# EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
# MINUTES OF THE OCTOBER 19, 2005 PENSION BOARD MEETING

1. Call to Order

Chairman Walter Lanier called the meeting to order at 8:50 a.m. in Room 203-P of the Milwaukee County Courthouse.

2. Roll Call

Members Present:
Linda Bedford
Walter Lanier
John Martin
Marilyn Mayr
John Parish
Dean Roepke
Thomas Weber

Members Excused:
Donald Cohen
Michael Ostermeyer

Others Present:
Charles McDowell, Director of Human Resources
Mark Grady, Principal Assistant Corporation Counsel
Gloria Morris, Retirement Coordinator
Gordon Mueller, ERS Fiscal Officer
Jack Hohrein, ERS Manager
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Patrick Race, Mercer Investment Consulting
Kristin Finney-Cooke, Mercer Investment Consulting
Patrick Silvestri, Mercer Investment Consulting
David Carter, NCM
Randolph Lestyk, NCM
Robert McManama, Loomis Sayles
Robert Haney, Attorney
Cliff Van Beek, Retiree
Ken Loeffel, Retiree
Michael Howden, Retiree
Florence Ignarski, Retiree
Virginia Schumann, Retiree
Dave Umhoefer, Milwaukee Journal Sentinel

3. Approval of Minutes of September 21, 2005 Meeting

Mr. Hohrein presented the corrected August meeting minutes for the Board's information.

**The Board reviewed and unanimously approved the minutes of the September 21, 2005 Pension Board meeting. Motion by Mr. Martin, seconded by Ms. Bedford.**

4. Report of Retirement System Manager

A. Ratification of Retirements Granted

Mr. Hohrein presented the schedule of Retirements Granted for the prior month's retirements and asked the Board to review them. He noted that there were no backDROP payments for October. Dr. Roepke asked about the accuracy of the job category and benefit amount for David R. Zepecki, who was the Director of Economic Development and ended his career at the Milwaukee County Zoo. Later in the meeting, Ms. Morris confirmed that this information was correct.

**The Board unanimously approved the schedule of Retirements Granted. Motion by Mr. Martin, seconded by Ms. Bedford.**

B. Informational Items

(i) Cash Liquidity Report.

Mr. Mueller presented a report on cash needs for ERS. He stated that the Retirement Office would require $10 million for November and approximately $5 million for December.

The Chairman asked whether the amounts required were tending to decrease. Mr. Mueller responded that they were not and that he expected ERS would require $10 million for January and $5 million for a few months after that.

The Board also discussed payment of administrative expenses, including fiduciary liability insurance, legal fees and technology expenses and the possible need for a cash flow policy.

(ii) Report on Waivers.

There were no waivers presented.

(iii) Request for Approval of Moving Costs.

The Board addressed Mr. Hohrein's request for reimbursement of his moving costs of $11,900. The Chairman asked whether the reimbursement is part of Mr. Hohrein's agreement with ERS. Mr. Hohrein stated that Mr. McDowell and Karen Jackson had told him in his final interview that his costs would be reimbursed. Ms. Mayr stated that the statute for civil service employees provides that positions can receive only salary unless a contract provides for extra benefits. The Chairman suggested that the matter be addressed later in the meeting with Mr. McDowell.

The Board resumed discussion of this issue later in the meeting. Dr. Roepke pointed out that the Board had not been involved in the hiring process. Mr. McDowell stated that County employment contracts have been eliminated. He noted that even though Mr. Hohrein is a County employee, ERS pays the entire expense. Ms. Mayr stated that the funding source for the expenses is irrelevant because funding from outside the County is also prohibited. She asked whether the County Board must approve the expenses.

The Chairman suggested that the Board could approve payment of the expenses subject to confirmation by Corporation Counsel that payment is permitted under state law, County Ordinance and ERS Rules. Dr. Roepke remarked that payment of moving expenses was never discussed with the Board and that it should not approve payment after the fact. He also opined that the Board should have been part of the hiring process. The Chairman commented that the Board had some involvement in hiring Mr. Hohrein. Mr. Weber questioned why the request was before the Pension Board. Mr. McDowell stated that the issue was an ERS funding issue, not a hiring issue. He also noted that it is not possible to do a nationwide manager search without paying moving expenses. The Chairman asked whether payment of these expenses should have been raised and approved at the outset. Ms.

Mayr commented that the auditor told her that County Board approval of moving expenses was not uncommon.

Mr. Weber made a motion, seconded by Ms. Bedford, to approve payment of Mr. Hohrein's moving expenses subject to confirmation by Corporation Counsel that payment is permitted under state law, County Ordinance and ERS Rules.

In addressing this motion, the Board discussed whether ERS is the appropriate source for payment of the expenses and whether the Board has the authority to make the payment. Mr. McDowell stated that he would go to the County Board if he must do so. The Board noted that a motion to lay over would take precedence over a motion to take action.

**The Board voted 5-2, with Ms. Bedford and Mr. Weber dissenting, to lay over the issue until Corporation Counsel could research the legality of the payment. Motion by Ms. Mayr, seconded by Dr. Roepke.**

5. Disability Applications

There were no disability applications.

6. Appeals and Claims – Justice Louis Ceci – Military Credits

The Board noted that Justice Ceci's request for military service credit had been laid over at the previous meeting. The Chairman indicated that a letter had subsequently been received from Justice Ceci's attorney withdrawing the request.

7. Discussion on Underfunding of 2006 Pension Contributions

The Chairman reported that the Board had received a letter from County Supervisor Nyklewicz asking that the Board reconsider its requested contribution and provide a new recommendation and analysis to the County Board. The Chairman stated that he believed the Pension Board had done its job well and had spent a great deal of time analyzing the data and issues related to the County contribution.

Dr. Roepke informed the Board that he had asked the research section of the International Foundation of Employee Benefit Plans to put together a package regarding procedures and options for public pension funds with contribution shortfalls. The Chairman stated that it was his expectation to discuss fiduciary obligations at the November Board meeting.

8. Closed Session

The Chairman stated that the Board may enter closed session to confer with the Board's legal counsel regarding strategy to be adopted with respect to litigation in which it is or is likely to become involved, for deliberating or negotiating the purchase of public properties, the investing of public funds or conducting other specified business, whenever the discussion will directly and substantially affect negotiations with a third party and to discuss an individual's disability retirement application, which may entail discussion of medical records of the applicant.

Mr. Howden opined that having closed session discussions discourages the public from attending Board meetings and requested that the Board consider scheduling closed session items last. The Chairman responded that the Board can take that into account, but that closed session depends on additional factors, such as arrival times of outside advisors, the length of discussion on open session items and the goal to address complex issues efficiently.

The Board unanimously agreed by roll call vote to enter closed session to address items 9, 10, 11 and 12. Motion by Dr. Roepke, seconded by Mr. Martin.

9. Appeals and Claims – Keith Kaczmarek – Notice of Claim – BackDROP Benefits

The Board discussed Mr. Kaczmarek's notice of claim in closed session.

Upon returning to open session, the Chairman stated that Mr. Kaczmarek's claim related to his application for pension benefits, which was filed on August 16, 2000. Mr. Kaczmarek claimed that someone in the Pension Office told him in August 2000 that sick and leave time kept him on as a County employee after December 31, 2000 and thus, he would be eligible for any new 2001 benefit enhancements. He also claimed that he was not told about impending changes to ERS in August 2000 and that he would have elected differently if he had been told about them.

**The Board unanimously agreed to deny Mr. Kaczmarek's claim. Motion by Mr. Weber, seconded by Ms. Bedford.**

10. Litigation Update

The Board remained in closed session to discuss the status of pending litigation.

11. Update on Cliff Van Beek Indemnification Request

The Board remained in closed session to discuss the indemnification request of Cliff Van Beek.

**Upon returning to open session, the Board agreed 5-1-1, with Ms. Mayr dissenting and Mr. Weber abstaining, to authorize the Chairman to negotiate an agreement with Mr. Van Beek settling all claims for a payment of $2250 and to sign an agreement on behalf of the Pension Board.**

12. Aon Corporation Settlement Agreement

The Board remained in closed session to discuss the proposed Aon settlement.

**Upon returning to open session, the Board unanimously agreed to accept the settlement amounts in class action litigation against Aon and authorized Mr. Hohrein to sign the settlement documents. Motion by Mr. Martin, seconded by Ms. Mayr.**

The Board returned to open session for the remainder of the meeting.

13. Investments, Mercer Consulting

A. Manager Presentations

(i) NCM

Mr. Carter, Vice President and Senior Portfolio Manager, and Mr. Lestyk, Vice President and Portfolio Manager, addressed the Board on behalf of NCM Capital. They first discussed NCM's goals of competitive performance, a well-diversified portfolio and a combination of risk control with return enhancement. They then described NCM's history and structure. They stated that NCM considers itself to be conservative and focuses on high grade, diversified portfolios to avoid risk. They mentioned that clients want a consistent stream of income and preservation of capital from a bond fund. They also described NCM's approach to meetings and its fixed income investment strategy and philosophy, investment process and sell discipline. Mr. Carter and Mr. Lestyk next compared NCM's performance with the Lehman Aggregate benchmark. They also gave an economic overview for the third quarter of 2005, including interest rates and globalization, and described NCM's strategy for the fourth quarter.

(ii) Loomis Sayles

Mr. McManama, Client Portfolio Manager, addressed the Board on behalf of Loomis Sayles. He first described Loomis Sayles's experience, resources and ownership structure. He discussed its fixed income structure, including the role of Portfolio Manager Dan Fuss, collaborative investment process and bond policy. Mr. McManama also described the interaction between the asset class teams and product team. He reviewed the investment results and calendar year returns as of September 30, 2005 as well as the current economic situation and outlook.

In response to a question from Dr. Roepke regarding the auto industry, Mr. McManama responded that Loomis was selling interests in GM, Ford and their suppliers, the value of which was decreasing because of uncompetitive labor contracts and high health costs. He explained that Loomis was instead buying securities from GM and Ford credit companies. Ms. Mayr asked whether selling GM or Ford would create losses in the portfolio. Mr. McManama responded that the sales would be reflected in the year-to-date returns. At the request of the Chairman, Mr. McManama also addressed the potential impact of future interest rates and the impending replacement of Alan Greenspan as Chairman of the Federal Reserve.

B. Asset/Liability Allocations – Alternatives 2 and 3

In response to a question from Dr. Roepke, Mr. Race summarized the comments made by the NCM and Loomis Sayles representatives. He recommended that the Board maintain but not immediately expand its allocation to high yield investments, noting Dan Fuss's record of exceptional talent at selecting high yield securities. This recommendation was based on uncertainties in yields, interest rates and the future direction of the next Federal Reserve Chairman. Mr. Race commented that this decision should be revisited as markets develop over the coming year.

Mr. Race next presented a report on portfolio structure alternatives. He first addressed an overall analysis of manager structure, alternative equity asset allocations and alternative fixed income allocations. He also provided an overview of terminology and assumptions used in the allocation analysis.

Mr. Race discussed the following concepts related to allocation of investments:

Concept 1: Increasing international equities. Mr. Race explained that increasing the allocation from 15% to 20% delivers a better Sharpe ratio than the current policy, but that the return is lower than the current allocation with equal allocation between Capital Guardian and GMO. He described Mercer's proposal for Concept 1, which was to confirm the policy allocation increase from 15% to 20% including small cap international, with an equal split between Capital Guardian and GMO. With Capital Guardian operating as both core and small cap international equity manager, this would mean a natural bias to GMO within core international equities.

Concept 2: The domestic equity management style. Mr. Race stated that the optimal approach from the analysis carried out was to move from a part indexed, part active approach to large cap management, to an all active large cap portfolio along with all active mid and small cap portfolios. This would mean putting approximately 15% of the portfolio with new large-cap growth/core fund managers. He explained that Mercer's proposal for Concept 2 was to revisit the decision in 12 months time, but to maintain the current allocation to indexed and active management across the domestic equity space.

Concept 3: Addressing the fixed income management options. Mr. Race explained that ERS's return would be maximized by concentrating the portfolio with Loomis but that risk was controlled best by diversifying among managers. Mr. Race also reiterated Mercer's concerns with increasing the high yield component with Loomis Sayles at this time, as discussed in answer to Dr. Roepke's question earlier in the meeting. Mr. Race stated that a role for NCM can be maintained with minimal overall impact on risk or return, but noted discussion at meetings earlier in the year which had concluded that NCM's added value to the ERS portfolio overall was marginal.

He then described Mercer's proposal for Concept 3. The proposal is to move the policy allocation to the previously-discussed 1/3:1/3:1/3 approach among Loomis, Mellon and JP Morgan. In addition, the proposal includes continuing the split within Loomis to Core and High Yield. Mercer also recommended reviewing the allocation in 2006 to account for evolving market conditions. It was noted that the Loomis part of this proposal had been covered in answer to questions earlier in the meeting.

Concept 4: Additional alternatives such as diversifying into additional real estate and hedge funds. While the opportunities to improve the overall balance of risk and return were significant enough to justify further discussion, Mr. Race noted that the disadvantages to this approach immediately included reduced expected returns and the substantial work required to educate the Board on choosing and implementing a high quality hedge fund portfolio. He explained that Mercer's proposal for Concept 4 was to talk with ING on the international real estate opportunities available over the coming quarter and follow up with a training program on a wider range of alternative investments, covering real estate, hedge funds, commodities and price earnings, potentially, as suggested by Board members, inviting Wharton faculty to deliver a custom session.

Finally, Mr. Race summarized Mercer's proposals and indicated that, while only minor changes were recommended now and through the end of 2006, this was because the ERS portfolio was seen to be structurally sound and well managed, as evidenced by its consistent strong showing against its peer group and its outperformance of the benchmark over time.

**The Board unanimously agreed to follow Mercer's recommendation to increase international equities from 15% to 20% with a skew toward GMO and a reduction of domestic equities from 36% to 31%. Motion by Mr. Martin, seconded by Mr. Parish.**

**The Board unanimously agreed to follow Mercer's recommendation to revise the fixed income allocation to 1/3 to Mellon (Index), 1/3 to JP Morgan Chase, 1/6 to Loomis Sayles Core and 1/6 to Loomis Sayles High Yield, with no funds to be invested by NCM. Motion by Mr. Martin, seconded by Ms. Bedford.**

In response to a question by the Chairman, Mr. Race stated that Mercer would rewrite the Board's investment policy statement to incorporate the decisions made by the Board.

C. Flash Report

Ms. Finney-Cooke presented the flash report for September 2005. She reported that ERS had an aggregate market value of approximately $1.52 billion on September 30, 2005 and that it led the Composite Market Index by 10 basis points, gaining 0.8% in the month of September. She also stated that value outperformed growth in the large cap arena but growth outperformed value in the small cap arena. Ms. Finney-Cooke reported the international equity markets experienced strong gains, while the investment-grade fixed income market declined 1.0% and high yield issues returned -1.0%, in-line with the broad market.

Ms. Finney-Cooke also reported on the JP Morgan Investment Management account, which will be funded from the Wells Capital Management account. She noted that the initial assets are approximately $113 million and that funding will be complete in October.

Ms. Finney-Cooke indicated that the core fixed income allocation is currently below the minimum range and that Mercer recommends taking the $10 million needed for November cash flow from Boston Partners, which is overweight. She also stated that due diligence meetings with Hotchkis & Wiley and Artisan Partners were scheduled for the November Board meeting.

Ms. Finney-Cooke also discussed investment manager performance. She noted that Hotchkis & Wiley had experienced underperformance but emphasized that Mercer still had confidence in that manager. She also stated that Ariel had underperformed in September due to its lack of energy stocks and inability to realize gains in that sector. More positively, she noted that Capital Guardian had exceeded its benchmark.

D. Long-Term Liquidity Report

Mr. Race presented information regarding ERS's liquidity. He stated that one option is to formalize the current process and assume cash needs of $10 million per month, sourcing them according to month-end evaluations. He noted that disadvantages of this option are that managers will not have much opportunity to plan for what could be in some managers' cases proportionately relatively large withdrawals and that ERS could on occasion end up with too much cash.

Mr. Race also addressed an alternative option, which is to build a matrix to pull smaller amounts of cash from each manager. He commented that an advantage of this option is that regularly taking small, consistent amounts of cash allows managers to plan ahead. Mr. Race noted that this strategy requires the Board to establish a rebalancing policy. He pointed out that ERS's assets will have to be rebalanced in due course anyway because the allocation is below the minimum for fixed income investments.

Mr. Martin proposed a third alternative, which is to take Mr. Mueller's 12-month forecast and have Mercer prioritize the sources in $5 million increments. He suggested that Mr. Mueller or Mr. Hohrein could inform Mercer of the amount required to fulfill ERS's cash needs. Mr. Race stated that this approach may be difficult to implement because the priority list will change monthly.

The Board also discussed transaction costs for withdrawing assets. Mr. Race indicated that it is generally less expensive to take from an index fund and suggested that the Board could adopt a strategy of taking assets only from Mellon and rebalancing among the managers to maintain allocations.

The Chairman suggested that the Board explore the alternatives further and address the auditor's concerns regarding dependence on Mr. Mueller and lack of a contingency plan as well. He proposed that the Board address policy, strategy and tactics for accomplishing its liquidity goals.

14. 2006 Pension Board Election Schedule and 2006 Meeting Calendar

The Board discussed the 2006 Pension Board election schedule and noted that Mr. Martin is finishing his first three-year term.

Dr. Roepke also mentioned the 2006 Board meeting calendar. Mr. Martin stated that the International Foundation conference was scheduled for October 8-11 in Las Vegas and should not conflict with the October Board meeting.

15. IT Vendor Status Update

Mr. Hohrein reported that Maximus has agreed to expand its services to include project management and vendor contract monitoring and also agreed to reduce its proposed price for these services from $643,500. He also reported that, as an alternative to Maximus's proposal, ERS has been searching for an individual to hire as a project manager, which would mean a lower cost to ERS. He stated that the Board may have to consider using a consulting firm in this capacity if a suitable candidate cannot be located.

Mr. Grady reported that he hopes to have the contract with Vitech completed by the November Board meeting. He stated that the contract process has been complicated because Vitech proposed a hosting contract and a software contract, while he prefers to have only one contract, Mr. Grady noted that he has requested that several schedules be attached to the contract. Mr. Hohrein noted that the Genesys system must be cut off for ERS and Human Resources at the same time.

16. RFP for ERS Service Providers

The Board discussed hiring a consultant to assist the Board in conducting service provider RFPs and reviewed a draft Request for Information/Qualifications for such a consultant. The Board also reviewed a project plan for the RFP process for actuarial services. Dr. Roepke suggested that one of the Board's counsel conduct the actuarial RFP with input from the Chairman, Mr. McDowell, Mr. Hohrein and Corporation Counsel, with a goal of completing the RFP by the end of January 2006. The Board directed Reinhart Boerner Van Deuren to prepare a draft RFP and then seek input from the Chairman, Mr. McDowell, Mr. Hohrein and Corporation Counsel.

17. Administrative Matters

A. Continuing Education/Board Retreats/Training and Professional Organizations

There was no discussion on this topic.

B. Future Board Topics

There were no future board topics addressed.

18. Adjournment

The meeting adjourned at 2:50 p.m.

Submitted by Steven D. Huff,
Assistant Secretary to the Pension Board