EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE JULY 15, 2009 PENSION BOARD MEETING

1. Call to Order

   Chairman Dr. Dean Roepke called the meeting to order at 8:34 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
   Jeffrey Mawicke
   Marilyn Mayr
   Dr. Dean Roepke (Chairman)
   Dr. Sarah Peck
   Guy Stuller

   Others Present:
   David Arena, Director of Employee Benefits, Department of Administrative Services
   William Domina, Corporation Counsel
   Gerald Schroeder, ERS Manager
   Gordon Mueller, Fiscal Officer
   Dale Yerkes, Assistant to the Fiscal Officer
   Vivian Aikin, ERS Administrative Specialist
   Monique Taylor, ERS Clerical Specialist
   Steven Huff, Reinhart Boerner Van Deuren s.c.
   Leigh Riley, Foley & Lardner LLP
   Brett Christenson, Marquette Associates, Inc.
   Ray Caprio, Marquette Associates, Inc.
   Jeremy Getson, AQR Capital Management
   Chris Palazzolo, AQR Capital Management
   Wayne Morgan, Baker Tilly Virchow Krause LLP
   Ken Loeffel, Retiree

3. Chairman's Report

The Chairman reported that the County appointed Mr. Yerkes to the position of Fiscal Officer Assistant.

The Chairman reminded everyone that the August Pension Board meeting has been canceled and the Board will reconvene in September.

4. Minutes of the June 17, 2009 Pension Board Meeting

The Pension Board reviewed the minutes of the June 17, 2009 Pension Board meeting.

The Pension Board unanimously approved the minutes of the June 17, 2009 Pension Board meeting. Motion by Mr. Cohen, seconded by Ms. Bedford.

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

(a) Retirements Granted

Mr. Schroeder presented the Retirements Granted Report for June 2009. He reported that 33 retirements were granted in May, noting that 12 retirees elected back DROPs, in amounts totaling $1,098,686.

(b) ERS Monthly Activities Report

Mr. Schroeder indicated that there were 7,295 retirees at the end of June and that ERS paid out $12,709,209 in benefit payments in June.

Mr. Schroeder reported on the Retirement Office's efforts towards converting 70 years of files into electronic format. He indicated that records are stored in two areas of the courthouse. He stated that the Retirement Office staff has culled through 7,500 cases in the mezzanine storage area and estimated that the project is 40% complete and will take the rest of the year to finish. He noted that the Retirement Office is restructuring the file system in the second floor records room. He commented that the second floor project is 10% done and will take until the middle of 2010 to complete.

Mr. Schroeder stated that nine Retirement Office staff members and one supervisor began the International Federation of Retirement Education's Certified Retirement Counselor program. He indicated that the self-study program which involves an exam results in the enrollee becoming a licensed Certified Retirement Counselor. He noted that the program could take between one and two years to complete.

In response to a question from Ms. Mayr, Mr. Schroeder stated that a consultant is currently writing procedures on the application of the Ordinances to various situations for the Retirement Office staff to follow. He stated that the Retirement Office staff also reviews Corporation Counsel legal opinions and applies them when administering benefits. He noted further that the Retirement Office staff also undergoes monthly training and testing.

Mr. Arena commented that the Retirement Office is now adequately staffed. He noted that Mr. Schroeder greatly improved the quality of the staff. Mr. Arena complimented Mr. Schroeder for his achievements. Mr. Arena encouraged the Pension Board to review the pension system enhancements.

Mr. Arena stated that ERS is "going green" and has enlisted the help of the Parks Department to help convert the approximately 300 people who receive benefit checks to switch to direct deposit. He indicated that a tree will be planted in their name with a brass plaque if they convert to direct deposit.

Ms. Mayr stated that October 15 is the target go-live date for the self-service portion of the V3 System. In response to a question from the Chairman, Mr. Schroeder indicated that he can provide individual or small group preview sessions on the V3 System to the Board members.

(c) Cash Flow Report

Mr. Schroeder presented the cash flow report, noting that nothing has changed significantly since the last report. He stated that ERS still needs $10 million per month for July, August and September benefit payments. In response to a question from Ms. Mayr, Mr. Mueller stated that ERS received $29 million from the Mercer settlement and that $1 million has been set aside and held back for potential claims on the recovery amount. Mr. Mueller noted that he will let the Board know if and when the $1 million becomes available. Mr. Mueller stated that the April lump sum payment figure on the cash flow report is now correct.

6. Investments

(a) AQR Capital Management

Messrs. Getson and Palazzolo distributed a report and presented on AQR's management of ERS's small cap value equity strategy. Mr. Getson provided an overview of the firm. He explained that AQR employs a strategy that involves selecting stocks on their value and momentum. He commented that research shows that a combination of value and momentum performs better than each strategy alone.

Mr. Getson reviewed AQR's investment process. He pointed out that value and momentum together only factor 50% into AQR's stock selection. He stated that AQR overweights stocks that meet its core characteristics, which he reviewed. He indicated that AQR performs textual analyses of conference call transcripts. He commented that AQR's strategies do present some risk. He noted that the most recent period has been unambiguously unique and difficult for active management.

Mr. Palazzolo reviewed ERS's returns for the first six months of 2009 and pointed out that there are positive signs for stock picking. He noted that macro level factors are affecting the market, which makes it more difficult to find differentiating factors among stocks.

In response to a question from the Chairman, Mr. Getson stated that the most simple definition of momentum is the change in a stock's price over a period of time, most commonly 12 months. In response to a question from the Chairman, Mr. Getson stated that AQR recently cut approximately 10% of its staff, which he noted consisted more of operations-side employees. In response to a question from the Chairman, Mr. Getson stated that AQR did experience big losses for some high risk seeking investors, but noted that ERS has a diversified portfolio.

In response to a question from Mr. Maier, Mr. Getson stated that the small cap strategy is now looking at accepting more funds because asset levels have fallen and the strategy is not capacity constrained. In response to a follow-up question, Mr. Getson stated that most of the decrease in the amount of assets managed by AQR has come from the decline in the value of assets, with some client outflow.

In response to a question from Dr. Peck, Mr. Getson reviewed the chart on page 38 of AQR's report and agreed that the correlations between stocks have drifted upward, but he stated that there are a variety of items that could be causing this upward trend. He indicated that it is very difficult to interpret macro economic signals in order to differentiate a stock's performance. He noted that industry signals are more important and that AQR has a macro level research team. He commented that AQR's confidence level in the performance of the stocks it selects goes down when applying macro level factors to stocks.

In response to a question from Ms. Bedford, Mr. Getson stated that AQR survived the market deleveraging because it learned from and appreciated the risk in the market. He pointed out that quantitative managers who employed only momentum strategies have performed poorly.

(b) Marquette Associates, Inc. Report

Mr. Christenson distributed Marquette's report and began discussing the equities and bond markets. He commented that the domestic stock market performed poorly from January 1 through March 9 and has performed well since March 9. He stated that there was a flight to quality in the bond market, which has resulted in poor performance for Treasuries.

Mr. Christenson compared ERS's current asset allocation to the asset allocation targets approved at the last Pension Board meeting. He stated that ERS had a market value of $1.594 billion as of June 30, 2009. He reported that some of the pension obligation bond funds have been allocated to existing investment managers. He noted that approximately two-thirds of the pension obligation bond funds have been overlaid and continue to be overlaid at a rate of approximately $20 million per week.

Mr. Christenson indicated that the $92 million invested in the Loomis Sayles' core fixed income strategy and $102.5 million in the Loomis Sayles' high-yield fixed income strategy represents approximately 12% of the portfolio. He reported that ERS has a total $690 million invested in fixed income, which comprises 43.3% of ERS's portfolio. He stated that ERS is overweight in fixed income compared to its target of 32%. He commented that ERS is slightly overweight in U.S. equities, with an allocation of 25.9% compared to its 23% target, and international equities, with an allocation of 18.2% compared to its 18% target.

In response to a question from Dr. Peck, Mr. Christenson stated that there is a mistake in Marquette's report, noting there are no assets invested in long/short funds or in infrastructure. Mr. Christenson recommended that ERS not commit any additional funds to private equity, as ERS's investment commitment to Adams Street Partners will be called over time. He noted that the $29 million received from the Mercer settlement will be added to the pension obligation bond cash overlay account.

Mr. Christenson stated that Marquette made a recommendation to liquidate the short-term cash account and eliminate several managers and transition that cash to existing investment managers.

Mr. Christenson reviewed the investment results for the pension obligation bond cash overlay program. He noted that the overlaid portion of pension obligation bond funds were up 2.3% in April, 4.1% in May and were down 0.4% in June. He indicated that $20 million of the pension obligation bond cash overlay funds was used to pay benefits and $66 million was allocated to existing investment managers. He stated that overall ERS's total portfolio was up 0.5% in June and up 4.5% for 2009 year to date.

Mr. Christenson compared the monthly performance of each asset class to its benchmark. He commented that all asset classes have performed well. He stated that Loomis Sayles has shown that fixed income is not always what it seems because an investor can still lose significant value in fixed income. He commented that fixed income should be the anchor of the portfolio because it provides liquidity to pay benefits. He pointed out that the Loomis high yield portfolio has acted more like an equity portfolio, which exposes ERS to more volatility.

Mr. Christenson reviewed the asset allocation that was approved at the last meeting. He compared the old asset allocation target to the new target. He presented a proposed interim target asset allocation range that would accommodate the current asset allocation targets and old targets as ERS implements its new asset allocation targets. In response to a question from Ms. Mayr, Mr. Christenson stated that ERS should achieve its new target asset allocation sometime in early 2010. Ms. Riley explained the need for the proposed target ranges as ERS implements its new asset allocation strategy. Mr. Maier commented that ERS is not ready to implement the new asset allocation targets and needs the proposed ranges to maintain flexibility in order to implement the targets.

The Pension Board voted 6-3, with Messrs. Stuller and Garland and Ms. Mayr dissenting, to adopt the proposed interim target asset allocation ranges as recommended by Marquette. Motion by Mr. Maier, seconded by Ms. Bedford.

Mr. Christenson reviewed the items that ERS must take action on. He indicated that Marquette needs approval to issue RFPs for an infrastructure investment manager and a long/short fund of funds investment manager. He commented that the long/short equity RFP is a lengthy process. He stated that there is no fee for Marquette to issue the RFPs and that it is prudent to start the process now because there is no August Pension Board meeting.

The Pension Board unanimously approved Marquette's issuance of RFPs for an infrastructure investment manager and a long/short fund of funds investment manager. Motion by Dr. Peck, seconded by Ms. Bedford.

Mr. Christenson reviewed some minor asset allocation changes, which involve liquidating the small cap growth, mid cap value and large cap growth strategies and transitioning that money to five existing managers. He stated that this action will require the use of transition managers. He indicated that the Pension Board could begin the transition process once the transition manager contracts are completed.

In response to a question from Mr. Maier, Mr. Christenson stated that ERS would fund the new small cap value investment manager with pension obligation bond money after the manager has been selected. In response to a question from

Mr. Maier, Mr. Christenson stated that the funds allocated to the small cap value managers will be split evenly between both managers. Mr. Christenson commented that using a transition manager is the most efficient way to transition money with the lowest cost. In response to a question from the Chairman, Ms. Riley stated that the transition manager contracts are in good shape and she needs to finalize them with Mr. Grady.

In response to a question from Ms. Mayr, Mr. Christenson stated that Marquette's recommendation for total number of managers needed by ERS depends on the asset classes selected. He indicated that Marquette recommends using two long/short fund of fund managers, two or more real estate managers in order to diversify, and two infrastructure managers. He pointed out that this most likely will result in six new managers.

In response to a question from Ms. Mayr, Mr. Christenson stated that this transition will be the largest transition that ERS will likely have to do and approximated the cost at $300,000. He commented he believes that the transition will add value net of fees. He noted that it will provide ERS with a better risk/return profile by paying an extra 20-30 basis points in fees. In response to a question, Mr. Christenson stated that a fund the size of ERS typically has around 25 investment managers.

The Pension Board voted 8-1, with Ms. Mayr dissenting, to authorize Marquette to begin liquidating the investments managed by Mellon Capital Management (large cap growth), EARNEST Partners, Artisan Partners (mid cap value) and Westfield and to transition the funds to Boston Partners ($23 million), Reinhart Partners ($23 million), Artisan Partners (mid cap growth) ($22 million), AQR ($15 million) and Mellon Capital Management (large cap core) ($33 million), upon the execution of the transition manager contracts. Motion by Mr. Maier, seconded by Mr. Mawicke.

Mr. Caprio reported on the progress of the RFPs for an emerging markets investment manager and a small cap value investment manager. He reported that Marquette received 31 responses to the small cap value RFP and 28 responses to the emerging markets RFP. He indicated that the RFP panel is making progress on the emerging markets RFP and might meet in August and have a recommendation to make to the Board at the September meeting. The Chairman asked Mr. Caprio to leave all completed action items on the timeline of action items since May. The Chairman requested that Marquette provide its August investment report to the Pension Board by e-mail.

(c) Investment Committee Report

Dr. Peck reported on the most recent Investment Committee meeting. She stated that Marquette provided the Investment Committee with an update on ERS's performance. She indicated that, along with her, Messrs. Stuller and Maier comprise the RFP evaluation panels for the small cap value and emerging markets RFPs as of now. Dr. Peck noted that the panel is planning on bringing in the finalists for both manager positions on the same day. She invited other interested Board members to come and observe or participate in the finalist presentations and panel evaluations.

7. Audit Committee Report

Mr. Stuller reported on the most recent Audit Committee meeting. He stated that the Committee reviewed a copy of the ERS 2009 annual report and provided a few minor comments.

He indicated that the Audit Committee reviewed a new protective survivorship option ("PSO") form and that the consensus was to approve the form. The Chairman commented that the Audit Committee recommended to remove Option 2, the 50% option, from the form and relabel Option 3 as the 100% option. He stated that Mr. Stuller was not in agreement with the majority of the Audit Committee members. Mr. Schroeder pointed out that the new form is on the back side of the old form in the meeting packets.

Mr. Stuller commented that he believes that Option 6, 10-year certain, and a back DROP option should be listed on the form as available benefits. He opined that the Retirement Office should be counseling members as to the availability of these options.

Mr. Arena stated that this is a balancing act between effective communication and too much detail. He suggested that it is better to have a clean form and have face-to-face meetings to keep people informed. In response to a question from Mr. Garland, Mr. Arena stated that the Retirement Office only provides counseling on the PSO form when asked to do so.

The Chairman stated that the Audit Committee wants to clean up the form and wants direction from the Pension Board. In response to a question from Dr. Peck, Mr. Huff stated that currently there are no legal determinations that the other benefit options are available under the PSO. In response to a question from Mr. Stuller, Mr. Schroeder stated he has a written legal opinion from Corporation Counsel that back DROPs are not available to a PSO beneficiary. Ms. Mayr pointed out that the PSO only takes effect if a member dies while employed.

The Pension Board voted 8-1, with Mr. Stuller dissenting, to accept the revised PSO form recommended by the Audit Committee. Motion by Dr. Peck, seconded by Ms. Bedford.

8. <u>Annual Audit – Baker Tilly Virchow Krause LLP</u>

Mr. Morgan distributed and presented ERS's annual report. He reported that Virchow Krause changed its named to Baker Tilly Virchow Krause LLP effective June 1, 2009 for branding purposes. He indicated that the auditors discovered no significant problems during the audit. He commented that his firm used materiality standards, which it generally does not share with management, and statistical and non-statistical sampling during its audit.

Mr. Morgan reviewed the communications that his firm prepared regarding the audit. He stated that GASB 50 was the only new accounting policy ERS adopted in 2008 and noted it did not have a significant impact. He reported that the audit focused on cross-training, the computer system conversion, the pension obligation bonds and IRS compliance. He noted the ERS's accounting judgments and estimates appeared reasonable when compared to 11 geographically diverse plans.

Mr. Morgan stated that ERS's management team was very helpful and open during the audit. He reported that there were no corrective material misstatements. He indicated that any valuation variance is projected over the entire portfolio and then compared to materiality. He noted that ERS had no disagreements with Baker Tilly or consultations with other accounting firms during the year. He commented that Baker Tilly is independent of ERS.

Mr. Morgan reviewed what his firm audited, which included the balance sheet and income statement, but did not include the management's discussion and analysis, footnotes or funding progress. He stated that the receipt of the pension obligation bond funds were not included in the financial statements because they were received after December 31, 2008, but were included in a footnote to the final statements. Mr. Morgan reported that Baker Tilly will meet with the Audit Committee next year to discuss next year's report.

Mr. Morgan discussed Baker Tilly's management comment letter and reviewed the types of control issues raised. He reported that there were no material weaknesses in control and there was only one significant deficiency in internal control. He indicated that ERS should implement some sort of process to review the valuations of ERS's investments, such as an internal audit. In response to a question from Dr. Peck, Mr. Morgan stated that the internal audit would involve reviewing various items prior to the auditor reviewing them. In response to a question from Ms. Mayr, Mr. Morgan responded that the internal audit function could be a part of the Retirement Office or Department of Administrative Services, or it could be part of a separate group. The Chairman requested that Mr. Morgan meet with the Audit Committee to discuss Baker Tilly's findings more in depth.

The Pension Board unanimously agreed to accept the annual report as presented, with the Audit Committee's corrections and clerical changes presented to ERS by legal counsel and others. Motion by Ms. Mayr, seconded by Dr. Peck.

9. <u>Proposed Ordinance Amendment – Referral to Pension Board – Comment Under Section 201.24(8.17)</u>

Mr. Domina discussed the recently proposed Ordinance amendments that would prevent represented deputy sheriffs from becoming eligible for benefit enhancements when transferring to a nonrepresented position. He stated that the intent of the proposed amendments is to maintain the status quo of represented deputy sheriffs when they move into a nonrepresented position. He commented that the Sheriff's department now oversees more departments and that promotions to nonrepresented positions generally occur from the ranks of represented deputy sheriffs who ratified a CBA which did not contain the 2000 benefit enhancements.

Mr. Domina stated that Ordinance section 201.24(8.17) requires the Pension Board to review any proposed changes to the pension Ordinances. He indicated that the Pension Board must take a position, even if the position is neutral. He pointed that the County Board meets next week and wants to take action on this item.

The Chairman commented that the Ordinance amendments seem to target employees and not upper level management. In response to a question from Mr. Maier, Mr. Schroeder stated there is no impact on the administration of benefits if the amendments are passed. Mr. Schroeder indicated that the Retirement Office staff will be trained on the new Ordinance changes. Mr. Domina stated that the actuary calculated there would be no cost to ERS by adopting the Ordinance amendments, but rather, ERS would save money if the County Board adopted the proposed Ordinance amendments.

In response to a question from Mr. Stuller, Mr. Domina clarified that the Ordinance amendments would apply to any represented deputy sheriff who transfers to any non-represented position even outside the Sheriff's department, even though the transfer most likely will occur within the Sheriff's department.

After reviewing the proposed Ordinance amendments to sections 201.24(2.8), 201.24(4.1), 201.24(5.15) and 201.24(5.16) of the Milwaukee County Code of General Ordinances and the actuary's analysis of the effect of the proposed Ordinance amendments, the Pension Board adopts the following resolution:

The Pension Board unanimously agreed to offer no formal comment regarding the proposed Ordinance amendments to sections 201.24(2.8), 201.24(4.1), 201.24(5.15)

and 201.24(5.16) of the Milwaukee County Code of General Ordinances and to waive the balance of its 30 day comment period provided for under section 201.24(8.17) of the Milwaukee County Code of General Ordinances. The Pension Board believes that it is in the best interest of ERS for the County Board to adopt Ordinance amendments which preserve assets of ERS and clarify the intended operation of the Ordinances. Further, the Pension Board authorizes its legal counsel to provide to Corporation Counsel comments regarding any tax and general legal compliance issues raised by the proposed Ordinance amendments. Motion by Mr. Maier, seconded by Mr. Cohen.

10. Administrative Matters

Dr. Peck stated that securities lending and brokerage could be removed from the list of future topics for the Investment Committee and that the "hedge fund" topic should be renamed long/short fund of funds. The Chairman stated that the follow-up discussion with the auditor should be added to the Audit Committee list of topics.

11. Disability Pensions – Earnings Reports – Rule 1010 Suspensions

Mr. Schroeder reported on the status of receiving earnings reports from members receiving disability pensions. He noted that he sent out certified letters to all seven people who had not provided earnings reports and only two people provided the Retirement Office with their earnings reports. He indicated that he wants to be able to suspend the benefit payments of the five members who have not provided their earnings reports.

The Pension Board unanimously approved the suspension of benefit payments for the five members who did not provide the Retirement Office with their earnings reports as required under Rule 1010. Motion by Mr. Cohen, seconded by Mr. Maier.

Ms. Bedford moved 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 and 14 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 9-0, to enter into closed session to discuss agenda items 12, 13 and 14. Motion by Ms. Bedford, seconded by Mr. Cohen.

12. Mary Sullivan – Interpretations of Section 201.24(5.16) for Part-Time Employees

In closed session, the Pension Board discussed the interpretation of Ordinance section 201.25(5.16) and whether to amend Rule 711 to clarify that a member's back DROP date shall be not less than one calendar year prior to the date the member leaves active service with the County.

Upon returning to open session, the Pension Board unanimously approved the amendment to ERS Rule 711, attached to these minutes as Exhibit A. Motion by Mr. Mawicke, seconded by Ms. Bedford.

13. Pending Litigation

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

    The Pension Board determined that there is nothing new to report on in the above captioned litigation.

    (b) *Milw. Cnty. et al. v. Mercer Human Resources Consulting*

    The Pension Board determined that there is nothing new to report on in the above captioned litigation.

14. Report on Special Investigation

    The Pension Board determined that there is nothing new to report regarding the special investigation.

15. Report on Compliance Review

    The Pension Board determined that there is nothing new to report regarding the compliance review.

16. Adjournment

    The meeting adjourned at 12:55 p.m.

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

EXHIBIT A

AMENDMENT TO THE RULES OF
THE PENSION BOARD OF THE EMPLOYEES'
RETIREMENT SYSTEM OF THE
COUNTY OF MILWAUKEE

RECITALS

1. Section 201.24(8.1) of the General Ordinances of Milwaukee County (the "Ordinances") provides that the Pension Board of the Employees' Retirement System of the County of Milwaukee (the "Pension Board") is responsible for the general administration and operation of the Employees' Retirement System of the County of Milwaukee ("ERS").

2. Ordinance section 201.24(8.6) allows the Pension Board to establish rules for the administration of ERS.

3. Section 201.24(5.16) provides for a back drop form of benefit for qualifying ERS members, and ERS Rule 711 details requirements for administering the back drop benefit.

4. The Pension Board wishes to clarify the proper interpretation of the requirement in section 201.24(5.16) and Rule 711 that the back drop date be not less than one year prior to the date the member leaves active service.

RESOLUTION

Pursuant to Ordinance section 201.24(8.6), the Pension Board hereby amends Rule 711(d) to read as follows:

711. Back DROP pension benefit.

(d) Back DROP date. The "back DROP date" is a date selected by the member that is not earlier than the earliest date that the member was eligible to retire and receive a benefit pursuant to section 4.1 or section 4.2 and that is not later than one year prior to the date the member elects to leave active county service. For purposes of this rule and section 5.16, the requirement that the back drop date be at least one year prior to the date the member leaves active county service shall be interpreted as one calendar year.

Effective upon adoption on July 15, 2009.