Attachment

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE APRIL 15, 2015 PENSION BOARD MEETING

1. Call to Order

The Chairman called the meeting to order at 8:15 a.m. in Conference Room 1 at the Italian Community Center, 631 East Chicago Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present	Members Excused
Laurie Braun (Vice Chair)	
Dr. Brian Daugherty (Chairman)	
Aimee Funck	
Norb Gedemer	
D.A. Leonard	
Gregory Smith	
Patricia Van Kampen	
Vera Westphal	

Others Present
Marian Ninneman, CEBS, CRC, ERS Manager
Mark Grady, Deputy Corporation Counsel
Josh Fudge, Milwaukee County Budget Director
Brett Christenson, Marquette Associates, Inc.
Ray Caprio, Marquette Associates, Inc.
Larry Langer, Buck Consultants
Steven Huff, Reinhart Boerner Van Deuren s.c.

3. Minutes—March 18, 2015 Pension Board Meeting

The Pension Board reviewed the minutes of the March 18, 2015 Pension Board meeting.

The Pension Board unanimously approved the minutes of the March 18, 2015 Pension Board meeting. Motion by Ms. Braun, seconded by Ms. Westphal.

4. Buck Consultants - Assumption and Funding Policy Discussion

Larry Langer from Buck Consultants distributed and discussed a booklet containing updated information on ERS's assumption and funding policy. Mr. Langer noted that today's presentation is a continuation of the discussion from the March 2015 Board meeting and includes some updated and new information.

Mr. Langer first provided a summary of the key issues discussed at the March 18, 2015 Pension Board meeting. The general objectives and framework of the actuarial valuation process were reviewed. Mr. Langer discussed ERS's current actuarial assumptions and methods in correlation to its current funding policy. The potential impacts of changing ERS's current investment return assumption outside of the normal five-year assumption policy review cycle were also discussed. Mr. Langer suggested that at this time, it is appropriate to maintain the five-year assumption review schedule and changes to the Fund's current rate of return should not be considered until the next five-year experience review scheduled for late 2017. While there is no mandated funding policy with regard to public sector funds, certain professional groups within the actuarial community recently collaborated and issued various Funding Policy White Papers which suggest best practices for public sector retirement plans. Mr. Langer stated that ERS's current 30-year amortization period for paying of its unfunded liability exceeds the recommended timeframe, as suggested in the White Paper issued by the Government Finance Officers Association ("GFOA").

Mr. Langer then discussed Buck's updated recommendations. It was noted last month that ERS currently conforms to the GFOA's recommended best practices by utilizing the entry age level percent of pay for its actuarial cost method. However, there are different variants to the entry age cost method and, after further analysis, Buck is recommending that ERS change from the aggregate entry age cost method to the individual entry age cost method. During the actuarial valuation, the overall costs for a member are developed to allocate past, future and current service costs. These overall costs are calculated under both the aggregate and individual entry age cost methods.

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Under the individual entry age cost method, the normal costs are calculated for each individual member. Under the aggregate entry age cost method, costs to pay for all future member contributions are calculated and smoothed out over the remaining careers of those members. Although these two methods may appear to be similar, that is only true when the benefit provisions are the same for the entire group. However, the benefit provisions have now changed for some ERS members. Consequently, when contributions are averaged or smoothed across the group as a whole, it is more reasonable to use the individual entry age as this method is more directly linked to the actual value of benefits accruing for each individual member. While the overall impact of changing to the individual entry age method would result in somewhat higher costs over the next five to ten years, costs would decrease over the longer term.

In response to questions from Messrs. Smith and Grady, Mr. Langer confirmed, that because of ERS's declining benefits structure, the averaging under the aggregate entry age cost method would push some of today's benefit costs to the future. Changing to the individual entry age cost method will keep benefit costs more current.

In response to a question from Ms. Braun regarding the estimated amount of short-term cost increases that would result from a change to the individual cost method, Mr. Langer stated that there would be an approximate increase of $1.5 million to ERS's normal costs.

Mr. Langer continued with a discussion of ERS's amortization period for its unfunded actuarial accrued liability. Much of last month's discussion focused on the GFOA's recommended best practices. Current best practices recommend that a plan's amortization period to pay off its unfunded accrued liability fall ideally within a range of 15 to 20 years and should never exceed 25 years. Because ERS's 30-year amortization period falls outside of current best practices, Buck is recommending that ERS move to a 20-year amortization period. After further analysis of the various White Papers, Buck is also recommending an additional change to the method ERS utilizes for payment of its administrative expenses. ERS's current policy allows its administrative expenses to be amortized over a period of ten years. However, current best practices adhere to the larger concept of assigning costs to appropriate periods and recommend immediate payment of administrative expenses. Because administrative expenses for any given period result from administering Fund investments for current members, it is appropriate that any resulting expenses are remitted that same year. The impact of this change in 2015 would result in an additional $1.8 million in costs, but the impact to costs in future years will decrease and will eventually become negative.

In response to a question from Mr. Grady regarding the estimated $1.8 million increase, Mr. Langer clarified the amount also includes the estimated $1.5 million increase to normal costs which would result from a change to the individual entry age method.

Mr. Langer next discussed Buck's updated recommendations. ERS should maintain its current asset valuation method and ten-year smoothing period. ERS should update its cost method from the aggregate entry age to the individual entry age. ERS should also update its amortization policy by reducing the amortization period for its unfunded liability from 30 years to 20 years. ERS should maintain its current five-year contribution variance policy but immediately reflect administrative expenses in the year following the expense. ERS should give consideration of having payments increase at 1.75% per year, which is generally more comparable to the level of revenue growth. Other policies and transitions may also be considered and modeled during this time.

In response to a question from Ms. Braun regarding discussions at last month's Board meeting that suggested future revenue growth may be flat, Mr. Grady answered that while the possibility of flat revenue growth was discussed, Mr. Manske also suggested a 1.75% growth rate was reasonable.

In response to a question from Ms. Van Kampen regarding which of the current recommendations the Pension Board has the legal authority to enact, Mr. Grady stated that the current Ordinances implicitly state that the Pension Board determines the actuarial assumptions which support the contribution request to the County Executive. However, it is the County Board that has the legal authority to determine the 20-year amortization period. The Pension Board may follow the actuarial advice and recommend the 20-year amortization period to the County Board, but it is ultimately the County Board's decision to accept or deny the Pension Board's recommendation.

In response to a question from the Chairman regarding the proposed timeline for implementing the updated recommendations, Mr. Langer stated the effect would be immediate. Mr. Manske suggested during last month's discussion that now would be a financially opportunistic time for the County to implement these types of changes.

In response to a question from Mr. Leonard, Mr. Grady stated that if the Pension Board should decide to include the 20-year amortization period as part of its general pension contribution recommendation to the County

Executive, there should be a statement added to the contribution request letter which indicates the requested contribution amount is based on a revised 20-year amortization period as recommended by Buck Consultants. The County Board can then decide to accept the budget or amend and recalculate it.

Mr. Grady added that the concept of paying off the Fund's liabilities as they occur, as opposed to pushing them off to the future, is more consistent with the County Executive's general policy on debt payment.

In response to a follow-up question from Ms. Braun, Mr. Langer affirmed that if the Pension Board accepts Buck's updated funding policy recommendations, all the changes that were built into the 2015 valuation will be highlighted in the contribution request letter to the County Executive.

Mr. Smith expressed concerns with maintaining the Fund's current 8% assumed rate of return. Mr. Smith asked Mr. Langer why the Pension Board should be comfortable maintaining the Fund's current rate of return when many other funds, such as AT&T and the State of Wisconsin, are moving well below 8%.

Mr. Langer answered that because these two types of funds operate under different rules, it is first important to separate corporate from public retirement systems. Secondly, it is important to realize that there is no singular investment return assumption applicable to all pension funds and it is unwise to compare investment return assumptions between various funds. Investment return assumptions across U.S. public pension funds are currently averaging around 7%. Buck believes that a fund's investment policy should be of primary consideration when reviewing the investment return assumption, taking into account a fund's appetite for risk and the nature of returns predicted over the very long-term. While Buck does project that it may be more difficult for the Fund to achieve the 8% return over the short-term with the currently low interest rates, the longer-term projections are more favorable. Because benefits are going to be paid out of the Fund for decades to come, it is important to view funding from a very long-term operational perspective. In terms of all the various assumptions, changes to the Fund's investment rate of return will have the greatest impact on contribution amounts and should not be changed lightly or often. If ERS would change its investment return assumption to 7% now, the normal cost of benefits would increase by approximately $4.2 million. Buck recommends reviewing ERS's investment rate of return at the next scheduled five-year experience review in two years.

In response to a follow-up question from Mr. Smith regarding current best practices, Mr. Langer stated that while other experts may disagree, he believes it is a best practice to refrain from making changes to a fund's investment rate of return outside of its regular five-year experience review. External influences, such as news reports and various articles, should not be a driving factor for these types of conversations. However, if dramatic changes were made to the Fund's investment policy, the investment rate of return may then warrant further review at that time.

Mr. Langer continued by stating that the idea of reducing the Fund's current investment rate of return with the hope that the Fund will outperform in the short-term is not advisable. However, considerations could be made at the next scheduled experience review to reduce the Fund's rate of return to a reasonable level where any second guessing would be eliminated. Another factor that should be kept in mind is the Fund's smoothed value of assets is currently at approximately $90 million over market value. As the Fund's smoothed value of assets are reflected over the next several years, they will serve as a cushion by augmenting any gap in the actual returns. This will provide some additional time until the next scheduled experience review.

Mr. Smith questioned whether a reduced time period for measuring the Fund's investment return assumption may be warranted if ERS should move from the aggregate to the individual entry age cost method, while simultaneously reducing the Fund's amortization period. The high number of current retirees in the Fund results in larger payouts now as opposed to the future.

Mr. Langer answered that the aggregate and individual cost methods relate to how benefits are accruing during the course of a member's active career, not how benefits are paid out. However, ERS does need to be cognizant of the high number of current retirees in the Fund and collaborate with the actuary and investment consultants with regard to how that specific metric impacts the Fund holistically.

Mr. Grady then noted that the City of Milwaukee Retirement System is currently using an investment rate of return of 8.25%.

Mr. Langer added that the City of Milwaukee's investment rate of return is at 8.25% for the next several years and is subsequently scheduled to increase to 8.5%. It is important to understand that a particular fund's investment rate of return should be an individual Board decision and should be closely monitored and reviewed in relation to its individual investment policy.

Mr. Langer continued with a discussion of the impact Buck's updated funding policy recommendations will have on ERS's gross contributions. Under ERS's current funding policy, contributions are expected to begin lower than contributions under the newly proposed policy. However, future contributions under ERS's current funding policy will increase quickly and more steadily than contributions under the newly proposed funding policy. It is also possible that contributions under the newly proposed funding policy may even decrease, if the Fund achieves the 8% investment rate of return while the unrealized asset gains are reflected. Total contributions under the proposed 1.75% increase with a 20-year amortization period are projected to increase in the short-term, but will level off or perhaps decrease in the future. Generally, increased contributions in the short-term will result in decreased contributions over time. With a change to the individual entry age cost method, 2015 gross contributions under the newly proposed policy would be approximately $43 million.

Mr. Langer concluded with a summary of Buck's updated funding policy recommendations. ERS should first work with Marquette to review the Fund's current investment return assumption and confirm ERS's current investment policy is deemed to be appropriate. If it is determined that ERS's current investment policy is appropriate, the investment return should be reviewed with all other assumptions at the next experience review scheduled in the second half of 2017. Consideration should also be given to reducing ERS's current amortization period from 30 years to 20 years. Buck recommends reducing the Fund's amortization period to 20 years, while simultaneously reducing future increases in payments from 3.5% to an expected revenue growth of 1.75%. Administrative expenses should no longer be amortized over a ten-year period but reflected in the year immediately following the expense. The actuarial cost method should be updated to reflect a change in the entry age normal cost method from the aggregate to individual method. Finally, it is important to keep communication lines open and focus on transition as needed to facilitate budgeting.

In response to a question from Ms. Van Kampen regarding the estimated contribution amount under the newly proposed policy, Mr. Langer stated that ERS's revised 2015 gross contribution amount is approximately $43 million. The revised figure includes increases in the normal cost related to the individual entry age cost method change, as well cost increases related to the change in payment of administrative expenses. If the recommended changes are not made, ERS's 2015 gross contribution amount under the current policy would be approximately $38.5 million.

In response to a follow-up question from Ms. Van Kampen, Mr. Grady stated that if the Board should approve the recommendations presented today, Buck would complete ERS's January 2015 valuation with the newly approved assumptions built in. The 2015 valuation results would produce the contribution amount, which the Board would then include in its contribution request letter to the County Executive. The Board's letter to the County Executive will also clearly explain all of the changes that were built-in to the 2015 valuation that resulted in the requested contribution amount as recommended by Buck Consultants.

In response to a question from Ms. Braun, Mr. Langer stated that because the offset from the $90 million in unrecognized gain should keep contributions lower if the Fund achieves the 8% return, the projected contribution amounts appear to remain fairly steady over the next few years. Without the unrecognized gain, contribution amounts would be higher in the first year and then level off over time.

In response to a question from Mr. Leonard, Mr. Langer confirmed that if the Board does not approve Buck's recommended changes, ERS's 2015 valuation will be completed under the terms of the current policy.

Ms. Braun then noted for the record that County Comptroller Scott Manske suggested at last month's Board meeting that due to recent cost reductions in the County, now would be a very opportunistic time to take action with regard to changing ERS's funding policy. If the Board takes action now, there will be less of an impact on ERS's members in the future and the County's future funding of ERS should become more stable.

In response to questions from Ms. Braun and Mr. Grady regarding the effect of the proposed policy changes on employee contributions, Mr. Langer stated that he does not have a final estimate, but the percentage of employee contributions may increase roughly to within a range of 5.5% to 6%.

Ms. Funck expressed concerns regarding the impact that the recommended changes would have on employee contributions and stated that the Board should have a better idea of the actual increase before approving any funding policy changes. Ms. Funck added that because future compensation is essentially predicted to remain flat, it would be too burdensome to have ERS employees absorb additional costs related to the funding policy changes.

Mr. Grady noted that while it may be a lot to ask employees to absorb a portion of the additional costs, it is important to keep in mind the concept of intergenerational equity discussed at last month's Board meeting. Active employees who are earning benefits at a much higher rate than newly hired employees should be paying for their higher level of benefits while they are earning such benefits. It could be perceived as fundamentally wrong to saddle future generations with those higher benefit costs.

Ms. Braun noted that as elected and appointed fiduciaries of the Fund, the Board has a fiduciary duty to ensure the financial stability of the Fund.

Messrs. Leonard and Grady stated that it is the actuary's recommendation that the proposed policy changes are in the best interest of the Fund. Furthermore, Mr. Manske stated at last month's Pension Board meeting that this is a financially opportunistic time for the County to implement pension cost increases related to the proposed funding policy changes. Because the County is currently saving millions related to health care costs and general spending decreases, it will be easier for the County to balance cost increases to the Pension Fund.

Milwaukee County Budget Director, Josh Fudge, suggested that the future savings in County contributions which are projected to result from the proposed policy changes could potentially be available in 2020 for future salary increases. Under the current funding policy, future contributions are projected to increase at a level that would likely prohibit any future salary increases.

Mr. Grady added that even if there are no future salary increases, total contributions under the newly recommended funding policy are predicted to increase in the short-term, but will then remain stable for both the County and ERS employees. Under the current funding policy, employee contributions will remain lower in the short-term but will continue to rise substantially over the long-term.

Mr. Langer stated that in terms of intergenerational equity, members who are currently accruing benefits under the 2% multiplier will be paying more for their share, as opposed to pushing those members' costs onto future generations of ERS employees.

Mr. Gedemer noted that Buck's updated funding policy recommendation is a compromise to reducing the Fund's 8% investment rate of return. The projected cost increases that would result from reducing the Fund's investment rate of return now would be too burdensome on both the County's budget and ERS employees. Buck's recommended funding policy changes are making positive changes now that will help ensure the long-term financial health of the Fund. Mr. Gedemer added that he is a firm believer in paying for expenses as they occur, and he does not want 2015 new hires in the Sheriff's Department to be responsible for funding his own benefits 20 years from now.

Ms. Braun stated that it is also very important for the Board to approve Buck's recommended changes to be compliant with the GFOA's recommended best practices by reducing the Fund's 30-year amortization period.

The Pension Board voted 5-1-1, with Mr. Smith abstaining and Ms. Funck dissenting, to approve the proposed changes to ERS's funding policy as recommended by Buck Consultants during today's Pension Board meeting, and to approve and recommend to the County Board the proposed assumption changes for use in ERS's January 1, 2015 actuarial valuation. Motion by Mr. Leonard, seconded by Ms. Van Kampen.

Mr. Smith stated that he abstained from the vote because he believes that changes to the Fund's investment rate of return should have been reviewed and discussed more completely.

5. IRS Compliance

The Chairman reported that Mr. Huff indicated there is no update to provide on agenda item 5.

6. Adjournment

The meeting adjourned at 9:30 a.m.

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