

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
MINUTES OF THE MARCH 16, 2005 PENSION BOARD MEETING

Chairman Walter Lanier called the meeting to order at 8:25 a.m. in Room 203-R of the Milwaukee County Courthouse.

1. Roll Call

Members Present:

Linda Bedford
Donald Cohen
Walter Lanier
John Martin
Marilyn Mayr
John Parish
Dean Roepke

Members Excused:

Michael Ostermeyer

Others Present:

Charles McDowell, Director of Human Resources
Gloria Morris, Retirement Coordinator
Gordon Mueller, Fiscal Officer, Employees' Retirement System
Bob Shupe, Employees' Retirement System
Ann To, Milwaukee County
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Brad Blalock, William M. Mercer, Inc.
Patrick Race, William M. Mercer, Inc.
Cliff VanBeek, Retiree
Michael Howden, Retiree
Kathy George, Maximus
Roy Eldridge, Maximus
Anita Brar, Capital Guardian
Fernando Hernandez, Capital Guardian
Tom Hancock, GMO
Carolyn Nelson, GMO

2. Approval of Minutes of February 9, 2005 Meeting

The Board unanimously approved the minutes of the February 9, 2005 Pension Board meeting. Motion by Mr. Martin, seconded by Ms. Mayr.

3. Reports and Requests from Retirement System Staff

A. Ratification of Retirements Granted

Ms. Morris presented the schedule of Retirements Granted for the prior month's retirements and asked that the Board ratify them. The Board noted some possible errors and inconsistencies. Retirement System staff answered questions, filled in missing information and corrected errors identified.

The Board unanimously approved the schedule of Retirements Granted, contingent upon the correction of entries for Pamela Bottoni, Dorothy Dean and Marguerite Daniel. Motion by Mr. Cohen, seconded by Dr. Roepke.

B. Director of Human Resources, Charles McDowell – Update on Staffing of ERS

Mr. McDowell reported that two support staff members had been hired for the Retirement Office and that the final three candidates have been selected for the manager position. He noted that he will meet with the committee consisting of the Chairman, Mr. Cohen and Dr. Roepke to discuss the candidates. The Chairman requested that Mr. McDowell forward the candidate's resumes to the committee members.

C. Gordon C. Mueller, Fiscal Officer

(i) Approval of Liquidity/Cash Flow Request

Mr. Mueller reported that he had communicated with Mercer regarding ERS's need for \$10 million by the end of April to make benefit payments. In response to a question by Ms. Bedford, Mr. Mueller stated that the \$10 million disbursement had been approved in February. Mr. Mueller also stated that an additional \$10 million would be necessary at the end of June. Ms. Bedford raised the issue of transaction costs and suggested further review of cash flow needs on a long-term basis.

Mr. Mueller indicated that he tries to keep ERS assets invested as long as possible and that he does not know the

amounts that will be needed to pay benefits until the lump sum amounts have been calculated.

The Board unanimously approved the liquidity request and voted to determine the funds from which the assets would be taken when Mercer arrived at the meeting. Motion by Mr. Martin, seconded by Dr. Roepke.

(ii) Approval of Payment of Administrative Expenses to County

The Board reviewed the schedule of ERS expenses for which the County requested reimbursement.

The Board unanimously approved the requested reimbursements. Motion by Mr. Martin, seconded by Ms. Bedford.

4. Maximus Technology Update

A. Update on Status of Technology System Consultant Contract

Ms. George reported that she had worked with ERS staff to document all processes relevant to an ERS technology system and that the next step is to develop evaluation criteria.

B. Discussion Regarding RFP Criteria for Technology System RFP

The Chairman noted that the Board may enter closed session for the purpose of deliberating or negotiating the purchasing of public properties, the investing of public funds, or conducting other specified public business, whenever competitive or bargaining reasons require a closed session. The Board unanimously agreed to enter closed session to discuss criteria for the RFP. Motion by Ms. Bedford, seconded by Mr. Cohen. The Board returned to open session after discussing this item.

5. Disability Retirement Applications

The Chairman stated that the Pension Board may enter closed session to consider medical or personal histories related to disability retirement benefits or to confer with legal counsel with respect to litigation in which it is likely to become involved, provided that motions are made and carried by majority vote to convene in closed session and the Chairman announces the nature of the business to be considered at such closed session. By

unanimous roll call vote, the Board agreed to enter closed session to discuss Item 5. Motion by Mr. Martin, seconded by Dr. Roepke.

Upon returning to open session, the Board unanimously approved the ordinary disability applications of Juanita Hardison, Anthony Kowalski and Helen Johnson. Motion by Mr. Martin, seconded by Dr. Roepke.

6. Investments, William M. Mercer

A. Investment Performance—Flash Report

Mr. Race presented the flash report for February 2005. The fund's aggregate market value as of February 28, 2005 was just under \$1.5 billion. Mr. Race noted that EARNEST Partners, Reinhart & Mahoney and Hotchkis & Wiley were funded in mid-February and are included in the asset allocation. Mr. Race noted that Lynch Jones Ryan had handled the transition to the new managers.

After discussion with Mr. Blalock and Mr. Race, the Board unanimously agreed to fulfill the liquidity request of \$10 million by taking \$5 million from Ariel and \$2.5 million each from Artisan Partners and Hotchkis & Wiley. Motion by Dr. Roepke, seconded by Ms. Bedford.

The Board discussed the allocation of funds and the possibility of alternative investments. The Chairman suggested further discussion on the allocation issues at the May or June meeting.

Mr. Blalock suggested updating the statement of investment policy to account for changes, including selection of four new managers. Mr. Race noted that the statement has been updated in draft form.

Upon an attendee's request, the Board agreed to provide copies, to the extent possible, of the flash report and other documents to the audience at future meetings.

Dr. Roepke and Ms. Bedford raised questions regarding the increased frequency of liquidity requests. Mr. Blalock responded that it is better to withdraw funds on a monthly basis to keep the assets invested as long as possible. Ms. Bedford inquired regarding increased costs related to more frequent withdrawals. Mr. Blalock indicated that ERS could rebalance assets into an index fund through crossing trades in anticipation of cash flow needs according to a

schedule. The Chairman suggested that the Board explore and discuss this issue in greater detail at the April meeting.

B. Manager Presentations

(i) Capital Guardian.

Ms. Brar and Mr. Hernandez addressed the Board on behalf of Capital Guardian and reported on Capital Guardian's investment performance. They noted that international and small cap investments have performed well recently. They acknowledged that Capital Guardian has lagged behind the market. They stated that Capital Guardian has made adjustments and, consequently, its organization and investment process are stronger than ever. They described Capital Guardian's bottom up investment policy, which is designed to increase returns and reduce risk by using a committee of managers, rather than one "star" manager. They discussed allocation of ERS assets and, in response to a question by Ms. Bedford, explained how the allocation is determined. They also reported on Capital Guardian's active manager approach, changes to the small cap team and the size of the ERS account. Dr. Roepke inquired about avoiding companies that support terrorism. Mr. Hernandez responded that most of the countries to avoid do not have established markets and that the research process screens these companies out.

(ii) GMO.

Ms. Nelson and Mr. Hancock addressed the Board on behalf of GMO. They discussed the ownership structure of GMO and its value investing approach. They also described GMO's criteria for quality companies and philosophy regarding portfolio structure. The Board agreed to discuss GMO in greater detail at the April meeting.

7. Board Education

A. Indemnification Process

Mr. Huff presented materials regarding the indemnification process applicable to Board members and ERS employees under the Ordinances. In response to a question by Ms. Mayr, Mr. Grady

noted that there were no precedents at the County level. The Board discussed the language of the Ordinances, noting that they indicate that ERS shall provide indemnification if a civil wrong was alleged that was committed within the scope of a member's duties. Mr. Huff noted that the Board need not indemnify by vote, but can do so. Mr. Huff pointed out that the indemnification provision is easily applied and readily understandable in the context of litigation, but more difficult to apply in other circumstances. He noted that, typically, the Board would vote in the litigation context to provide funding for the defense of a lawsuit.

Mr. Huff also raised questions for the Board to consider, such as whether a "proceeding" has to be a court proceeding or can include something like an ethics board investigation, how to define a "civil wrong" and how to determine whether an action is within the scope of a Board member's duties. In addition, Mr. Huff suggested that the Pension Board could ask a third party, such as a court, the State Attorney General or Corporation Counsel to issue an opinion on a request for indemnification, although these parties could decline to rule on such a request.

B. Doctrine of "Vested Benefits"

Mr. Huff presented an outline of Wisconsin case law addressing the vested benefit theory. He provided updated information regarding the Champine case, which was very recently partly reversed by the Wisconsin Court of Appeals. Ms. Riley pointed out that these cases involved Ordinances (or their equivalent), rather than pension system rules and that the Pension Board does not have authority to grant benefits.

C. IRA Rollover Process

Mr. Huff presented a memorandum regarding new rules for the automatic rollover of mandatory cash outs exceeding \$1,000 to IRAs. He indicated that these rules have a January 1, 2006 compliance deadline for public retirement plans such as OBRA, which means that the County Board must make any necessary amendments by the end of its first regular session beginning on or after January 1, 2006 and that OBRA must operate in accordance with the new rules on the same day.

Mr. Huff noted that ERS does not permit mandatory cash outs and no action is required for ERS. He also stated that the OBRA

Ordinances require the mandatory cash out of members' benefits by a single lump sum distribution if the member's benefit is \$5,000 or less, the member terminates County employment and the member is absent from County employment for five years. The Board discussed options for complying with these rules for OBRA, including requesting that the County Board amend the OBRA Ordinances to limit the amount of the mandatory cash out to \$1,000 or less, eliminating mandatory cash outs or providing for automatic rollovers of mandatory cash outs between \$1,000 and \$5,000.

Mr. Huff also presented a memorandum and Rule regarding a default procedure for eligible rollover distributions. In response to a question previously raised by Mr. Mueller, Mr. Huff reported that the Retirement Office may distribute a member's lump sum benefit directly to the member if the member fails to complete a direct rollover election if the Pension Board adopts and the Retirement Office follows default procedures for such distributions. He indicated that, to implement the default procedure, the Retirement Office must provide appropriate notice to members who are eligible for direct rollover distributions no earlier than 90 days and no later than 30 days before the dates of their distributions. Mr. Huff also noted that, if a member fails to elect a direct rollover distribution and the Retirement Office makes a lump sum cash payment to that member, it must withhold 20% of the distribution for federal income tax purposes.

The Board unanimously agreed to adopt Rule 1037, Default Procedure for Eligible Rollover Distributions, effective as of March 16, 2005. At the suggestion of Dr. Roepke, the Board revised Rule 1037 to note that the Pension Board shall withhold the amount required by the Internal Revenue Service, as amended from time to time, from any eligible rollover distribution paid directly to a distributee. Motion by Mr. Cohen, seconded by Dr. Roepke. The final Rule is attached to these minutes as Exhibit 1.

D. RFP Process for Service Providers

The Chairman presented information on RFPs for service providers in the context of best practices. Ms. Bedford inquired regarding the prior process for RFPs. The Board discussed utilizing resources from the International Foundation of Employee Benefit Plans and other contacts. Ms. Bedford noted that the Board was not bound by the County's RFP process and may want to consider using an RFQ

(Request for Qualifications) to identify what the Board is looking for and seek the best candidates in a more streamlined manner.

8. Legal Counsel on Interpretation and Possible Amendment of Rules, Ordinances and Statutes

The Chairman stated that the Pension Board may enter closed session to confer with legal counsel with respect to litigation in which it is likely to become involved, provided that motions are made and carried by majority vote to convene in closed session and the Chairman announces the nature of the business to be considered at such closed session. By unanimous roll call vote, the Board agreed to enter closed session. Motion by Mr. Martin, seconded by Ms. Bedford.

The Board discussed potential challenges to potential changes in the buy in program and potential litigation regarding IRA rollovers.

Upon returning to open session, the Board agreed 5-2, with Ms. Mayr and Dr. Roepke dissenting, to direct Mr. Huff to prepare a Rule to sunset the buy in program after advance notice to ERS members and supporting documents for review at the April Pension Board meeting.

9. Administrative Matters – Future Agenda Topics

Dr. Roepke requested that Mr. Huff's study of the legal role and function of the Director of Human Resources with respect to ERS be addressed at the April Pension Board meeting. The Chairman noted that an audit of the operation of ERS conducted by Virchow Krause would be discussed at the April Pension Board meeting.

10. Adjournment

The meeting adjourned at 3:50 p.m. Motion by Mr. Martin, seconded by Mr. Parish.

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

EXHIBIT 1

By Corporation Counsel

A RESOLUTION

To authorize the Corporation Counsel to investigate and prosecute potential claims or causes of action in favor of the Milwaukee County Employee Retirement System arising out of the conduct of any party who participated in the development of the 2000 pension benefit enhancements.

WHEREAS in 2000, certain additional and increased retirement benefits (the 2000 pension benefit enhancements) were granted to members of the Milwaukee County Employee Retirement System through amendments to the Milwaukee County pension ordinance, s. 201.24, M.G.C.O., and corresponding negotiated amendments to the collective bargaining agreements between Milwaukee County and bargaining units representing Milwaukee County employees, and

WHEREAS at the time the 2000 pension benefit enhancements were granted, mistaken or incomplete information was provided with regard to the potential cost of those enhancements, and

WHEREAS the 2000 pension benefit enhancements have resulted in enormous costs to the Employee Retirement System which were not recognized or understood at the time they were granted, and

WHEREAS increased numbers of employees have elected the "back-drop" benefit, and "back-drop" payments through January, 2005, have totaled in excess of \$75,000,000, depleting the assets Employee Retirement System fund in that amount and causing additional costs due to loss of earnings which the fund could have realized on those assets.

WHEREAS numerous parties had active roles in the design, analysis and promotion of the 2000 pension benefit enhancements, and

WHEREAS it is in the best interests of the Milwaukee County Employee Retirement System to investigate the conduct of those parties to determine whether any of them was legally culpable and to pursue any viable claim the Milwaukee County Employee Retirement System may have against any culpable party, now therefore

BE IT RESOLVED that the Corporation Counsel, with the assistance of Attorney Leigh Riley of Foley and Lardner as special outside counsel to the pension board, is authorized to investigate whether any party who had an active role in the design, analysis or promotion of the 2000 pension benefit enhancements may be legally culpable and whether the Milwaukee County Employee Retirement System may have a viable claim or cause of action against any such party or that party's insurer for any of the benefits payments or other costs resulting from those enhancements.

BE IT FURTHER RESOLVED that the Corporation Counsel is authorized to commence and maintain civil action(s), following consultation with the Milwaukee County Pension Board, against any party who had an active role in the design, analysis or promotion of the 2000 pension benefit enhancements for the purpose of providing security to the funds of the Milwaukee County Employee Retirement System.

BE IT FURTHER RESOLVED that the Corporation Counsel is authorized to engage and retain private counsel to assist him in the activities described in the foregoing paragraphs.

EXHIBIT 2

AMENDMENTS TO THE RULES OF THE EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

RECITALS

1. Section 201.24(11.1) of the Milwaukee County Code of General Ordinances (the "Ordinances") describes the buy back program available through the Employees' Retirement System of the County of Milwaukee ("ERS").

2. Ordinance section 201.24(11.1) allows former County employees who previously withdrew the balance of their membership accounts and who then return to County employment to buy back prior pension service credit by redepositing the prior membership account balance with interest.

3. Ordinance section 201.24(11.1) requires returning employees to repay the previously withdrawn amount with interest within two years of returning to County employment.

4. ERS Rule 404 describes the calculation of interest on buy back amounts.

5. ERS Rule 404 states that interest on buy back amounts will equal the amount that the previously withdrawn amount would have earned had it remained within the employee's membership account. Interest will be calculated at the aggregate rate of return earned by ERS assets during each applicable year.

6. Ordinance section 201.24(8.6) allows the Pension Board of the Employees' Retirement System of the County of Milwaukee (the "Pension Board") to establish rules for the administration of ERS.

7. The Pension Board desires to clarify the operation of the buy back program.

8. The Pension Board desires to clarify and further specify the method for calculating interest on buy back payments.

RESOLUTIONS

1. Pursuant to Ordinance section 201.24(8.6), the Pension Board hereby creates and adopts Rule 1036 to read as follows:

1036. Buy Back Applications.

- (a) A member who terminates and withdraws his membership account and who then later returns to active County employment may restore the ERS service credits previously earned by buying back those credits through the buy back program.
- (b) A member may buy back prior service credit and have that service credit restored if:
 - (1) The member renders two years of service with the County subsequent to resuming active County employment; and
 - (2) Within the two-year period after the member returns to active County employment, the member redeposits the amount withdrawn from the membership account with interest thereon to date of redeposit.
- (c) Interest on the buy back repayment shall be calculated in accordance with Rule 404.
- (d) A member may submit an application to participate in the buy back program at any time during the two years following the member's resumption of active County employment. However, full repayment of the withdrawn amount, along with the calculated interest amount, must occur within two years of the member's resumption of employment, regardless of when the member applies for participation in the buy back program.
- (e) If the member does not elect to restore prior service credit by participating in the buy back program within the two-year period following resumption of employment, the member's prior service credits shall be permanently canceled.
- (f) The Pension Board, in its own sole discretion, may expand the repayment period solely for the purpose of compliance with applicable federal, state or municipal laws.

2. Pursuant to Ordinance section 201.24(8.6), the Pension Board hereby amends and restates Rule 404 in its entirety to read as follows:

404. Interest Rate on Employee Buy Backs.

- (a) If a member elects to participate in the buy back program to restore prior service credit, as described in Ordinance section 201.24(11.1), the member must redeposit the previously withdrawn membership account amounts with interest thereon to the date of redeposit.
- (b) Interest shall equal the amount that the withdrawn amount would have earned had the withdrawn amount remained in the membership account throughout the "withdrawal period" beginning on the date of withdrawal and ending on the date of full repayment.
- (c) The Retirement Office will calculate interest by using the aggregate ERS annual rate of return for each calendar year included in the withdrawal period. As described in subsection (d) below in greater detail, all rates of return used in the interest calculation shall be determined and frozen as of the date of the Retirement Office's interest calculation.
 - (1) In years ERS experienced negative returns, the Retirement Office will apply a negative return in this interest calculation.
 - (2) In partial years, including the years during which the member repays the buy back amount, the Retirement Office will apply the annual rate for the given year on a per diem basis to calculate the full amount of interest owed.
- (d) The interest rate used to assess interest during the "buy back repayment period" will depend upon whether the member asks to buy back service in the member's first year of reemployment or the member's second year of reemployment.
 - (1) If the member asks to buy back service in the member's first year of reemployment, the Retirement Office will calculate interest through the second anniversary of the member's return to County employment (the deadline for repayment of the buy back amount), using the same interest rate for the year of the member's return and throughout the buy back period. The interest rate will equal the ERS annual rate of return for the full calendar year prior to the member's return to employment.
 - (2) If the member asks to buy back service in the member's second year of reemployment, the Retirement Office will

calculate interest through the second anniversary of the member's return to County employment (the deadline for repayment of the buy back amount). The Retirement Office will assess interest for the year of the member's return using the actual ERS rate of return for that year. The Retirement Office will use the actual ERS rate of return for any other calendar year during the buy back period that is fully completed before the member's asks to buy back prior service. The Retirement Office will assess interest for any partial year during the buy back period (with such interest assessed on a per diem basis), using the ERS annual rate of return for the last fully completed calendar year during the buy back period as the interest rate.

- (e) If a member repays the total withdrawal amount with interest prior to the end of the two-year buy back period, the Retirement Office will provide the member with an interest rebate for the member's overpayment of interest at a per diem rate.
- (f) If the member fails to repay the total withdrawal amount with interest prior to the end of the two-year buy back period, the Retirement Office will permanently cancel the service which the member seeks to buy back, and the Retirement Office will refund to the member the entire amount paid by the member to the Retirement Office to attempt to buy back service.

3. Rule 1036 and amended and restated Rule 404 shall be effective January 1, 2005.

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