

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE SEPTEMBER 17, 2008 PENSION BOARD MEETING

1. Call to Order

Chairman Dr. Dean Roepke called the meeting to order at 8:37 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
Roy Felber
Mickey Maier
Jeffrey Mawicke
John Parish
Dr. Sarah Peck
Dr. Dean Roepke (Chairman)

Members Excused:

Marilyn Mayr

Others Present:

David Arena, Director of Employee Benefits, Department of Administrative Services
William Domina, Corporation Counsel
Mark Grady, Principal Assistant Corporation Counsel
Gerald J. Schroeder, ERS Manager
Vivian Aikin, ERS Administrative Specialist
Gordon Mueller, Fiscal Officer
Dale Yerkes, Assistant to the Fiscal Officer
Wendy Kraly, Milwaukee County IMSD
Sushil Pillai, V3 Project Manager
Bess Frank, Ad Hoc Oversight Committee
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Kristin Finney-Cooke, Mercer Investment Consulting
Anita Brar, Capital Guardian
Eran Klein, Capital Guardian
Ken Loeffel, Retiree
Louis Metz, Retiree
Nancy Beck-Metz, Retiree
Esther Hussey, Retiree

Gloria Yelezyn, Retiree
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*

3. Chairman's Report

The Chairman discussed the preparation required for the Pension Board's annual meeting at the Zoofari Center on February 18, 2009. Dr. Peck suggested that the Retirement Office procure a speaker to present on the state of the economy. Mr. Loeffel opined that coffee and a continental breakfast should be provided prior to the meeting.

The Chairman stated that he has received several positive comments regarding Mr. Schroeder's performance as permanent ERS manager and that he is pleased with Mr. Schroeder's performance.

4. Minutes of the July 16, 2008 Pension Board Meeting

The Pension Board reviewed the minutes of the July 16, 2008 Pension Board meeting.

The Pension Board unanimously approved the minutes of the July 16, 2008 Pension Board meeting. Motion by Mr. Cohen, seconded by Mr. Maier.

5. Reports of Employee Benefits Director, ERS Manager and Fiscal Officer

(a) Retirements Granted

Mr. Schroeder presented the Retirements Granted Reports for July and August 2008. He reported that 36 retirements were granted in July, noting that 11 retirees elected backDROPs in amounts totaling \$643,570, and that 15 retirements were granted in August, with 5 retirees electing backDROPs in amounts totaling \$781,677.

(b) ERS Monthly Activities Report and Organizational Chart

Mr. Schroeder reviewed the 2008 ERS Monthly Activities Reports for July and August 2008. He reported that in August the Retirement Office sent out letters to 142 members receiving disability pensions requesting that the members provide earned income statements to the Pension Board. Mr. Schroeder explained that the Retirement Office sought to ensure that these members did not exceed the income limitation threshold that would require a reduction of their disability pensions.

Mr. Arena told the Board that he was sad to announce that an ERS employee, Brenda Guthrie, passed away on Sunday night from a fairly recent illness.

Mr. Arena pointed out that the new custody agreement with Bank of New York Mellon will provide ERS with substantial cost savings over the next five years.

Mr. Arena distributed and explained the organizational chart for the Milwaukee County Division of Employee Benefits. He indicated that the department has increased in size by 40% since last year. He reported that there has been an upgrade in the training and level of service of the employee benefits staff. He stated that the next departmental challenge is to fill two open positions within the department.

Mr. Schroeder reported on two open two clerical positions within the department. He discussed how the Retirement Office is trying to transition the administrative specialist positions into pension counselors through increased training and development of a procedures manual.

Mr. Schroeder distributed and explained an approved vested pension rights brochure. He stated that the brochure is the first in a series of 15 planned brochures intended to provide basic information and clarification to ERS members who are close to retirement. He noted that the Retirement Office plans to distribute approximately two brochures per month.

Mr. Schroeder reported that the Retirement Office held a preretirement information session on August 29 at Wilson Park. He noted that approximately 150 individuals attended the 4-hour meeting. The session combined presentations by the Social Security Administration, ERS and the County's deferred compensation department. He indicated that another such session is planned for December 16 at Washington Park. He stated that the Retirement Office plans on having two of these sessions per year and may add another session per year if warranted by demand.

Mr. Schroeder stated that he met with Jason Gates, the County's Risk Manager, to discuss the progress of the fiduciary liability insurance request for proposal. Mr. Schroeder indicated that responses to the fiduciary liability insurance RFP are due on October 15 and that five major insurance firms are expected to submit proposals.

(c) Waivers

Mr. Schroeder noted that benefits waivers had been submitted to the Retirement Office by Jack Takerian, Christopher Happy and Timothy Russell. In response to a question from the Chairman, Mr. Grady stated that Mr. Takerian executed benefit waivers because he was being considered for the first time for confirmation by the County Board in his position. In response to a question from Mr. Felber, Mr. Grady stated that Corporation Counsel's and the Pension Board's position is that benefits waivers are irrevocable.

The Pension Board unanimously agreed to accept the waivers presented by Mr. Takerian, Mr. Happy and Mr. Russell. Motion by Mr. Cohen, seconded by Ms. Bedford.

(d) Cash Flow Report

Mr. Mueller distributed and discussed the cash flow report. Mr. Mueller stated that ERS will need cash flow of \$10 million per month for benefit payments until the end of the year. He indicated that he is unsure of the source of the \$10 million needed for September benefit payments. In response to a question from Mr. Mawicke, Mr. Mueller said the requested \$10 million per month is needed to pay benefits because the cash outflow demands are not met by the cash inflow received from ERS's dividends and interest. Mr. Mueller explained how ERS's cash flow situation and cash needs change throughout the course of the year.

The Pension Board voted 7-1, with Mr. Felber dissenting, to approve Mr. Mueller's cash flow request for \$10 million per month for benefit payments from October through December 2008 with the source of the funds to be recommended by Mercer. Motion by Mr. Cohen, seconded by Mr. Parish.

Mr. Mueller explained the differences between the 2008 budget and the 2008 actual costs through August and the projected costs for the remainder of the year. He stated that investment manager fees were well under budget due to the fact that these fees are based on the size of ERS's portfolios under management, which have decreased in size during the down market. He indicated that salaries and wage expense was lower because there was no permanent ERS manager and some other positions went unfilled. He pointed out that temporary help expense was higher than expected because the ERS manager was a temporary employee for part of the year, a temporary assistant to the fiscal officer was retained, and an increased number of temporary employees were needed for the imaging project. He also noted that custody fees were lower than budgeted because of the termination of the actively managed foreign equity account and the reduction of Bank of New York Mellon's fee to a flat \$50,000 fee per year.

Mr. Mueller stated that fiduciary liability premiums have been decreasing, which resulted in budget savings. He indicated that the budget was revised to reflect Mr. Pillai's budget for the V3 project. He noted that outside legal fee expense was over-budget primarily due to tax compliance issues, but he highlighted that litigation expense was under-budget, which helped offset overall legal fees. He pointed out that the investment consulting expense increased due to a cost-of-living adjustment for Mercer's fees. He commented how there was an increased expense in keeping the Genesys system current through the end of the conversion

to the V3 System. He discussed how the actuarial fees were over-budget due to extra charges from special projects.

Mr. Mueller discussed the current situation with Lehman Brothers. He indicated that Bank of New York Mellon called him on Monday to discuss the situation. He noted that Mellon worked all weekend to mitigate the problems. He reported that Mellon had called in all securities loans made to Lehman Brothers, which amounted to \$590,000. He stated that all loans should be paid by the end of the week on a cash basis settlement. He noted that ERS had 108% collateral for its loans, which totalled \$640,000. He indicated that he expects full payment by the end of the week and anticipates no losses on Lehman Bros. securities on loan. He stated that there were some Lehman Brothers securities in the Short-Term Investment Fund, which have been placed into a separate liquidity fund to be liquidated, and ERS will share pro rata in those liquidation proceeds.

Mr. Schroeder distributed and discussed the 2009 Pension Board and committee meetings schedule. The Chairman indicated that starting in December, all of the committee meetings will begin at 2:30 p.m. Upon hearing no objections, the Chairman stated that the 2009 meeting schedule is final.

6. Investments

(a) Investment Manager Report – Capital Guardian

Mr. Klein and Ms. Brar distributed a report on Capital Guardian's management of ERS's international small cap equity strategy and presented it to the Pension Board on behalf of Capital Guardian.

Mr. Klein discussed Capital Guardian's investment philosophy. He noted that Capital Guardian invests for the long term while managing short-term risk. He stated that Capital Guardian's goal is to produce consistently superior long-term investment results for clients. He detailed Capital Guardian's four-step investment process, which involves research, communication, stock selection and implementation/risk control. He noted that Capital Guardian's management has not changed since Capital Guardian's last presentation to the Pension Board.

Mr. Klein stated that the value of ERS's portfolio under management by Capital Guardian was \$45.2 million as of August 31, 2008, which is down from \$73.6 million at December 31, 2007. He attributed the decrease in the portfolio's size to ERS's withdrawals from the portfolio this year and the portfolio's poor performance. He stated that the portfolio has decreased in value approximately 27% year to date due to the volatility in the asset class. He indicated that he is comfortable with the prospects for the asset class and the recoupment of the portfolio's value. Ms. Brar stated that ERS should stay the course and focus on the

long term investment horizon. She discussed the volatile nature of the international small cap equity market.

Dr. Peck asked why Capital Guardian is underperforming its benchmark, net of fees for the ten-year and lifetime timeframes. Ms. Brar responded that Capital Guardian's performance lagged in its earlier periods of managing the ERS portfolio because it did not have regional analysts, which it added between 2000 and 2002 to strengthen the overall investment process.

Ms. Brar reviewed the portfolio's diversification by country and by sector. She discussed the portfolio's 20 largest holdings. In response to a question from the Chairman, Ms. Brar advised that investors not attempt to time the market and provided an example of how trying to time the market can result in negative returns. In response to a question from Dr. Peck, Ms. Brar stated that Capital Guardian classifies the location of a company based on the MSCI, but noted that Capital Guardian's analysts look at the specific countries in which a company does business to determine a company's sources of income.

(b) Mercer Report

Ms. Finney-Cooke presented Mercer's Flash Report for August 2008. She stated that ERS had a market value of just over \$1.46 billion at the end of August and that ERS's market value increased by 0.1% during August, which matched the performance of the reference index. She commented that there is great volatility in the financial markets.

Ms. Finney-Cooke reviewed the performance of each investment manager and each asset class. She indicated that Boston Partners beat its benchmark for August and the year to date. She noted that EARNEST Partners also exceeded its benchmark for August and year to date.

Ms. Finney-Cooke reported that ERS is in-line and in-balance with its asset allocation targets. Ms. Finney-Cooke stated that ING is outperforming its index for the year to date. The Chairman asked Ms. Finney-Cooke to review ING's participation in the subprime mortgage area.

Ms. Finney-Cooke provided an overview of the financial markets and indicated that she will send the Pension Board a Mercer-prepared market commentary. She commented how the subprime market has caused significant dislocations in the markets. She discussed the effects the rapid deleveraging of financial institutions had on the markets. In response to a question from Dr. Peck, Ms. Finney-Cooke explained the Treasury's intervention with respect to Fannie Mae and Freddie Mac. In response to a question from Ms. Bedford, Ms. Finney-Cooke discussed how the Lehman Brothers bankruptcy has caused investors to lose confidence in the

markets. Ms. Finney-Cooke indicated that ERS had approximately \$400,000 exposure in Lehman Brothers stock, which was sold at a 70% loss. She noted that Merrill Lynch was acquired by Bank of America and would have filed for bankruptcy if not for the purchase.

Ms. Finney-Cooke discussed the circumstances surrounding the financial problems at AIG, the world's largest insurer. She stated the AIG's subsidiaries are regulated insurance companies and more rigid standards apply to them. She indicated that AIG's problem was caused by \$400 billion in counterparty swap insurance, which is unregulated. The counterparty swap insurance led to a liquidity crunch at AIG, which led to AIG's credit rating being downgraded and forced AIG to raise additional capital. She noted that AIG had an \$18 billion loss in the second quarter. She commented that AIG is involved in so many areas that it is too big to allow to fail, because there would be worldwide consequences if it failed. In response to a question from Ms. Riley, Ms. Finney-Cooke responded that ERS's exposure to Lehman Brothers is low because the exposure is in an index fund and not an active fund.

Ms. Finney-Cooke stated that the stress in the swap market will continue. She noted that the markets have never been through a period like this before. She opined that the Federal Reserve will lower interest rates and indicated that this loose monetary policy will cause inflation. She stated that Mercer is monitoring Lehman Brothers counterparty risk and will inform the Pension Board of any updates.

In response to a question from Dr. Peck, Ms. Finney-Cooke stated that financial institutions are trying to raise capital. Dr. Peck indicated that the raising of cash will cause upward pressure on interest rates. Mr. Maier noted that ERS is underweight in private equity and inquired about the opportunity to invest in distressed debt private equity funds. Ms. Finney-Cooke stated that those type of investments might not generate the anticipated returns and that the desirability of those investments might be reevaluated. Dr. Peck stated that distressed debt private equity funds are high risk because the investor does not know exactly what it has or is purchasing.

The Chairman asked Ms. Finney-Cooke to keep the Board apprised of ERS's exposure to risk. The Chairman stated that at a future Investment Committee meeting there should be an educational session on Treasury leverage in government. The Chairman and Dr. Peck requested that any white papers produced by Mercer be forwarded to the Pension Board.

(c) Investment Committee Report

Dr. Peck reported on the September 2, 2008 Investment Committee meeting. She stated that Mercer presented an overview of investments in commodities. She indicated that the Investment Committee is educating itself about various investment classes in anticipation of the upcoming asset allocation study. She noted that the Investment Committee reviewed Mercer's July 2008 Flash Report. She stated that the Investment Committee agreed on its meeting schedule for 2009.

7. Chair and Vice Chair Selection Process

Mr. Grady distributed and discussed a memorandum on the history of, and procedures for, electing a Chair and Vice Chair of the Pension Board. He stated that there are no rules relating to the selection or retention of the Pension Board Chair and Vice Chair. He concluded that the Pension Board is free to draft a Rule relating to this practice or to continue its past practices.

8. Vitech Project Report

Mr. Arena stated that the Vitech project is coming down the home stretch. He introduced Wendy Kraly from Milwaukee County IMSD.

Mr. Pillai provided a brief overview of the Vitech project. He indicated that there is a higher stress level as well as a higher level of focus among the team members. He noted that the life and health portion of the project is targeted to be completed between October 17 and October 31.

Mr. Pillai stated that training of the Retirement Office staff on the V3 System will begin on October 11. He pointed out that significant levels of testing are necessary. He indicated that there will be four levels of internal testing followed by three levels of Vitech testing. He reviewed the highlights of the V3 project from July and August, and indicated that he will update the Pension Board on the project's status through the go-live date. He noted that he converted the project's budget to Mr. Mueller's format and approach.

Mr. Arena stated that the Vitech conversion is the County's second largest project after the Ceridian conversion. The Chairman requested that the Pension Board continue to receive monthly reports on the status of the Vitech project. In response to a question from Mr. Felber, Mr. Pillai stated that there are no problems with the interface between the V3 System and Ceridian.

9. Vitech Implementation Oversight Committee Report.

Mr. Parish stated that the Vitech Implementation Oversight Committee is tracking the current go live date of the V3 System. He noted that V3 System testing continues and

that system training will begin in October. He indicated that the next few months will be busy for the Retirement Office.

10. Audit Committee Report

Mr. Parish reported that the request for proposal for investment consulting services was issued in late August with responses due on October 1, 2008. He stated that the investment consulting RFP Evaluation Panel will meet on October 8, 2008 from 12 – 3 p.m. to review the proposals.

The Pension Board discussed retaining Mr. Mellinger as a consultant to assist in evaluating the investment consultant RFP responses, similar to the role he served as a consultant for the custodian RFP. The Pension Board noted that the Board's advisors had identified no other qualified candidates to assist in evaluating the RFP who were not disqualified because they were receiving the investment consulting RFP or serving on the Pension Board. The Pension Board indicated that Mr. Mellinger's proposed fee of \$9,500 seems reasonable compared to the fee paid for his evaluation of the investment custodian RFP responses and the additional work required for the evaluation of the investment consultant RFP responses. Pension Board members noted that they were pleased with Mr. Mellinger's prior work on the investment custodian RFP evaluation process, and expressed confidence that Mr. Mellinger will add value to the investment consultant RFP evaluation process.

The Pension Board unanimously approved retaining Mr. Mellinger as a consultant to assist with the investment consulting RFP evaluation process for a flat fee of \$9,500. Motion by Mr. Felber, seconded by Mr. Cohen.

11. Administrative Matters

The Pension Board agreed to update the future topics list to include a discussion of exchange traded funds. Dr. Peck suggested adding proxy voting to the future topics list. The Chairman indicated that proxy voting should be added to agendas for the next Audit Committee and Investment Committee meetings.

12. Disability Pensions

(a) Earned Income Statements – Rule 1010

Mr. Schroeder stated that he sent certified letters to the members who failed to return their earned income statements. He indicated that the Retirement Office needs Pension Board approval before it suspends the benefits of Kelly Vernon. He noted that Ms. Vernon has not returned her earned income statement. In response to a question from Dr. Peck, Mr. Schroeder stated that he is certain she received the letter. Ms. Aikin stated that Ms. Vernon called and stated that she received the letter and would send the earned income statement to the Retirement Office, but

she failed to return the statement. In response to a question from Mr. Felber, Mr. Schroeder replied that the letter indicated that her pension would stop if the form was not returned to the Retirement Office by the return date. In response to a question from Mr. Felber, Mr. Grady stated that the Retirement Office will reinstate her benefits with back payments once she returns a suitable earned income statement.

The Pension Board unanimously agreed to suspend the benefits of Kelly L. Vernon until she provides the Retirement Office with a suitable earned income statement. Motion by Mr. Cohen, seconded by Mr. Felber.

Mr. Grady stated that a discussion of Lori Jemison's circumstances should be added to next month's agenda.

(b) Disability Applications

Ms. Bedford moved that the Pension Board adjourn into closed session for the purpose of receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation and for considering the financial, medical, social or personal histories or disciplinary data 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 or data.

The Pension Board voted 8-0 by roll call to enter into closed session to discuss Agenda Items 12(b), 13, 14, and 15.

(i) Sherry Ransom – ODR Request for Reconsideration.

Upon returning to open session, Mr. Grady stated that Ms. Ransom's ordinary disability application was denied on November 14, 2007 and the denial was affirmed on appeal. Mr. Grady noted that she did not appeal to the Pension Board within 20 days after the denial by Judge Buckley. Mr. Grady indicated that Ms. Ransom asked for reconsideration. Mr. Grady advised that the Pension Board not waive the one-year time frame before a person can reapply for a disability pension because there are no compelling facts indicating a reason to do so in Ms. Ransom's case.

The Pension Board unanimously agreed to deny Ms. Ransom's request for reconsideration of the denial of her ordinary disability pension application. Motion by Mr. Cohen, seconded by Mr. Felber.

Ms. Riley recommended that the Retirement Office send Ms. Ransom a letter informing her of the denial of her request for reconsideration and her right to reapply for a disability pension after November 14, 2008.

(ii) Michael Elm – ADR.

Upon returning to open session, the Pension Board unanimously agreed that in light of the extraordinary circumstances and unusual delays outside Mr. Elm's control, in order to expedite the process of considering his application for a disability pension, if the Retirement Office staff reviews the Medical Board report and determines the Medical Board recommends approval of an accidental disability pension, the Pension Board conditionally approves Mr. Elm's accidental disability pension application subject to affirmation by the Pension Board at the October meeting, but if the Medical Board's report does not recommend approval or makes no recommendation, then Mr. Elm's circumstances will be discussed at the October Pension Board meeting. Motion by Mr. Felber, seconded by Mr. Cohen.

(iii) Karen Grimm – ODR.

Upon returning to open session, the Pension Board unanimously approved Ms. Grimm's ordinary disability application based upon the recommendation of the Medical Board. Motion by Mr. Cohen, seconded by Mr. Felber.

13. Pending Litigation

The Board discussed the following pending litigation in closed session:

Milwaukee County, et al. v. Mercer Human Resource Consulting.

14. Report on Special Investigation

The Board discussed the report on the special investigation in closed session

15. Report on Compliance Review

The Board discussed the report on compliance review in closed session.

16. Adjournment

The meeting adjourned at 12:45 p.m.

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