EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE SEPTEMBER 15, 2010, 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
Linda Bedford (Vice Chair)
Donald Cohen
Keith Garland
Mickey Maier (Chairman)
Jeffrey Mawicke
Marilyn Mayr
Dr. Sarah Peck
David Sikorski
Guy Stuller

Others Present
David Arena, Director of Employee Benefits, Department of Administrative Services
Mark Grady, Principal Assistant Corporation Counsel
Gerald Schroeder, ERS Manager
Dale Yerkes, ERS Fiscal Officer
Monique Taylor, ERS Clerical Specialist
Steven Huff, Reinhart Boerner Van Deuren s.c.
Alec Montgomery, Industry Funds Management
Monte Tarbox, Industry Funds Management
Brian Wrubel, Marquette Associates, Inc.
Ray Caprio, Marquette Associates, Inc.
Ken Loeffel, Retiree
Victor Salbashian, Milwaukee County Employee

3. Minutes – July 21, 2010, Pension Board Meeting

The Pension Board reviewed the minutes of the July 21, 2010, Pension Board meeting.

The Pension Board unanimously approved the minutes of the July 21, 2010, Pension Board meeting. Motion by Mr. Stuller, seconded by Ms. Mayr.

4. Reports of ERS Manager and Fiscal Officer

(a) Retirements Granted, July and August 2010

Mr. Schroeder distributed a revised August Retirements Granted Report.

Mr. Schroeder presented the Retirements Granted Report for July 2010. Eighteen retirements were approved in July, with a total monthly payment amount of $26,342. Of those 18 retirements, 11 were normal retirements and seven were deferred vested retirements. Seven retirees elected backDROPs in amounts totaling $1,343,204.

Mr. Schroeder presented the Retirements Granted Report for August 2010. Thirty-one retirements were approved in August, with a total monthly payment amount of $46,118. Of those 31 retirements, 22 were normal retirements and nine were deferred vested retirements. Fifteen retirees elected backDROPs in amounts totaling $2,694,108.

(b) ERS Monthly Activities Report, July and August 2010

Mr. Schroeder distributed a direct deposit progress report and a V-3 strategic plan report.

Mr. Schroeder presented the Monthly Activities Report for July and August 2010. ERS had 7,363 and 7,386 retirees at the end of July and August, respectively, and paid out $13,222,930 in benefits for July and $14,671,838 for August. Mr. Schroeder indicated that the average number of retirements over the previous three months has decreased from earlier in the year.

Mr. Schroeder then presented an update regarding mandatory direct deposit of retiree pension checks. The number of paper checks ERS issues decreased from 196 in June 2010 to 46 in September 2010.

ERS sent its third notice to retirees explaining the use of debit card accounts with U.S. Bank for retirees who have not provided a direct deposit form. ERS has tested the debit card system to be used for applicable retirees. A retiree living in Canada will be able to use the debit card, but will be subject to a $3.00 fee.

Mr. Schroeder next presented an update on a five-year strategic plan for the V-3 system. A key part of the strategic plan is Ordinance compliance. In response to a question from the Chairman, Mr. Schroeder stated that the V-3 system is about 85% automated but part of the strategic plan is to reduce the amount of manual work ERS staff must perform. Mr. Schroeder indicated quality assurance enhancements are another key part of the strategic plan. ERS is also committed to County ownership of the V-3 system in 2011 when ERS will perform certain functions on-site. The strategic plan will be integrated into the annual budget to enable ERS to fund these initiatives.

Mr. Schroeder discussed a draft 2011 schedule of Board and Committee meetings. He suggested Board members review the tentative schedule and consider approval at the next meeting.

(c) Fiscal Officer/Cash Flow Report

Mr. Yerkes distributed a Portfolio Activity Report for August 2010 showing the change in the balance of ERS's investments with each manager during the month. He noted this report is not available in time to send in the premailer but will be available at each Pension Board meeting. In response to a question from the Chairman, Mr. Yerkes indicated the report shows the values carried by BNYM.

Mr. Yerkes then presented the ERS cash flow report. He reported that ERS needs cash flows of $10 million for October, $15 million in November and $15 million in December.

In response to a question from Ms. Mayr regarding whether these cash flow amounts can accommodate potentially large backDROP payments, Mr. Yerkes indicated it is difficult to forecast when members will actually retire. He stated that ERS maintains about $28 million in ready cash, which should be sufficient to cover any large backDROPs.

The Pension Board unanimously approved the liquidation of assets to fund cash flow of $10 million for October, $15 million in November and $15 million in December. The amounts should be withdrawn from investments designated by Marquette. Motion by Ms. Mayr, seconded by Mr. Cohen.

5. <u>Investments</u>

(a) <u>IFM Infrastructure Manager Report</u>

Alec Montgomery and Monte Tarbox of Industry Funds Management ("IFM") distributed copies of a presentation.

Mr. Tarbox indicated that Alec Montgomery is IFM's head of infrastructure in North America. He stated that IFM is an infrastructure specialist with offices in Australia, New York and London. IFM has an infrastructure staff of about 33 people.

Mr. Tarbox stated that IFM has two funds. One fund is situated in Australia with Australian pension funds as investors. The other fund, in which ERS is invested, is a global fund composed of Australian and U.S. investors. The global fund has more investors from the U.S. than from Australia.

Mr. Tarbox discussed IFM's investment strategy. IFM focuses on mature infrastructure investments. IFM prefers to invest in infrastructure businesses that have a monopoly position in their local economy or have high barriers to entry. IFM also looks to invest in infrastructure businesses with modern plant facilities and strong records of health and safety, labor relations and environmental standards. IFM targets investments in infrastructure businesses with inelastic demand. Because these infrastructure businesses are often regulated, IFM looks for assets that are regulated in a rational and sensible manner. There are currently no transportation or social infrastructure investments in the global fund. Also, IFM prefers not to invest much in new construction.

Mr. Tarbox explained that IFM's goal for the global fund is to earn a return in excess of 10% per year. Of that 10% or greater return, 6% to 8% will come from cash generated by the businesses in which IFM invests. During the period of June 2010 through August 2010 in which ERS has invested with IFM, ERS has had a return of about 6%. The initial commitment from ERS of $60 million was valued at

$63.7 million as of August 31, 2010. ERS is the second largest investor in IFM's U.S. limited partnership. Reinhart was faster than any of IFM's other 19 U.S. investors' counsel in investment document turnaround time.

Mr. Montgomery described the global fund in which ERS is invested. One of the advantages of IFM's open-ended fund structure is that when IFM drew down commitments at the end of May, ERS gained immediate access to a diversified portfolio in the U.S. and Europe. IFM's goal is to have approximately 50% of its infrastructure assets in North America and 50% of its infrastructure assets in Europe. IFM's U.S. infrastructure assets include investments in Colonial Pipeline, NAEA and Duquesne Light Holdings. U.K. infrastructure assets in which IFM has invested include Arqiva, Wales & West Utilities and Anglian Water Group. IFM also has European infrastructure assets. All of these businesses are regulated except NAEA and Arqiva. IFM believes that the advantage of a good regulatory framework is that it ensures a fair return on capital.

Mr. Montgomery discussed IFM's recent investment in 50 Hertz. 50 Hertz is an example of a regulated electricity transmission network. IFM drew down ERS funds in late May 2010 to fund that transaction, which was completed in June 2010. IFM acquired a 40% interest in a regulated electricity transmission network in northwest Germany in a partnership with Elia. Elia is the Belgian transmission network owner and operator. IFM typically partners with an operating company in the industry with operational expertise which complements IFM's financial expertise. For the 50 Hertz transaction, IFM has an expected return of about 12.5%.

Mr. Montgomery then commented on IFM's investment in Dalkia Polska. In this transaction IFM partnered with Dalkia International to invest in the Polish district heating business. IFM anticipates a return of approximately 17% for its Dalkia Polska investment. In response to a question from the Chairman, Mr. Montgomery indicated the expected returns for IFM's investments in 50 Hertz and Dalkia Polska are based on valuations completed by IFM. Independent valuations of 50 Hertz and Dalkia Polska are scheduled for next quarter. Mr. Tarbox indicated that valuations are critical for open-ended funds.

In response to a question from Dr. Peck, Mr. Montgomery stated that IFM prefers negotiated deals for its investments versus participating in an auction of the investment.

In response to a question from the Chairman, Mr. Tarbox stated that IFM has not sold any of its assets in the global fund but has sold assets from its Australian fund. Mr. Tarbox indicated there are four reasons why IFM would sell an asset. First, if the business does not perform as expected. Second, if someone offers a price that is well above what IFM believes the asset is worth. Third, when IFM believes regulators are not making sound decisions. Finally, when an IFM partner has different views than IFM about how to manage an asset.

Mr. Caprio asked Mr. Tarbox to describe the impact of currency fluctuations. Mr. Tarbox explained that half of the portfolio is designed to be non-U.S. dollar currency. This creates currency fluctuations. Over the last two years, currency fluctuations have ranged from 1% to 3% from quarter-to-quarter. However, the fluctuations balance out over time. While IFM's goal is to have a return of 2% to 3% per quarter in local currency, currency fluctuations may make the return harder to see in U.S. dollars. In response to a question from Dr. Peck, Mr. Tarbox noted that IFM could separate the currency fluctuation from the return in its quarterly numbers.

In response to a question from Dr. Peck, Mr. Tarbox explained that although IFM hedges in the Australian Fund, it does not do so in the global fund. Mr. Tarbox indicated that to hedge requires too much uninvested cash or the expense of buying options. IFM has found that investments in infrastructure typically represent a small portion of a fund's investment portfolio. Also, big public funds told IFM that it is easier for them to hedge at the plan level.

Mr. Montgomery described some of the investments that IFM is considering. While it is difficult to predict what its next investment will be, IFM is considering investing in a variety of sectors and countries.

(b) Marquette Associates Report

Brian Wrubel and Ray Caprio of Marquette Associates, Inc. distributed both quarterly and monthly reports.

Mr. Wrubel first described the fixed income markets through August 2010. The overall fixed income markets have been quite strong over the past few months. A main reason for the strong returns is the fact that investors have moved money from the stock market to the bond market. The corporate bond market in particular has had strong returns. Specifically, BarCap Corporate AAA, AA, A and BBB bonds almost all had a return of at least 10% year-to-date. The return of a 10-year treasury is currently about 2.7% versus IFM's performance to date of 8% in the global fund.

Mr. Wrubel next discussed U.S. equity market returns. U.S. stocks had a return of -4.5% in August 2010. There has been volatility in the stock market recently. The market peaked in April 2010 while in May 2010 the market was down about 8%. In June 2010, the market was down about 6% while in July 2010, the market was up about 6%. The market is currently up about 6% for the month of September 2010. One of the reasons ERS added hedged equity is to reduce volatility.

Mr. Wrubel next reported that the performance of the U.S. equity markets on a ten-year basis has not been strong. The S&P 500 is down about 2% on a ten-year basis, including dividends. The Russell 1000 value index had a return of 1.9% on a ten-year basis while the Russell 1000 Growth index had a return of -5.4% over the same time period. This illustrates the need for diversification.

Mr. Wrubel then described the international equity market environment. During August 2010, the return of the MSCI EAFE (Local) index was -2.7% while the return of the MSCI EAFE (in U.S.$) index was -3.1%. However, for the last quarter, the return of the MSCI EAFE (Local) index was -1% while the return of the MSCI EAFE (in U.S.$) index was 5.1%. Over the one-year period, the return of the MSCI EAFE (Local) index was 0.1% while the return of the MSCI EAFE (in U.S.$) was -1.9%. Over the 10-year period, the return of the MSCI EAFE (Local) index was -1.4% while the return of the MSCI EAFE (in U.S.$) was 1.5%, which is about a 3% difference over the last 10 years.

In response to a question from the Chairman regarding the 10-year returns and the performance of value stocks, Mr. Wrubel recommended structuring the ERS portfolio by allocating funds to higher quality value stocks, mid-cap growth stocks and small-cap companies with earnings to outperform the broad market.

Mr. Wrubel indicated that some sectors of the stock market have performed well over a 10-year period, such as emerging markets.

Mr. Wrubel then presented the August 2010 flash report. The ERS portfolio has a market value of approximately $1.7 billion in assets through August 2010. The ERS portfolio is overweight in fixed income, where it is holding money until it funds its investments in commercial real estate and infrastructure. The allocation to fixed income will decrease as ERS funds those investments. In response to a question from the Chairman, Mr. Caprio indicated that Marquette is not recommending any rebalancing at this time.

Mr. Wrubel then reported on market values by manager. ERS has good exposure to emerging markets in its investment with Barings. Investors look for growth in the global economy such as in emerging markets to offset the lack of U.S. and European growth.

Mr. Wrubel then discussed the performance of the ERS fund. The return of the ERS fund is 1.8% gross of fees year-to-date. The fixed income composite has a return of 8% year-to-date, beating the benchmark of 7.8%. The return of the domestic equity composite is -3.2% year-to-date, outperforming the benchmark of -4%. The international equity composite is performing in line with the benchmark year-to-date. The long-short equity composite had a return of -0.3% for August 2010, beating the benchmarks.

Mr. Wrubel then reported on the August 2010 manager returns. While the GMO large-cap value fund performed well up until about four years ago, the fund has underperformed the benchmark on a four-year basis. K2 and ABS protected capital fairly well, beating the benchmarks for August 2010. IFM had a return of 2.9% for August 2010 versus the benchmark of 0.3%.

In response to a question from Mr. Grady regarding the underperformance versus the benchmarks of the GMO international small companies fund for August 2010 and year-to-date, Mr. Wrubel indicated that GMO uses the same investment philosophy for both its large-cap and small-cap funds. Dr. Peck suggested the Investment Committee review the performance of both the GMO international small companies fund and the GMO large-cap value fund.

Mr. Caprio noted that international small-cap equity managers sometimes do not focus on beating the benchmarks in contrast to international large-cap equity managers. He recommended a long-term approach with small-cap and emerging markets investments.

Mr. Caprio then discussed the fund's rankings for the past quarter. The ERS fund versus total public funds ranked in the 25th percentile. The ERS fund versus funds over $1 billion ranked in the 36th percentile. He also noted the fund's rankings for the past year. The ERS fund versus total public funds ranked in the 25th percentile. The ERS fund, compared to funds over $1 billion, ranked in the 42nd percentile. Mr. Caprio explained that on this report the lower the number, the better the ranking. He stated that the ERS fund performed well relative to its peers. The allocations to fixed income and long-short equity helped increase the ERS fund's rankings.

Mr. Wrubel next discussed investment management fees. ERS has exceptionally low fees compared to industry average fees, with the exception of fees paid to Artisan Partners.

6. Audit Committee Report

Mr. Stuller reported on the September 2, 2010, Audit Committee meeting. Sushil Pillai first provided the Audit Committee with an overview of the Investment Portfolio Assessment project recommended by Baker Tilly. Mr. Schroeder explained that in addition to the current 60-day assessment that is performed, this will be a short-term County quality assurance initiative. He indicated the Audit Committee will receive a final report on this topic and then it may come before the full Board.

The Audit Committee next discussed the possibility of using a uniform approach for V-3 programming. Currently, some calculations are based on pay periods while others are based on a specific date. Mr. Schroeder indicated the Audit Committee requested that he bring some examples for further discussion to a future Audit Committee meeting.

The Audit Committee then discussed which services will be included in the upcoming RFP process. Mr. Grady indicated the Audit Committee will start the Actuarial RFP process for Board consideration over the winter months with a July 1, 2011 contract start date. Mr. Grady indicated he will try to send an RFP out for legal services soon.

Next, the Audit Committee discussed the County audit sign-off process. Mr. Grady indicated that both ERS's auditors and the Audit Committee would like the Chairman of the Pension Board to sign off on the audit in addition to the ERS Manager.

The Audit Committee then discussed the deferred vested retirement notification policy. Currently, there are about 300 deferred vested members who reached age 60 and have not contacted ERS. ERS staff is concerned that these individuals will not receive a pension benefit if they die without contacting ERS.

Mr. Grady explained that ERS Ordinances do not require ERS staff to contact deferred vested members regarding their eligibility for benefits. However, ERS now has the capability with the V-3 system to notify deferred vested members of their eligibility for benefits. The Audit Committee recommended ERS send a notification to deferred vested members 60 days prior to normal retirement age encouraging them to apply for benefits. The Chairman indicated that this would be a new management practice and not a change to ERS Ordinances or Rules.

Mr. Grady stated that another possible approach is to send a letter only at termination explaining that an individual will be eligible at stated ages and events. This approach is less significant than sending a letter 60 days prior to normal retirement age. ERS past practice regarding whether notices were sent to deferred vested members has varied over the decades.

The Pension Board unanimously agreed to accept the Audit Committee's recommendation that ERS send a notification to deferred vested members 60 days prior to normal retirement age encouraging them to apply for benefits. Motion by Ms. Mayr, seconded by Mr. Cohen.

Mr. Stuller suggested also sending a notification to deferred vested members eligible for early retirement. Mr. Schroeder indicated that ERS members receive information regarding future benefit entitlements upon termination of County employment. In response to a question from Mr. Stuller, Mr. Schroeder explained ERS has a brochure series explaining rules for deferred vested members and the rules are also available online. Next year ERS will issue a summary plan description after clearing it though corporation counsel. There could be additional V-3 programming costs to also notify deferred vested members eligible for early retirement because service credit would also be a factor in the timing of the notifications.

In response to a question from Dr. Peck, Mr. Schroeder explained that the V-3 system is not programmed to notify deferred vested members eligible for early retirement. Dr. Peck indicated she believes the Pension Board should research any costs of making this change to the V-3 system before deciding whether to notify deferred vested members eligible for early retirement.

In response to a question from Mr. Mawicke, Mr. Grady indicated that the deferred vested members eligible for early retirement are a subset of those deferred vested members who will receive a notice 60 days prior to normal retirement age. In response to a question from Mr. Sikorski, Messrs. Grady and Schroeder indicated they were not aware of any history of notifying deferred vested members who are eligible for early retirement

The Chairman suggested that Mr. Schroeder research the costs involved, bring that information to the next Audit Committee meeting, and that the Pension Board reconsider this issue at its next meeting.

The Audit Committee then discussed the ERS check register. The Audit Committee decided to review the check register quarterly. In response to a question from the Chairman regarding ERS internal controls, Mr. Yerkes stated that once ERS hires an assistant fiscal officer, the responsibilities of writing checks and reviewing bank statements will be divided among different ERS staff members. In response to a question from the Chairman, Mr. Yerkes indicated that both he and the County Audit Department receive the bank statements simultaneously. In response to a question from Ms. Mayr, Mr. Yerkes noted that he completes the bank statement reconciliation and then sends the reconciliation to the County Audit Department for review.

The final topic the Audit Committee discussed was the Portfolio Summary Report. Mr. Yerkes will distribute the report monthly to Pension Board members.

7. Investment Committee Report

There was no Investment Committee report because the September 3, 2010, meeting was cancelled.

8. Administrative Matters

The Pension Board discussed additions and deletions to the Pension Board, Audit Committee, and Investment Committee agendas. Dr. Peck suggested that trade cost analysis and private equity education be added to the Investment Committee agenda.

9. Use of ERS Members as Hearing Examiners

Mr. Grady explained that he drafted a memorandum in 2006 to the Pension Board regarding the use of ERS members as hearing examiners for two reasons. First, Justice Ceci had substantial periods of unavailability to serve as a hearing examiner. Thus the appointment of additional hearing examiners was necessary and Mr. Grady wanted to raise the issue of whether the Board should appoint retired judges to be hearing examiners for appeals. Many retired Milwaukee County judges are ERS members. Second, Justice Ceci filed a claim against the Pension Board relating to his pension benefits, which he later withdrew.

Mr. Grady stated that he indicated in the memorandum that he did not believe it was a direct conflict for ERS members to serve as hearing examiners because they will not rule on their pensions. Justice Ceci continues to serve as a hearing examiner.

In response to a question from Dr. Peck, Mr. Grady indicated that ERS has about three to five disability appeals annually. Mr. Grady indicated that each hearing lasts only a few hours. ERS pays hearing examiners approximately $175 per hour. The hearing examiner's decision can be reviewed by the Pension Board if requested by the disability pension applicant.

Dr. Peck suggested the Pension Board not use judges who have legal claims pending against ERS. Ms. Mayr suggested having more than one retired judge available to serve as a hearing examiner.

10. Private Equity Investment

Mr. Cohen moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(e), with regard to item 10 for considering the investing of public funds, or conducting other specified public business, whenever competitive or bargaining reasons require a closed session.

Mr. Cohen also moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(f), with regard to item 11 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, 13, 14 and 15 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 8-0 to enter into closed session to discuss agenda items 10, 11, 12, 13, 14 and 15. Motion by Mr. Cohen, seconded by Mr. Mawicke. Voting in favor were Mr. Cohen, Mr. Garland, Mr. Maier, Mr. Mawicke, Ms. Mayr, Dr. Peck, Mr. Sikorski and Mr. Stuller.

The Pension Board took no action on item 10.

11. Disability Matters

(a) Applications

(i) Kelley McClendon, ODR

Upon returning to open session, the Pension Board discussed Kelley McClendon's ordinary disability pension. The Medical Board recommended that the Pension Board grant Ms. McClendon's ordinary disability pension application.

In open session, the Pension Board unanimously approved accepting the Medical Board's recommendation to grant an ordinary disability pension application. Motion by Mr. Cohen, seconded by Mr. Stuller.

(ii) Jason Foeckler, ADR

The Pension Board discussed Jason Foeckler's accidental disability pension. The Medical Board recommended that the Pension Board grant Mr. Foeckler's accidental disability pension application.

In open session, the Pension Board unanimously approved accepting the Medical Board's recommendation to grant an accidental disability pension application. Motion by Mr. Cohen, seconded by Mr. Stuller.

(b) Earned Income Limit-Victor Salbashian Application

The Pension Board took no action on this item.

12. Lynne Marks Overpayment

The Pension Board took no action on this item.

13. Application of the City-County Transfer Provisions to the Re-Employment of a Retired Member

The Pension Board took no action on this item.

14. Pending Litigation

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

The Pension Board took no action on this item.

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

The Pension Board took no action on this item.

15. Report on Compliance Review

The Pension Board took no action on this item.

16. Adjournment

The meeting adjourned at 12:30 p.m.

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