

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
MINUTES OF THE MAY 18, 2005 PENSION BOARD MEETING

Chairman Walter Lanier called the meeting to order at 8:20 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
Michael Ostermeyer
John Parish
Dean Roepke

Members Excused:

None

Others Present:

Charles McDowell, Director of Human Resources
Jack Hohrein, ERS Manager
William Domina, Corporation Counsel
Mark Grady, Principal Assistant Corporation Counsel
Gloria Morris, Retirement Coordinator
Gordon Mueller, Fiscal Officer
Anh To, Milwaukee County
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Patrick Race, Mercer Investment Consulting
Kristin Finney, Mercer Investment Consulting
Ray Eldridge, Maximus
Cliff Van Beek, Retiree
Ken Loeffel, Retiree
Albert Brooks, ERS member
Scott Manske
Brian Price, Gonzalez, Saggio & Harlan, LLP
Dennis Skelly, Mercer Human Resource Consulting
Matt Stuart, Mercer Human Resource Consulting

2. Welcome New ERS Manager

The Chairman welcomed new ERS Manager, Jack Hohrein. He noted that Mr. Hohrein previously worked as a CPA, has worked in the employee benefits area since 1979 and has over 25 years of experience working with

multiemployer benefit plans. The Chairman thanked Ms. Morris for the wonderful job she did as interim ERS Manager and Pension Board Secretary.

3. Approval of Minutes of April 20, 2005 Meeting

The minutes were presented for approval. Ms. Mayr asked whether the Board could start forwarding non-confidential documents to interested parties. The Chairman responded that providing these documents to interested parties is one of Mr. Hohrein's objectives.

The Board approved the minutes of the April 20, 2005 Pension Board meeting 7-0-1, with the Chairman abstaining due to his absence. Motion by Mr. Martin, seconded by Mr. Cohen.

4. 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 the Board to review them.

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

The Chairman noted that one of Mr. Hohrein's goals would be to reduce input error in the Retirements Granted.

B. Gordon C. Mueller, Fiscal Officer – Liquidity Request

Mr. Mueller presented the projected cash flow report for the remainder of 2005. He stated that the Retirement Office tries to keep a two-month reserve of liquid assets but he estimates that ERS will be \$12 million below that goal at the end of June. He requested that ERS receive \$10 million per month through the end of 2005. He offered to coordinate with Mercer on liquidity needs. Mr. Mueller also reported that the projected amount of lump sum DROP payments is \$2.5 million per month and that the amount of regular pension payments is over \$10 million per month.

5. Maximus Technology Update

Mr. Eldredge reported on the status of the technology RFP. He noted that potential vendors' RFPs are due today and that Maximus expected to receive 3 RFPs. He also noted that four vendors, Ceridian, Vitech, Covansys and Levi, Ray & Shoup (Pension Gold), attended the Vendor Pre-Proposal conference on April 26, 2005 and that one of those vendors will not submit an RFP. Ms. To stated that the vendors who attended the conference are the major players in the pension area. Mr. Eldredge reported that Maximus and ERS collaborated to answer written vendor questions regarding the RFP on May 4, 2005.

Mr. Eldredge and Ms. To then explained the process for handling the RFPs. They noted that a subject matter expert and a management expert would analyze the proposals. Maximus would then rank the proposals and recommend its final choice after presentations from the vendors. Finally, they noted that Maximus would ask the vendors for their best and final offers.

The Board discussed the schedule for presenting the decision on the vendors. In response to a question from the Chairman, Mr. Eldredge stated that Maximus would not be ready to present a decision at the June 15, 2005 Pension Board meeting and asked that the Board schedule a special meeting for June 29. The Chairman asked whether the presentation could be handled at the July Pension Board meeting instead. Mr. Eldredge responded that contracts must be signed and the County's payroll provider must be notified of the decision by mid-July so a special meeting would be necessary. The Chairman noted that the Board would get back to Maximus regarding scheduling the special meeting.

6. Litigation Update

The Chairman stated that the Pension Board may enter closed session to discuss an individual's disability retirement application which may entail discussion of, among other things, medical records of the applicant or to confer with legal counsel, who is rendering oral or written advice concerning strategy to be adopted with respect to litigation in which it is or is likely to become involved. By unanimous roll call vote, the Board agreed to enter closed session to discuss litigation and disability applications. Motion by Dr. Roepke, seconded by Mr. Cohen.

While in closed session, the Board discussed the following pending cases:

- A. *Zeiger et al. v. Milwaukee County et al.*
- B. *Oldenburg v. Milwaukee County et al.*
- C. *Bilda et al. v. Milwaukee County et al. ("Bilda I")*
- D. *District Council 48 v. Milwaukee County et al.*

7. Disability Applications – Albert Brooks

While in closed session, the Board discussed the ordinary disability application of Albert Brooks.

Upon returning to open session, the Board unanimously approved the ordinary disability application of Albert Brooks. Motion by Dr. Roepke, seconded by Mr. Parish.

8. Pension Benefit Waivers

The Board unanimously agreed to accept the benefit waivers of Vera Westphal and Jack Hohrein, waiving their rights to the back DROP benefit, the additional 0.5% multiplier and the 25% retention incentive bonus. Motion by Mr. Martin, seconded by Dr. Roepke.

9. Quarterly Ethics Reports

Mr. Grady reported that ethics reporting forms for the second quarter had been mailed and that the forms were the same as those used for the first quarter. He also noted that the first quarter reports were considered filed. Dr. Roepke opined that the forms were difficult to complete. Mr. Martin indicated that he had received notice that the County's outside auditor had requested his ethics statements. He asked whether Board members knew why the auditor was reviewing the forms. Mr. Grady responded that, like any other public document, the Ethics Board need not provide a reason for requesting the statements.

10. Actuarial Report – Dennis Skelly

Mr. Skelly and Mr. Stuart presented a report on the 2005 actuarial valuation results for ERS. They reported on the actuarial cost method used for ERS and explained that future payments to ERS are discounted by the assumed long-term investment return rate. They noted that the current guideline that was adopted by the Board uses a rate equal to the 10-year actual return of the fund within a 7.5%-9.0% corridor. The report also explained how unfunded liabilities are amortized and contributions are calculated.

Mr. Skelly and Mr. Stuart also discussed ERS member demographics and noted that the number of retirees has increased and the number of active employees has declined since 2004.

The report outlined the factors included in calculating the 2005 contribution requirement and noted that the actual 2005 requirement is \$37.6 million, compared to the budgeted requirement of \$37.8 million. Ms. Bedford and Dr. Roepke raised questions regarding the funded percentage for 2004 and 2005.

Ms. Mayr inquired how to reflect an increase in unfunding. Mr. Skelly responded that most liabilities are funded over 30 years. Ms. Mayr and the Chairman discussed whether the Pension Board should be concerned about unfunding. Mr. Ostermeyer noted that contributions must be within reason and reflected on what happens if the Board determines that the County should make a larger contribution. Ms. Mayr noted that the Board has a responsibility to be concerned about required contributions being made to the fund. The Chairman questioned what contribution would be too low or what unfunded percentage too high.

Mr. Skelly pointed out that one of the Board's chief duties is to set actuarial assumptions and explained that the intention of all actuarial methods of funding are to get to 100% over a long period of time. However, he also noted that poor investment performance can suddenly reduce the funded status of the fund.

The Chairman requested that Mr. Skelly review the funded status of ERS's peer group for the June Board meeting. Mr. Ostermeyer requested that the peer group be defined based on the maturity of the fund (*i.e.*, number of active members vs. number of retirees). Mr. Skelly responded that the data is most likely unavailable because the public data is based strictly on the number of participants and the fund's assets. However, he stated that the information is comparable because accrued liabilities and asset level depends on the benefits to be paid.

The Board discussed back DROP benefit assumptions. Mr. Skelly also requested that the Board change to an alternative assumption for back DROP benefits. The Chairman indicated that he would like to review projected back DROPs of the remaining 5,000 County employees before selecting a different assumption. Mr. Ostermeyer observed that the funding percentage assumption is much more important than the back DROP assumption.

Mr. Skelly and Mr. Stuart next reported on the 2006 baseline budget and assumptions and reviewed ERS's experience for 2004. They noted that the 10-year return of the fund is 10.9% and that based on the Board's guideline, the funding interest rate would increase to 9.0%. They stated that 9.0% is aggressive given the current economic climate and recommended changing the current guidelines and not increasing the assumed funding rate. They also pointed out that recent surveys show the average return assumption for public funds is approximately 8.0%.

The Chairman inquired about the process for setting the interest rate assumption. Mr. Huff suggested that the Board set the best percentage instead of calculating the contribution amount. The Chairman agreed. Mr. Ostermeyer stated that he is not comfortable with 9.0%. He suggested that the Board needs to change the policy and raised the following questions regarding the current actuarial range:

- A. Is a ten year retrospective look at earnings a valid way of determining the anticipated earnings of ERS?
- B. Is it appropriate to establish 7.5% and 9.0% as the lower and upper ends of the range?
- C. Is the Board policy currently in effect and the methodology used by Mercer in its actuarial calculations capturing the capital markets projections prepared by Mercer Consulting for ERS?
- D. How do ERS's recent funding interest rate assumptions compare to the funding interest rate assumptions used by other similarly-situated plans?

Mr. Stuart noted that 2 years ago, the 9.0% rate fell to 8.5% under the policy based on the 10-year average rate of return. Additionally, the actuary held the assumption at 8.5% although it would have risen to 9.0% using the 10-year average rate of return. Dr. Roepke noted that he had worked with 10 similarly-sized public funds at the Wharton School seminar and that group had focused on 7.5% as the rate to be used.

Mr. Skelly recommended that the next steps the Board should take are to approve the 2006 budget assumptions and send a letter to the County Board requesting funds. He noted that this letter has been sent to the County Board in the first week of June in recent years. The Board discussed scheduling a special meeting for additional discussion by June 15. Mr. Grady noted that the Chairman can sign the letter to the County Board if the authority is delegated to him.

The Chairman noted that Mr. Loeffel questioned whether Mr. Grady's sidebar conversation with Dr. Roepke during the actuary's report violated the open meetings law. Mr. Grady stated for the record that he did not think it was a violation.

11. Administrative Matters

A. Continuing Education, Board Retreats and Training

The Chairman requested that the Board consider holding a special meeting or Board education retreat to cover subjects such as fiduciary duties, the asset liability model and Ordinance training. He suggested that such meetings be held once per quarter on a Saturday morning with two or three 90-minute sessions at each meeting.

Ms. Mayr indicated that she did not plan to attend the International Foundation of Employee Benefit Plans conference. She also requested a report on the 2005 travel expenses that had already been approved.

Dr. Roepke reported on the Wharton School conference and noted that Part II would be held in September.

B. Future Board Topics

There was no separate discussion of future Board topics.

12. Investments -- Mercer Investment Consulting

A. Manager Presentations

There was no manager presentation.

B. Investment Performance—Flash Report

Mr. Race and Ms. Finney addressed the \$10 million per month projected liquidity request discussed earlier in the meeting by Mr. Mueller.

The Board unanimously agreed to approve the \$10 million liquidity request for June 2005. Motion by Dr. Roepke, seconded by Mr. Martin.

Mr. Race and Ms. Finney next presented the flash report for April 2005. They indicated that performance in the various markets has not been strong in 2005. They noted that the only trends are that value stocks have outperformed growth stocks and large cap has outperformed small cap. They also pointed out that the Board must select asset classes to achieve the actuarial rate selected and that the Board cannot simply rely on investment managers to sufficiently outperform their benchmarks in order to compensate for a shortfall.

Mr. Race and Ms. Finney also reported that Hotchkis & Wiley had closed investment of the asset/style portfolio that ERS had chosen. They indicated that this is a positive development for ERS because Hotchkis & Wiley will not be managing too large a fund in the mid cap value equities style, which limits the amount of a particular security that can be purchased without affecting the price. Board members raised questions regarding the reasons Ariel does not close its small cap equity portfolio and indicated that they would ask Ariel at the next presentation why it does not believe there is a need to close the style.

The Board discussed the asset/liability study and the need to review structural issues, compare investments in bonds vs. equities and review international investments. Mr. Race also indicated that the Board should address its investments with Capital Guardian, which is predicting a down year for 2005. Mr. Race noted that the Board will probably want to reduce or eliminate these investments.

Ms. Bedford raised a question regarding requests by two highly-regarded local business leaders that the Board consider Israel Bonds. The Chairman responded that his practice regarding such proposals is to send them to Mercer. Mr. Race also indicated that Bank One and Loomis will be able to review such proposals mid-summer.

Dr. Roepke noted that he had heard projections about inflation and the potential negative impact on bond performance and asked whether ERS should reduce its bond exposure. Mr. Race responded that the Pension Board may want to consider buying Treasury Inflation-Protected Securities through Mellon. He also stated that if inflation remains at less than 3%, such securities are unnecessary. However, they would be helpful if inflation is higher.

13. Litigation Update

The Chairman stated that the Pension Board may enter closed session to confer with legal counsel, who is rendering oral or written advice concerning strategy to be adopted with respect to litigation in which it is or is likely to become involved. By unanimous roll call vote, the Board agreed to enter closed session for additional discussion of current litigation. Motion by Mr. Martin, seconded by Dr. Roepke.

During closed session, Mr. Price reported on the status of *Vernon v. Milwaukee County et al.*

14. Cliff Van Beek Indemnification Request

The Board returned to open session to discuss Mr. Van Beek's request for indemnification. The Chairman opened the discussion by handing out materials provided by Mr. Huff, Mr. Van Beek and Mr. Domina. He also noted that the core question the Board should consider is whether Mr. Van Beek's actions arose out of or occurred within the scope of his duties as a Pension Board member.

Dr. Roepke asked whether anyone had noted any problems with the reports provided by Mr. Van Beek from 1996 through 2003. Mr. Van Beek responded that they had not. He indicated that Board members had been told by former Corporation Counsel Robert Ott, former Department of Human Resources Director Gary Dobbert and former Pension Board Secretary and ERS Manager Jac Amerell to keep track and list items of value on their ethics statements. He indicated that Board members understood that this did not include the value of meals associated with events such as seminars and vendor conferences and that they had no way of determining the value of such meals. Mr. Van Beek also stated that he had put every ticket that had a listed price on his ethics statements and opined that the new Ethics Board had changed the rules for acceptable reporting without notice to the Pension Board.

The Board discussed the Ethics Board's findings of fact with respect to Mr. Van Beek's case. Dr. Roepke asked Mr. Huff and Ms. Riley about past Board member activities and reporting requirements. Ms. Riley agreed that the Board encouraged and voted on attendance at all conferences. Mr. Huff recalled that Mr. Ott had requested Board members to report anything valued at over \$50 and that he and Ms. Riley had deferred to Mr. Ott on the reporting requirements. Dr. Roepke asked whether Corporation Counsel had a conflict in representing both the Pension Board and the Ethics Board.

Mr. Domina responded that it was his responsibility to determine whether there was a conflict.

Mr. Domina also indicated that the information provided by Mr. Van Beek is irrelevant to the Board's inquiry because the Board is precluded by the Ethics Board's findings and Mr. Van Beek's no contest plea from finding that there were no ethics violations. He emphasized that the issue to be decided is whether Mr. Van Beek was acting within the scope of his duties. Mr. Van Beek stated that his actions were taken within the scope of his duties because relationships with money managers are crucial in administering ERS and the ethics code indicated that incidental meals need not be reported. Mr. Domina countered that the violations were not within the scope of Mr. Van Beek's duties. He stated that the violations were not related to Mr. Van Beek's duties as a Pension Board member because they were separate from the conferences he attended.

The Chairman stated that the Board may enter closed session to discuss a case that is a controversy among adverse parties that was the subject of a judicial or quasi-judicial trial or hearing before the Pension Board or to confer with legal counsel, who is rendering oral or written advice concerning strategy to be adopted with respect to litigation in which it is or is likely to become involved. The Board voted 7-1, with Ms. Mayr dissenting, to enter closed session to continue discussion of Mr. Van Beek's request for indemnification. Motion by Dr. Roepke, seconded by Mr. Parish. After returning to open session, the Board agreed to lay over Mr. Van Beek's request until the June 2005 Board meeting.

15. Adjournment

The meeting adjourned at 3:05 p.m. Motion by Mr. Parish, seconded by Ms. Bedford.

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