts was no longer needed, so trading with currencies switched to a U.S.-traded future on MSCI EAFE. Currency was only traded for ERS between April and December 2009. An existing agreement requires a set spread for all trades, and the Pension Board has requested an examination to ensure compliance with that agreement. BNY Mellon reviewed 294 trades, which revealed a net benefit to ERS of $122,000, and was able to generate pricing improvement on many different trades.

Mr. Keleher then stated that one trade, executed on November 23, 2009, was found to be out of tolerance. BNY Mellon at that time had an automated pricing system where orders were electronically shipped to the treasury desk and a spread applied. Because this occurred on a Japanese holiday, a manual adjustment was made, but incorrectly. BNY Mellon found $47,000 that is owed to ERS, and that money will be reimbursed to ERS. In total, and including the net gain of $122,000, that amounts to $169,000 for ERS. BNY Mellon is still investigating how this happened, but is confident that it will not happen again. Overall, the overlay program is performing as desired by allowing ERS to participate in equity and volume returns.

Mr. Sullivan then stated that a recent examination of all FX-related language in all contracts confirmed compliance. Additionally, there were no post-2009 FX contracts. A letter of compliance and historical data runs of every FX trade performed for ERS, along with the terms for every currency, are available for review.

In response to a question from Dr. Peck about the incorrect manual entry, Mr. Keleher stated that the person responsible is no longer with the firm and, because the incident happened years ago, it is difficult to verify exactly what happened.

In response to a question from Mr. Huff, Mr. Keleher stated that the Board does not need to do anything to receive the reimbursement. This was an error made by BNY Mellon, and the reimbursement is a simple process that will also include any lost interest.

Mr. Huff then thanked BNY Mellon and Marquette Associates for handling the examination request.

(b) <u>Marquette Associates Report</u>

Ray Caprio and Brett Christenson of Marquette Associates distributed and discussed the first quarter report and the June 2012 monthly report.

The Chairman first suggested that it would be beneficial to provide an overview of basic investment vocabulary at some point at the Investment Committee for new members to the Board. Mr. Christenson agreed.

Mr. Christenson then stated that a Marquette Investment Symposium on new investment ideas will take place in September in Chicago. The Board will be invited to attend.

In response to a question from Dr. Peck, Mr. Christenson stated that he is not sure whether anything regarding securities lending is available on Marquette's website, but that Marquette could post some information on the topic.

Mr. Christenson first discussed the market environment. In the U.S. economy, crude oil is down slightly and gas prices are better, although still high. Inflation is currently in line, which is good news for the economy. In fixed income, the yield curve is down again, which is a result of the uncertainty in Europe. There is also uncertainty in the U.S. with a barely-moving economy and interest rates on treasuries dropping even further. With bonds, most of the return comes from yields. When interest rates start to rise, the bond portfolio, at about 29% of the overall portfolio, will begin to show some price depreciation and eventually become a drag in terms of the 8% actuarial rate of return. The Board may want to consider a discussion relating to Phase 2 of the asset allocation and address reducing the bond portfolio.

In response to a question from the Chairman, Mr. Christenson stated that there are options to hedge inflation risk. For example, if ERS stays with a fixed income portfolio, senior secured loans is an asset class of bonds with a LIBOR yield, plus 1% or 2%. As interest rates rise, these bonds will not experience any price depreciation, but rather appreciation. A significant portion of the portfolio is now in construction, with real estate at 14% or 15%. These are assets that have an inflation component built in, as do equities. However, that inflation is still a few years out; in the meantime, there is a low yield in bonds. Marquette is not as concerned with inflation right now as it is with the overall low yields likely to occur for a number of months.

In response to a question from Dr. Peck, Mr. Christenson stated that the maturity on the senior secured loans is 5 years, sometimes shorter than that.

Mr. Christenson continued by stating that the U.S. stock market had a negative quarter, despite good returns. The Wilshire 5000 was up 3.9% in June, but down 3.1% overall for the second quarter. With a strong year-to-date return of 9.2%, it will likely prove to be the best-performing asset class. In the global economy, inflation, the GDP, and employment rates are similar to that of the U.S. Growth for major developed countries looks to be slow. The international monetary fund, in its world economic outlook, is projecting global growth during 2012 to average 3.5%. Advanced economies—or developed economies like the U.S. and the major European countries—are expected to expand by 1.5% in 2012 and 2% in 2013. Emerging and developing economies are expected to expand by 5.8% in 2012 and 6% in 2013. Over the last few years, ERS has gradually increased exposure to the emerging market. It is an attractive asset class, and something that should continue to be addressed over the next number of meetings in terms of potentially making small changes to the asset allocation.

In response to a question from Dr. Peck, Mr. Christenson stated that developing economies are experiencing a slight increase in labor costs, becoming more low-to-middle class and demanding more product. These countries are not burdened by the debt that exists in developed countries.

Mr. Christenson then stated that the international markets have struggled. However, the ACWI ex. U.S. yield is over 3%, which is a high yield for international markets. The P/E ratio of this broad index is fairly steady at just over 10%, which is a conservative valuation of this equity market. The current market is rocky and there is a lot of uncertainty overseas, which results in a fairly stagnant market over the last few years. Some of these companies continue to grow, however, and their valuations look attractive when the P/E is considered.

Mr. Christenson concluded by stating that real estate is a newer asset class that ERS entered into after a depreciation trend coming out of the financial crisis. There has been consistent appreciation in the real estate market over the last eight quarters, but dramatic loss in commercial real estate. Overall, real estate is still rebounding from the crisis, but since ERS timed its investment well, the real estate portfolio will hopefully continue to show earnings.

Mr. Caprio then discussed the total fund composite, at $1.7 billion as of the end of June. There were outflows of $26.8 million over the last three months for benefit payments. The largest component of the fund is fixed income, at 27%, as a stand-alone asset class, with JP Morgan and Mellon Capital as the investment managers. One manager uses a passive approach and manages by buying all bonds in the index. The other manager actively picks bonds in the market. The allocation had been reduced because of the low yield environment. Marquette focuses on things like real estate infrastructure and hedge funds, and will continue that focus this year to achieve higher yield on the portfolio with less risk. The approach with the U.S. equity portfolio, at 23% of the Fund, is to find large-, mid-, and small-cap managers to cover the spectrum of U.S. markets and realize growth and value. Some managers have strong diversification and use active management to read the market when stock picking. International equity, at 18% of the Fund, has been a drag the last few years, but similar to other portfolios, Marquette focuses on having exposure to emerging markets and small-cap value with both active and passive management for growth and diversification. Hedged equity, at 10% of the Fund, helps reduce volatility. These funds will not provide the up return when the markets are rallying and strong, but they will reduce the volatility long-term. Real estate, at 8% of the Fund, is a strong income-generator in commercial and private. Three managers buy property in that asset class; all three have a different approach and are geographically diverse. Across the country, they have multiple property types, and the focus is to buy properties that can be leased out long-term, that are highly operational, and that generate all if not most return income from appreciation. The funds are stable and complement the bond portfolio. The portfolio is not yet back to pre-crisis levels, so there is still a good yield to be had. Infrastructure, at 7% of the Fund, has two managers with a conservative focus on the yield and a focus on hedging inflation long-term. They are now correlated with the U.S. stock markets and the international markets. Private equity, at 1% of the Fund, is the most recent asset allocation. The target is lower, but over time the commitments to the two new managers will most likely bring value.

Mr. Caprio then discussed annualized performance, gross of fees, on a 3-month basis. The total Fund was down 2.1% for the second quarter of 2012. Fixed income was up 2%, so being conservative in bonds paid off this quarter. U.S. equities were again down 4.2%, and the benchmark was down 3.2%. International was down 7.4%, and the benchmark was down 7.4%. There were negative returns in hedged equity since hedged equity is stocks, but with slightly less volatility than the Wilshire 5000. Real estate was a strong point, up 3%. Infrastructure and private equity are lagging a bit. They typically report 60 to 90 days after quarter end so the returns in the report are preliminary, but most likely will be positive for the quarter.

Mr. Caprio next discussed the individual investment managers. In fixed income year-to-date, JPMorgan outperformed the Barclay Aggregate by 40 basis points. The U.S. equity composite, while underperforming the Wilshire 5000 at 9% versus 9.4%, still had a strong return in this market, and the rank will also be strong relative to peers. In international, Marquette focuses on the relative performance of the managers. Barings outperformed the MSCI EAFE year-to-date, though GMO large-cap continues to trail. They were terminated, however, and Morgan Trust will be funded in the coming weeks. Various emerging markets are slightly behind the benchmark year-to-date. Some of these investments have only been in the fund for a short period, and Marquette will evaluate them on a 3- to 5-year basis, per the guidelines. In hedged equity, returns to date were disappointing. ABS is not performing well, down 0.2% with the benchmark up 1.2%. K2 has turned around and is performing better than ABS, so Marquette will likely need to meet with ABS. Real estate year-to-date is up 6%, with a 3% return for the quarter. Infrastructure is up 3.7% year-to-date versus a benchmark of 3.5%. Good things are happening in the portfolio. Based on the second quarter market environment, the ranks should be strong relative to the public.

Mr. Caprio then stated that Marquette recommends rebalancing the portfolio because hedged equity is overweight by $4.7 million, and that should continue to be drawn down and then used for benefit payments in the future. Marquette's recommendation is to pull $3.8 million from ABS and $900,000 from K2, with an anticipated receipt date of mid-October.

The Pension Board unanimously approved rebalancing the portfolio out of hedged equity through a third-quarter drawdown of $3.8 million from ABS and $900,000 from K2. Motion by Dr. Peck, seconded by Mr. Sikorski.

In response to a question from the Chairman regarding the underweight to fixed income, Mr. Caprio stated that the large withdrawal is coming out of real estate and infrastructure and the small out of the hedge fund. Marquette will either go to fixed income or benefits to better realign the portfolio. Marquette also anticipates a discussion at the August or

September Investment Committee meeting on adjusting the asset allocation, with one suggestion being to reduce fixed income from the current 29%.

The Chairman then stated that he does not anticipate having a formal Pension Board meeting in August, unless there is urgent business, to which Ms. Ninneman responded that there was not. The Chairman also stated that he also does not anticipate having any August committee meetings.

Mr. Christenson then noted that the actuary will be attending the October meeting.

The Chairman then reminded the Board that Mr. Muller requested an active management report at the September Audit Committee meeting.

In response to a question from Ms. Van Kampen as to whether moving away from fixed income using other asset classes would make it more difficult to meet the actuarial rate of return, Mr. Christenson stated that it may be prudent to change the policy benchmark. However, it depends on the other asset classes. A move from fixed income to equities would be simple. However, Marquette has an asset class to introduce that may be more difficult to replicate. Improving the policy benchmark may also help gauge whether the Fund is doing well.

8. Investment Committee Report

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

9. Audit Committee Report

The Chairman reported on the July 3, 2012 Audit Committee meeting.

The Audit Committee first discussed the Pension Board retiree election. Only one eligible candidate, D.A. Leonard, submitted the required nomination papers, so a retiree election will not be held. Ms. Mayr submitted nomination papers but is ineligible because she has not been off the Board long enough. D.A. Leonard will take the oath of office prior to the September Board meeting, where he will be introduced.

The Audit Committee next discussed the Pension Board employee election. Various staff members were polled on their views of the employee election voting experience, and an education or marketing plan was developed to promote future elections. The election process can now move forward and still maintain the cost effectiveness of the electronic voting while minimizing potential security issues.

The Audit Committee then discussed the 5-year experience study that Buck Consultants is scheduled to conduct in 2012. The timing of the study was discussed with consensus that work should begin now for a findings review at the September Board meeting. The focus will be on the actuarial assumptions.

The Audit Committee next discussed Accidental Disability Retirement (ADR) and the Rule of 75. ERS questioned whether a member qualifying for the Rule of 75 can still apply for an ADR. Response from counsel was that eligibility for normal retirement, such as through the Rule of 75, does not disqualify a member from applying for a disability pension, but reaching normal retirement age does.

The Audit Committee then discussed the ongoing VCP filing with the IRS and whether there is opportunity to provide the IRS additional information to make sure any other issue discovered since the initial filing is addressed. Additionally, a letter will be sent to the IRS to determine the status of the VCP since the Board has not heard back from the IRS on the matter.

In response to a question from Mr. Sikorski, Ms. Ninneman stated that notification of the retiree election was published in the ERS Communicator, which the retirees received with their direct deposit notification in May. Nomination papers were available the following Monday. Ms. Mayr confirmed that the retiree election notification was sent far enough in advance.

The Chairman then stated that the topic of lengthening the voting period for special employee elections would be discussed later in the meeting under Administrative Matters.

In response to a question from the Chairman, Ms. Ninneman stated that extending the voting period would not increase the election cost with Votenet.

The Board then discussed the proposed changes to Rule 1013. At the Chairman's request, Ms. Ninneman explained that this rule codifies when a member can no longer make changes to his or her form of benefit or, if applicable, beneficiary designation. In the normal retirement process, an active employee picks a future date to retire, selects various retirement options, and then signs a retirement application. The employee can make changes up to the selected retirement date. In the emergency retirement process, however, an active employee can sign a retirement application indicating the termination of employment that day and retire the very next day. The employee moves directly from active to retired. In these cases, the employee must schedule a retirement appointment to select the various retirement options. These members cannot make changes after they select their retirement options.

The Pension Board unanimously approved amending Rule 1013 to codify longstanding emergency retirement practices, attached to these minutes as Exhibit A. Motion by Ms. Van Kampen, seconded by Dr. Peck.

10. Administrative Matters

The Chairman first addressed the open Vice Chairman position on the Pension Board. Dr. Peck then nominated Mr. Sikorski, who accepted the nomination.

The Pension Board unanimously approved the nomination of David Sikorski to the position of Vice Chair on the Milwaukee County Pension Board. Motion by Dr. Peck, seconded by Ms. Van Kampen.

The Pension Board then discussed additions and deletions to the Pension Board, Audit Committee, and Investment Committee topic lists. The Chairman stated that the BNY Mellon contract costs item should be removed from the Audit Committee list and the GMO item should be removed from the Investment Committee list.

Mr. Grady stated that the BNY Mellon Fees item should be removed from the Pension Board agenda.

Dr. Peck suggested that securities lending be added as a topic for the Investment Committee.

The Pension Board next discussed the authorization and methodology for special employee elections. The Chairman stated that the methodology discussed earlier for promoting elections is in place. However, extending the voting period still needs to be addressed.

Mr. Sikorski stated that he is in favor of extending the voting period from 4 days covering a weekend to 7 days to reduce the chance of an employee missing the voting window for whatever reason.

Dr. Peck then stated that a 10-day voting period might be better to accommodate weekend schedules and time away from the office.

In response to a question from Mr. Grady, Ms. Ninneman stated that in future regular elections, a 10-day voting period would be problematic with a primary and a final election because the elections occur within two weeks of each other.

Mr. Grady then stated that the days on which the voting would occur could be worked out so they do not create a problem, but that he recommends a 7-day voting period to avoid the problem altogether.

After general Board discussion as to effects of a 7- or 10-day voting period on all elections, the Board agreed that a 7-day voting period would be sufficient if the voting were to run from a Friday to a Friday.

The Chairman then noted the two open seats on the Board, each with a different term expiration. In the past, candidates were asked to declare the seat for which they were running, and the Board needs to decide whether to maintain that process.

Mr. Grady stated that the motion discussed at the June Board meeting was to assign the candidate receiving the most votes in the special election the longer term and the candidate receiving the second-most votes the shorter seat term, regardless of majority vote, and then cancelling the second election.

Mr. Gedemer stated that his experience is that the second election does not matter that much, especially for remainder-of-term elections. However, it may be beneficial to have the upcoming special election act as a test for the new promotion methodology using both a primary and a second election. Once the results are known, changes can then be made.

Mr. Grady then stated that because the election is a special election, the Board is free to run it any way it wants. For example, a rule could be added stating that if there are only two candidates, the winner could be decided by a coin flip.

The Board then had a general discussion as to how past elections were conducted, how many votes should be allowed per employee, and the process used to assign which term to which candidate.

The Pension Board unanimously approved the authorization, pursuant to Rule 1020, of 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 the 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. The election voting period will also be extended to 7 days. Motion by Mr. Sikorski, seconded by Mrs. Van Kampen.

The Chairman then stated that the Board should have the two new members by October, or as early as September if only two nominations are received.

11. <u>Disability Matters</u>

The Board discussed ERS Rule 1010 and the income reporting and suspension of benefits as they relate to Fannie May Ellis. Ms. Ellis is currently on disability and has not been complying with the Statement of Earned Income requirement by filing tax returns and schedules with the Retirement Office.

The Pension Board unanimously approved the suspension of disability benefits for Fannie May Ellis until compliance with ERS income disclosure requirements in Rule 1010. Motion by Dr. Peck, seconded by Mr. Sikorski.

Mr. Sikorski moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(f), with regard to item 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 12 and 13 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 12 and 13. Motion by Mr. Sikorski, seconded by Ms. Van Kampen.

12. 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.

13. Report on Compliance Review

In open session, the Board discussed the backDROP modification Ordinance change.

The Chairman first stated that the role of the Pension Board is not to set benefit policy for the County but to review and provide comment as to whether changes affect ERS in areas such as reprogramming, implementation, or cost.

Mr. Grady then provided an overview of the amendment. A backDROP benefit is based on a date in the past after the employee first qualified for retirement and on which an employee wants to base their retirement benefit. Under the existing Ordinance, if an employee wants to terminate employment in 2022 and chooses 2017 as the backDROP retirement date, the employee's final average salary, years of service, and the multiplier for those years of service are based on 2017. The monthly annuity, then, is computed using those factors and paid out to the employee beginning in 2022 according to the retirement option the employee chose.

Under the changed Ordinance, and using the same example, the monthly annuity is computed using the same factors. However, the lump sum benefit calculation for the backDROP would be based on a date of September 1, 2012 rather than 2017. The monthly annuity for that employee had they retired in 2012 is multiplied by the 5 years of backDROP, plus the interest and the COLA, to determine the lump-sum backDROP amount. The Ordinance change would not affect an employee who chose a backDROP date before September 1, 2012. However, the further the backDROP retirement date is after September 1, 2012, the greater the effect on the employee. As time goes on, the lump-sum portion of the benefit will decrease.

Mr. Grady continued by stating that the Ordinance will be considered the next day at the Finance Committee of the County Board. Additionally, estimated savings as a result of this change is $1.2 million per year, approximately $800,000 of which would be savings to the County and approximately $400,000 would be savings in the form of reduced contributions by employees. The change applies to all employees, except for deputies because deputies do not have a backDROP benefit, and except for firefighters because pension changes must be collectively bargained with firefighters.

Ms. Ninneman then stated that the Ordinance amendment would require a programming change to Vitech. The one-time cost for the change is significant because it affects three branches of logic. If the change involves just a modification to the logic, the cost range would be $250,000 to $350,000, but if it involves a total redesign, the cost could increase to as much as $500,000.

In response to a question from Ms. Van Kampen, the Chairman stated that costs associated with an Ordinance change have never prevented the change from being passed, but that those costs have also never been as significant.

In response to a question from Mr. Gedemer, Ms. Ninneman stated that ERS would begin making changes to Vitech as soon as the Ordinance is passed, using a manual process to compute affected backDROPs until the modifications are complete, in order to comply with a September deadline.

The Board agreed with Ms. Mayr's suggestion to reference the cost as a one-time cost in the Board's response to the Ordinance change.

Mr. Hanchek then noted that using the co-development group to make the required changes could potentially reduce the one-time cost.

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

The Pension Board offers no formal comment regarding the proposed Ordinance amendments to section 201.24(5.16) of the Milwaukee County Code of General Ordinances codifying backdrop eligibility provisions for employees and modifying the timing for calculating the backdrop lump sum payment, 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 result in an additional one-time cost to the System of $250,000-$500,000. 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.

Motion by Dr. Peck, seconded by Ms. Van Kampen.

14. Adjournment

The meeting adjourned at 11:30 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. The Pension Board has previously interpreted the Ordinances and Rules to disallow a member from changing his or her beneficiary under Options 2, 3, 4, or 5 after a certain date because the benefit amount for those forms of benefit is calculated to include the beneficiary's characteristics. Furthermore, to change a member's beneficiary under Options 2, 3, 4, or 5, or a member's form of benefit option after elected, subjects ERS to increased costs and administrative burdens due to recalculations of benefits.

4. The Pension Board believes that it is appropriate to modify Rule 1013 to clarify the date after which no changes can be made to a member's form of benefit or survivor annuity beneficiary.

RESOLUTION

Effective July 18, 2012, pursuant to Ordinance section 201.24(8.6), the Pension Board hereby amends Rule 1013 to read as follows:

1013. Optional forms of payment.

(1) *Available forms.* In addition to the forms of payment provided by section 201.24(7.1) of the Ordinances, the following forms of payment shall be permitted pursuant to section 201.24(7.2) of the Milwaukee County Code of General Ordinances. Payment shall be made on the last business day of the month:

(a) *Option 4. Twenty-five (25) percent co-pensioner option.* This form of benefit provides a reduced monthly benefit payable to the member for his or her lifetime with monthly payments continuing upon the death of the member for the life of a designated beneficiary in an amount equal to twenty-five (25) percent of the amount that had been paid to the member during his or her lifetime. Benefit payments shall be made as follows:

[1] During the month of the member's death, the beneficiary and the member's estate will each receive a pro rata portion of the member's lifetime benefit payment payable for the month of the member's death.

[2] Benefit payments will commence to the beneficiary as of the first day of the month following the month in which the member dies.

The amount of the benefit shall be computed pursuant to tables supplied by the actuary to the board. This form of benefit is available without approval of the board.

(b) *Option 5. Seventy-five (75) percent co-pensioner option.* This form of benefit provides a reduced monthly benefit payable to the member for his or her lifetime with monthly payments continuing upon the death of the member for the life of a designated beneficiary in an amount equal to seventy-five (75) percent of the amount that had been paid to the member during his or her lifetime. Benefit payments shall be made as follows:

[1] During the month of the member's death, the beneficiary and the member's estate will each receive a pro rata portion of the member's lifetime benefit payment payable for the month of the member's death.

[2] Benefit payments will commence to the beneficiary as of the first day of the month following the month in which the member dies. Benefit payments to the beneficiary shall continue until the beneficiary dies.

The amount of the benefit shall be computed pursuant to tables supplied by the actuary to the board. This form of benefit is available without approval of the board.

(c) *Option 6. Ten-year certain annuity.* This form of benefit provides a reduced monthly benefit payable to the member for his or her lifetime. If a member who is receiving this form of benefit dies before receiving one hundred twenty (120) monthly payments, then monthly payments in the amount payable at the time of the member's death shall continue to the member's designated beneficiary until a total of one hundred twenty (120) payments have been made in the aggregate to the member and his or her designated beneficiary (or, if the member's designated beneficiary has predeceased the member or dies before a total of one hundred twenty (120) payments have been made, then to the member's spouse, or, if none, then to the member's estate). The amount of the benefit shall be computed pursuant to tables supplied by the actuary to the board. This form of benefit is available without approval of the board.

(d) *Option 7. Any other form.* A member may apply to the board to receive his or her benefits in any other form permitted by section 201.24(7.2) of the Milwaukee County Code of General Ordinances. The board will generally deny any such request on the grounds that the standard six (6) optional forms of benefit set forth in section 201.24(7.1) and in Rule 1013(a)(1), (2) and (3) provide sufficient options to members and that any other form of benefit subjects the system to unnecessary administrative expense and burden. Further, pursuant to Rule 1021, the board will not grant any request for a lump sum benefit. However, the board, in its sole discretion, reserves the right to determine whether to approve a member's application for a benefit under this Rule 1013(a)(4). The board shall review such requests pursuant to Rule 1035. The board or, where board responsibility has been delegated to others, such delegates shall have complete authority to determine the standard of proof required in any case and to apply and interpret this Rule 1013(a)(4). The decision of the board or its delegates shall be binding upon all persons dealing with the system or claiming any benefit hereunder, except to the extent that such decision may be determined to be arbitrary or capricious by a court having jurisdiction over such matter. A member shall be required to pay all costs incurred by the system to evaluate each form of benefit requested by the member.

(2) *Beneficiary designation.* If a member elects a form of benefit under which benefits may continue to a beneficiary after the member's death, then the member shall be required to designate a beneficiary in writing on forms approved by the board and submitted to the board at the time the member elects such a form of benefit.

(a) A member being paid a benefit pursuant to Option 1 listed in section 201.24(7.1) or Option 6 listed in this Rule 1013(l)(c) may change the designation of the named beneficiary at any time. A member being paid a benefit pursuant to Options 2 or 3 listed in section 201.24(7.1) or Options 4 or 5 listed in this Rule 1013(1)(a) and (b) may not change the designation of the named beneficiary after the later of: (1) the member's retirement effective date or, (2) if the member is an emergency retirement applicant, the date on which the member permanently elects a benefit option and designates a beneficiary.

(3) *Actuarial equivalent.* The forms of benefit under section 201.24(7.2) of the Milwaukee County Code of General Ordinances and Rule 1013 shall be the actuarial equivalent of a member's pension as calculated pursuant to Rule 1014.

(4) *Lump sum distribution request.* Pursuant to Rule 1021, a request for any form of benefit that constitutes a lump sum benefit will not be granted.

(5) *Changes to Form of Benefit*. A member may not change the form of benefit he or she elects after the later of: (1) the member's retirement effective date or, (2) if the member is an

emergency retirement applicant, the date on which the member permanently elects a benefit option and designates a beneficiary.