EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
MINUTES OF THE DECEMBER 20, 2006 PENSION BOARD MEETING

1. Call to Order

   Chairman Dean Roepke called the meeting to order at 8:35 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, WI 53202.

2. Roll Call

   Members Present:
   Linda Bedford
   Donald Cohen
   John Martin (Vice Chairman)
   Marilyn Mayr
   Michael Ostermeyer
   John Parish
   Dr. Sarah Peck (not yet sworn in)
   Dr. Dean Roepke (Chairman)
   Thomas Weber

   Members Excused:
   None

   Others Present:
   Mark Grady, Principal Assistant Corporation Counsel
   Jack Hohrein, ERS Manager and Pension Board Secretary
   Gordon Mueller, Fiscal Officer
   Vivian Aikin, ERS Administrative Specialist
   Donald Campbell, ERS Project Manager
   Steven Huff, Reinhart Boerner Van Deuren s.c.
   Leigh Riley, Foley & Lardner LLP
   Brad Blalock, Mercer Investment Consulting
   Kristin Finney-Cooke, Mercer Investment Consulting
   Timothy Holihen, JPMorgan Asset Management
   Jason Ciaglo, JPMorgan Asset Management
   Dick Stackpool, AON Financial Services Group
   Rick Lindquist, AON Financial Services Group
   Cliff Van Beek, Retiree
   Ken Loeffel, Retiree

3. Chairman's Report

(a) Welcome Dr. Peck

The Chairman welcomed Dr. Peck to the Board meeting, which was the first meeting she attended since being appointed a Board member. She was not able to vote at the meeting because she was not yet sworn in as a Board member.

(b) Pension Board Election

The Chairman explained that January 2, 2007 is the due date for the election forms for the next Board election. He indicated that he would submit the signatures for his candidacy on December 20, 2006.

(c) Request for Proposal for Mellon's Services

The Chairman stated that he will direct the Audit and Compliance Committee to conduct an RFP for custodial services to ERS.

4. Approval of Minutes of November 15, 2006 Meeting

The Board discussed the November 15, 2006 meeting minutes. After a discussion of the language in section 10 of the minutes, the Board directed that a paragraph be added to section 10 indicating an action item follow-up from Mercer on monitoring trade costs of managers.

In addition, the Board agreed that section 18(a) should reflect that Board members may attend a maximum of three out-of-town meetings. Ms. Mayr also noted that Board members may obtain 30 hours of educational credit at seminars presented by the International Foundation of Employee Benefit Plans in Brookfield, Wisconsin.

The Board reviewed and approved the minutes of the November 15, 2006 Board meeting 7-0-1, with the two changes discussed above. Mr. Ostermeyer abstained because he did not attend the November meeting. Motion by Mr. Martin, seconded by Mr. Cohen.

5. Report of Retirement Systems Manager

(a) Ratification of Retirements Granted

Mr. Hohrein presented the Retirements Granted report for the prior month's retirements and asked the Board to review them. The report included two back DROP requests. Mr. Hohrein indicated that the Retirement Office will be busy with retirement appointments through February.

The Board unanimously accepted the Retirement Granted report. Motion by Mr. Martin, seconded by Ms. Bedford.

(b) Report on Waivers

Mr. Hohrein reported that no waivers were submitted this month.

(c) Report on ADR Project and Overpayments

Mr. Hohrein noted that the Retirement Office is working to obtain reexaminations of the several accidental disability pensioners who did not provide the requested financial information.

The Chairman indicated that the Board authorized Corporation Counsel to initiate litigation against individuals who have been incorrectly paid. Mr. Grady stated that he has sent out correspondence to one individual, and that if there is no response to the correspondence he will begin to initiate litigation.

(d) Annual Meeting Notice and Plans

Mr. Hohrein distributed a document that will serve as a notice to retirees of the annual meeting. The meeting notice paragraph of the document will be sent, along with the direct deposit notices, to retirees who receive their benefits through direct deposit. The paragraph encouraging direct deposit will be included in the notice to retirees who receive their benefits in the form of a written check, rather than direct deposit. The Board suggested that the document be revised to state that retirees are "strongly urged" to receive benefits through direct deposit.

Mr. Hohrein indicated that he is developing a policy for benefit payments. He stated that he would like the Audit and Compliance Committee to mandate direct deposit for all new retirees. Dr. Peck suggested that the Retirement Office could note that direct deposit is a safer option than sending a check in the mail to retirees.

(e) Report of Member Statistics

Mr. Hohrein distributed a handout describing the ratio of active members to retiree members from 2005 to 2006 and a report outlining the retirement history from 1991 to 2006.

(i) Ratio of Active Members to Retirees

Mr. Hohrein explained that the ratio of retirees to active members is growing. The Chairman stated that he had requested the chart because it demonstrates the growing percentage of retirees, which he indicated tends to reduce the funding percentage of ERS.

The Board members noted that ERS is a mature fund. Ms. Mayr commented that downsizing County employment makes the cost of benefits higher per active employee.

The Chairman informed Dr. Peck that she will receive a list of the dates and times of all Board meetings, as well as an invitation to serve on the Investment Committee or Audit and Compliance Committee.

(ii) Retirement History Report

Mr. Hohrein stated that Mr. McDowell requested information regarding the number of retirements from 1991 to 2006, including the reasons listed for the three years with the highest numbers of retirements. Mr. Hohrein indicated that he will keep this chart updated. The Board members suggested that the report could be used at the annual meeting in February as well.

6. Legal Update

(a) *Bilda, et al. v. Milwaukee County, et al.*

Mr. Huff noted that the *Bilda, et al. v. Milwaukee County et al.* litigation had concluded because the Wisconsin Supreme Court refused to hear the case.

(b) *Milwaukee County, et al. v. Mercer Human Resource Consulting*

Mr. Grady indicated that there were new developments in the *Milwaukee County, et al. v. Mercer Human Resource Consulting* case. First, he noted that the County had terminated Quarles & Brady LLP as bond counsel. In addition, he stated that Mr. McNeil asked the federal judge in the case to move forward with the case.

7. Report of Fiscal Officer – 1st Quarter 2007 Liquidity Needs

Mr. Mueller, as the ERS Fiscal Officer, presented a report on ERS's 2007 first quarter liquidity needs. He reported on the projections for ERS as of

December 20, 2006. Mr. Mueller noted that ERS was finishing strong in December 2006, reporting $3 million to $4 million over the reserves. He indicated that, because of this strong finish in December 2006, ERS would have a liquidity need of only $5 million in January 2007. Mr. Mueller projected that County contributions would be $5 million per month in early 2007. Therefore, he explained that ERS's liquidity needs through May 2007 should only be $5 million per month and he stated that it was possible that there would be no liquidity need in June 2007. However, he noted that he will need to re-evaluate these numbers in March 2007 and every month after that. At this time, Mr. Mueller asked the Board for authorization of $5 million per month for ERS's January, February and March 2007 liquidity needs.

The Board unanimously agreed to withdraw $15 million for ERS's January, February and March 2007 liquidity needs at a rate of $5 million per month. Motion by Mr. Martin, seconded by Ms. Mayr.

8. Investments

(a) Mercer Report

Mr. Blalock distributed the flash report for November 2006. He indicated that ERS had an aggregate market value of approximately $1.6 billion at the end of November, representing a 2.4% increase during November, leading the Reference Index by 20 basis points. Mr. Blalock also reviewed market performance for November 2006. He explained that the large cap domestic equity market advanced 2.1% during the month, while small cap equity gained 2.6% in November. In addition, value outperformed growth in both the large and small cap arenas. He noted that the international investment grade fixed income gained 1.2% during the month and high yield issues returned 1.6%.

Mr. Blalock next reported on ERS's investment allocation. He noted that ERS is currently underweight in core fixed income and slightly overweight in high yield fixed income, relative to ERS's investment policy. He indicated that $66 million will be transferred to fixed income using the Mellon index between December 29, 2006 and January 4, 2007.
Mr. Blalock explained that the policy measures are highlighted on the flash report. He noted that this means that whichever policy applies to a particular investment manager is highlighted in the report.

Ms. Finney-Cooke indicated that Boston Partners is ahead for November, but behind for longer periods. She noted that the same is true for Artisan Partners. She indicated that Westfield Capital Management ("Westfield") and AQR performed well in the short term, but Mr. Blalock pointed out that

Mercer has only been managing the Westfield and AQR money for two months.

Mr. Blalock stated that he will raise questions at the January Investment Committee meeting regarding the continuing investments in REITs because he believes that there is a slight bubble in REITs. He noted that REITs were up 40.7% in one year and 30% per year for three years. Therefore, he concluded that it is probably time to remove some money from these investments.

Ms. Mayr expressed concern over the REIT issue, noting that Mercer raised the concern about REITs with the Board two months ago. She indicated that the Board, as a body, has not been proactive in taking action, but rather has merely discussed REITs at meetings. She inquired whether it is possible that the market will be down if they wait another two months to act.

Mr. Blalock provided some history in response to Ms. Mayr's concern. He indicated that the Board voted only to invest in real estate through publicly traded securities. He said that taking money out of the REITs would not be difficult. Mr. Blalock explained that only $81 million of ERS's $1.6 billion is invested in REITs. Further, he stated that the entire return would not be lost by a delay in changing the investments. Mr. Blalock pointed out that one difficult question is where to place the money if the Board hopes to have real estate exposure, as set forth in the investment policy. He suggested that the Board invest in the institutional market through open-end real estate funds, which have components of a pool of properties, as opposed to closed-end funds.

The Board members indicated that there will be no January Investment Committee meeting. Ms. Mayr again expressed her concern that it will be two months before any action is taken. Mr. Grady noted that the Investment Committee could discuss REITs at the February Investment Committee meeting and the Board could take action at the February Board meeting.

Ms. Mayr asked Mr. Blalock why he believes that the REIT investments are not currently at risk. Mr. Blalock indicated that the transaction costs of going in and out of investments would exceed the possible losses of remaining invested in REITs until a successor investment is selected.

Ms. Bedford noted that the Bank of New York and Mellon, which have very different cultures, would be merging in the near future. She asked whether this merger raises any concerns that the Bank of New York will be in control, rather than Mellon, considering that ERS follows Mellon's approach. Mr. Blalock responded that the merger would take place in July 2007 at the earliest. He agreed that Bank of New York and Mellon have two very different custodian styles. He stated that there are many operational questions, which must be resolved before the merger occurs, including what to do with the index funds. He explained that there will only be a few custodians left in business after the merger.

Mr. Grady inquired whether it is currently a bad time to conduct an RFP for a custodian. Mr. Blalock indicated that moving a custodial relationship is one of the most difficult things to do. He stated that starting a process now is a good idea because there will only be three or four providers in the custody business. Mr. Grady and Ms. Bedford asked how a custodian could put in a proposal without knowing everything that will happen with respect to the merger. Mr. Blalock indicated that no one will know until late spring what is actually going on. Mr. Grady suggested that the Board delay the RFP responses until May. He also suggested that Mr. Mueller watch for changes in the way Mellon provides custodial services.

The Chairman asked that the Retirement Office provide a monthly report to the Audit and Compliance Committee on Mellon's performance.

(b) JPMorgan Asset Management

Mr. Ciaglo, of Chicago, Illinois, and Mr. Holihen, of Columbus, Ohio, distributed booklets and made a presentation regarding JPMorgan Asset Management ("JPMorgan"). First, they explained that JPMorgan uses bottom up security selection and has sector-by-sector managers, not macro managers. They noted that JPMorgan does not generally make big duration bets.

Mr. Holihen explained that JPMorgan has the same team it had two years ago and that in ten years there have only been two retirements on the team, demonstrating their ability to retain investment managers.

Mr. Holihen outlined the market value of ERS's investments with JPMorgan. He reported that ERS's investments have performed well over the last three months and that the market value of ERS's investments has exceeded the Lehman aggregate Bond Index since its inception in October 2005. He explained that the year-to-date performance has been satisfactory.

Next, Mr. Holihen reviewed the fixed income portfolio. He noted that ERS was overweight in mortgages and slightly underweight in corporate bonds.

The Chairman questioned Mr. Holihen regarding the mortgage investments and the application to the Board's evaluation of REITs. Mr. Holihen replied that many of the mortgages are insured. Ms. Bedford explained that mortgage backed securities relate to residential properties whereas REITs relate to commercial properties. In addition, Mr. Holihen reported that JPMorgan invests in many higher quality investments and there are no concerns to call to the Board's attention.

Mr. Holihen also reviewed the market update. He noted that he was surprised at how well the high yield market has done. He stated that the spreads among investments are relatively close; therefore, one must look at the investments security-by-security. Finally, Mr. Holihen reviewed the economic outlook and portfolio strategy for ERS. He indicated that the labor market continues on solid footing, but that it will be weaker with the slowing of construction in the near future. He also noted that inflation has generally been benign. Mr. Holihen explained that JPMorgan predicts that the Federal Reserve will discuss concerns about inflation until it cuts interest rates in the second half of 2007.

(c) Investment Committee Report

Mr. Hohrein distributed the minutes of the December 7, 2006 Investment Committee meeting. Mr. Martin explained that there were two main purposes to the December meeting. The first purpose was to begin a review of Capital Guardian. The Investment Committee determined that the policy guidelines call for a review of Capital Guardian based on its inadequate performance. Mr. Martin noted that Mercer has begun to help the Investment Committee with its review of Capital Guardian.

Mr. Martin stated that the second purpose of the meeting was to introduce Schroder Investment Management to the Investment Committee. Peter Clark and Chris Cook, of Schroder Investment Management ("Shroder") presented an overview of their company and its investment programs. After their presentation, Mr. Blalock compared their performance with several of ERS's current managers and indicated that ERS's current managers have outperformed Schroder's portfolio.

Ms. Mayr added that the minutes do not include everything accomplished at the meeting. Specifically, she noted that the minutes did not document the socially responsible investment policy issue regarding the Sudan, which was presented as a future committee topic.

9. Report on Fiduciary Liability Insurance Renewal – Dick Stackpool and Rick Lindquist

Mr. Stackpool, from Minnesota, and Mr. Lindquist, the local Milwaukee contact, made a presentation regarding fiduciary liability insurance on behalf of AON Financial Services Group ("AON"). They explained that John Rath, who formerly handled ERS's account, recently retired from Milwaukee County. Consequently, they were handling the renewal. They addressed the Board's need for fiduciary liability insurance in 2007. Mr. Stackpool stated that this would be AON's third renewal of fiduciary liability insurance for ERS. Mr. Stackpool explained that ERS currently maintains $30 million of coverage, with a $150,000 deductible for indemnifiable acts or claims against ERS.

Mr. Stackpool stated that ERS has had a good loss history over the past two years, with many cases being won. He reported that the quoted premium for 2007 is currently $398,653 and the renewal premium would likely be cut back by $10,000-$15,000. Mr. Grady noted that there is a very narrow market for fiduciary insurance and all previous payments made by carriers were for defense costs only. Mr. Martin asked whether the Board could expect a significant reduction in premiums if there were no new claims next year. Mr. Stackpool responded that carriers typically look for a three to five year time period without claims before reducing premiums. Additionally, the carriers had expressed concerns that ERS's funding percentage has fallen. The funding percentage is also taken into account to determine premiums. In response to a question from Mr. Martin, Mr. Stackpool stated that recourse waivers were included in the premium. Mr. Hohrein noted that the County, not ERS, pays for the recourse premium.

In response to a question from Mr. Grady, Mr. Stackpool stated that the $30 million coverage is sufficient, based on ERS's assets and number of participants, compared to other similarly-sized funds. However, he noted that some fiduciaries might opt for more or less coverage under similar circumstances.

The Board unanimously accepted the carriers' renewal proposals for 2007, with rate modifications to be determined. Motion by Mr. Martin, seconded by Ms. Mayr.

Mr. Ostermeyer inquired whether AON could present to the Board earlier than December in the future. Mr. Stackpool explained that carriers rarely release quotes over 30 days before the coverage will begin, but noted that he could try to get such quotes 45 days before coverage would begin in an effort to be able to present at the November meeting in future years.

10. Closed Session

The Chairman stated that, pursuant to Wisconsin Statutes section 19.85, the Board could enter closed session for considering information which could have an adverse effect on the reputation of the person mentioned. For example, the Board may elect to enter closed session to discuss an individual's retirement or disability application.

The Board unanimously agreed by roll call vote to enter into closed session to consider Item 11.

11. Disability Application – Shirley Nash

Upon returning to open session, consistent with the recommendation of the Medical Board, the Board unanimously agreed to deny the ordinary disability application of Shirley Nash. Motion by Mr. Martin, seconded by Mr. Ostermeyer.

12. Implementation of New Technology Software – Donald Campbell

(a) Project Plan and Status

Mr. Campbell reported on the V3 timetable regarding the project plan and status. He noted that April 22, 2008 is the date for completion of rollout for the V3 system. Mr. Campbell stated that the Retirement Office is still reorganizing the ERS records room with a target completion date of April 30, 2007. In response to a question from the Chairman, Mr. Campbell explained that the Retirement Office was still sorting and organizing the material so that the information can then be scanned. Mr. Campbell stated that there will be milestones soon. However, Vitech first needs to agree on the milestone dates. He explained that the documentation of the Ordinances and Rules and the reworking of the milestone payment schedule are in process. Further, Mr. Campbell noted that the Retirement Office must review and approve 312 specification documents and then ERS must test approximately 500-700 testing scripts to ensure that the system works properly.

Mr. Campbell outlined some of the key challenges in the V3 timetable, including the department restructuring in 2007. The Chairman noted that the County Board is moving ERS from the Department of Human Resources to the Department of Administrative Services. Mr. Campbell recommended that the project continue to progress, even if ERS reports to a different department. Mr. Campbell expressed his desire to go on record saying that the sponsorship support he has received from Mr. McDowell and Dr. Jackson has been exemplary.

Mr. Campbell next reported that the expert who was working on the ERS forms has discussed the forms and the benefits handbook with Mr. Hohrein and Mr. Grady. He explained that there are different views regarding what should be included in the benefits handbook. The expert had looked at other government organizations and what handbooks they have. She agreed to assist in preparing a handbook after she was finished with the forms work, if she was retained to do so. The Chairman indicated that he did not request a benefits handbook if it in any way conflicts with the conversion time table. In addition, the Chairman asked whether it would save time and money to build a benefits handbook into the system conversion and indicated that there was no reason that the benefits handbook could not wait until after the conversion.

Ms. Mayr stated that she had a sample benefits handbook and that there had not been any ERS benefits handbooks since the 1980's. Mr. Martin noted that, as an employee, it was his personal view that a benefits handbook was very much needed. Mr. Martin indicated that the Buck document, which describes ERS benefits, was phenomenal. He stressed that a handbook would be a wonderful resource not only for members but for the Retirement Office staff as well.

Mr. Hohrein explained that there is a new Human Resources manual for County employees that includes very little information on retirement. He also indicated that Mr. Grady, who was not present at the time, expressed his concern regarding how to treat different unions in the handbook. In addition, Mr. Hohrein noted that disability standards must be researched. Mr. Hohrein stated that he believes a handbook is needed, but much thought should be given to how to treat each union and their individual benefit structures.

Mr. Huff indicated that the issue of multiple unions is an issue commonly faced by employers in the private sector. He explained that sometimes it is appropriate to have multiple groups or unions covered in one handbook and other times it is appropriate to have each single group or union covered in separate handbooks.

The Chairman indicated that tailoring a handbook to specific situations helps to eliminate confusion and that he is happy to hear that Mr. Campbell can produce different books for different groups. The Chairman also commented that he liked the term summary plan description for the handbook. Ms. Mayr suggested that the handbook should not be called a summary plan description to avoid confusion with a health summary plan description. Mr. Ostermeyer asked whether a summary plan description was required. Mr. Huff responded that in the private sector, a summary plan description is required by ERISA. However, in the public sector it is not required. Mr. Huff noted that a ~~benefits handbook helps to head~~ off claims in the public sector even though it is not required. The Chairman gave an example of a situation in which the County may interpret a requirement differently than others interpret it. Mr. Ostermeyer indicated that the benefits handbook is an extremely complicated task. He suggested that the cost be carefully considered and then compared to the benefits provided by the handbook verses alternatives to creating a handbook.

Ms. Mayr pointed out that the annual report contains some information about pensions. Mr. Martin replied that the annual report information is part of the problem, because the reader sometimes draws incorrect conclusions from the incomplete information. The Chairman asked the Board members whether they would like Mr. Campbell to explore the costs of a benefits handbook. Mr. Hohrein noted that a benefits handbook must be kept updated with all changes to the Ordinances or Rules and must also correct misinformation. Mr. Campbell stated that V3 must be capable of manipulating through the benefits matrix anyway. Dr. Peck asked whether V3 could keep a record of what information is provided. Mr. Ostermeyer indicated that he would not be opposed to a benefits handbook, but that he needs to have a handle on the cost and complexity of the technology before making the decision.

The Chairman then concluded that there was a clear consensus from the Board to explore this option. Mr. Campbell asked who would participate in the exploration. The Chairman stated that Mr. Hohrein would participate in the exploration and others who might be involved in the exploration could be identified at a future Audit and Compliance Committee meeting.

(b) Vitech Contract

In response to a question from the Chairman, Mr. Campbell indicated that the Board need not go into closed session to discuss the Vitech contract because the contract is not under negotiation at this time. Mr. Campbell then distributed additional materials in the form of spreadsheets, milestones and costs.

Mr. Campbell explained that the total cost for the V3 migration is identified as $7,533,373 with overruns included. He stated that the overruns through the time of implementation caused the increase in the project cost over the $6.7 million contract. He also stated that the project cost summary describes costs for additional resources needed, one of which is not under contract until 2007. Mr. Campbell noted that he will address any necessary changes to the contract with Mr. Grady. The Chairman suggested that Mr. Grady seek help from additional counsel if it is needed.

In response to a question from Ms. Bedford, Mr. Campbell explained that there has been a disconnect between the parties, where Vitech assumed that there were more available resources from ERS and ERS assumed that there were more available resources from Vitech. He noted that the parties have resolved the misunderstanding.

Mr. Hohrein added that new arrangements are currently being negotiated with Vitech. He explained that in addition to additional costs for Vitech, there are additional costs for non-Vitech providers that were not on the RFP. Mr. Campbell indicated that he does not know whether life and medical will be provided by Vitech or whether it will be provided by Ceridian. He noted that either way it would not be a cost to ERS.

Ms. Mayr commended Mr. Campbell for his work on the Vitech project.

13. Closed Session

The Chairman stated that, pursuant to Wisconsin Statute Section 19.85, the Board could enter closed session for considering financial, medical, social or personal information which could have an adverse effect on the reputation of an ERS member. For example, the Board may enter closed session to discuss possible rule change or application of a rule relating to forms of benefits for retirees. The Board unanimously agreed by roll call vote to enter into closed session to consider item 14.

14. Pension Application for Discharged Employees

Upon returning to open session, the Board voted to (1) suspend the operation of ERS Rule 806 and (2) direct Corporation Counsel and other legal counsel to the Board to prepare a temporary ERS rule that eliminates vested deferred pension rights under the "fault or delinquency" provision of Section 4.5 of the Ordinances when a County employee's employment is terminated in connection with work-related conduct that results in a felony conviction, 7-1, Mr. Weber voting against. Motion by Mr. Ostermeyer, seconded by Ms. Bedford.

15. Administrative Matters

(a) Continuing Education, Board Retreats, Training and Professional Organizations

The Board discussed upcoming seminars and conferences at the International Foundation of Employee Benefit Plans ("International Foundation") and Government Finance Officers Association ("GFOA"). Specifically, Ms. Britt, the ERS Coordinator, requested approval for her attendance at the International Foundation's Retirement Plan Basics seminar, the Chairman requested approval for his attendance at the International Foundation's Hedge Fund seminar and Mr. Mueller, the ERS Fiscal Officer requested approval for his attendance at the GFOA's Annual Conference on June 10-13, 2007 in Anaheim, California.

The Board unanimously approved attendance at the International Foundation's seminars listed above for those who requested approval and for any interested Board members and unanimously approved Mr. Mueller's attendance at the GFOA's Annual Conference. Motion by Mr. Martin, seconded by Ms. Bedford.

Mr. Martin informed the Board that there was a U.S. Pensions conference in Colorado Springs, Colorado in March 2007. He explained that issues involving alternative pension investments, including hedge funds, would be addressed at the conference. Mr. Martin noted that there was no charge for this conference. No Board members showed interest in attending the conference.

(b) Future Board Topics

No future Board topics were discussed at this meeting.

16. Adjournment

The meeting adjourned at 1:25 p.m.

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