

2005 DRAFTING REQUEST

Bill

Received: 10/24/2005

Received By: rchampag

Wanted: Soon

Identical to LRB:

For: Alberta Darling (608) 266-5830

By/Representing: Tom

This file may be shown to any legislator: NO

Drafter: rchampag

May Contact:

Addl. Drafters:

Subject: Employ Pub - retirement

Extra Copies: MES

Submit via email: YES

Requester's email: Sen.Darling@legis.state.wi.us

Carbon copy (CC:) to:

Pre Topic:

No specific pre topic given

Topic:

Investment options for City of Milwaukee Employees' Retirement System

Instructions:

See Attached.

Drafting History:

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/?				_____			Local
/1	rchampag 10/27/2005	jdyer 11/08/2005	chaugen 11/08/2005	_____	sbasford 11/08/2005	mbarman 11/08/2005	

FE Sent For:

at intro
12/2

<END>

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By/Representing: **Tom**

This file may be shown to any legislator: **NO**

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/?	rchampag	1/8 jld	ch 11-8	ch SF 11-8			

FE Sent For:

<END>



Department of Administration
Budget and Policy Division

Tom Barrett
Mayor

Sharon Robinson
Director of Administration

Sharon Cook
Director of Intergovernmental Relations

October 12, 2005

Senator Alberta Darling
Representative Jason Fields
State Capitol
Madison, WI 53702

Re: Legislation to allow the City of Milwaukee Employees' Retirement System to invest funds according to the provisions of the Uniform Prudent Investor Act.

Dear Senator Darling and Representative Fields,

Thank you for agreeing to draft companion bills for this important City of Milwaukee legislative initiative. Attached you will find several documents with supporting information for drafting the legislation. In the following order, the documents are as follows:

- Copy of the legislative proposal.
- Background information on the City of Milwaukee Employees' Retirement System (CMERS) investment practices.
- Overview of the Uniform Prudent Investor Act prepared by RVKuhns and Associates for the Alaska Permanent Fund Corporation.
- Chart comparing asset allocations of CMERS to the average for peer public retirement funds.
- Letter from the Milwaukee City Attorney suggesting amended statutory language.

Please feel free to contact me at (414) 286-3492 or jgonda@milwaukee.gov to discuss the contents of this packet. I would be happy to provide you with any additional information regarding the proposal.

Sincerely,

Jennifer C. Gonda
Legislative Fiscal Manager – Sr

CC: Wally Morics, City Comptroller
Anne Bahr, Executive Director, MERS



Department of Administration
Budget and Policy Division

Tom Barrett
Mayor

Sharon Robinson
Director of Administration

Sharon Cook
Director of Intergovernmental Relations

Proposal to allow the City of Milwaukee Employees' Retirement System to invest funds according to the provisions of the Uniform Prudent Investor Act.

Adopted in 2003, Wisconsin's Uniform Prudent Investor Act is based on a national model to govern public trust fund investments. In summary, the Act:

- Eliminates outdated investment restrictions;
- Requires that investment vehicles selected meet standards of quality and care generally applicable to fiduciaries; and
- Requires that investment vehicles selected are consistent with the purposes and objectives of the trust as a whole.

The prudent investor approach has become the standard for public pension plans as it emphasizes constructing well-diversified portfolios, taking into account risk and return.

The investment of retirement funds for the City of Milwaukee is currently governed by Chapter 62.63(3) of Wisconsin Statutes. Last updated in the 1960's, this statute limits the types and amounts of investments that the Employees' Retirement System can make. It allows it to:

"invest funds from the system, in excess of the amount of cash required for current operations, in loans, securities, and any other investments authorized for investment of funds of the public employee trust fund under s. 25.17 (3) (a) and (4). The independent retirement system board is subject to the conditions imposed on the investment board in making the investments under s. 25.17 (3) (e) to (g), (4), (7), (8) and (15) **but is exempt from the operation of ch. 881.**"

Chapter 881 is Wisconsin's Uniform Prudent Investor Act. Most public retirement systems in the United States are able to invest under the terms of this Act, but the City of Milwaukee is exempt. Sponsored by Rep. Towns, 2005 Assembly Bill 167 even proposes to extend the Uniform Prudent Investor Act to school district trust funds for post-employment benefits. It passed the Assembly and is now headed to the Senate floor.

The City would like to have legislation introduced that will extend the provisions of Chapter 881 to the Employees' Retirement System as well. This change will allow our Annuity and Pension Board to update its investment portfolio to modern trust fund standards, providing the City with a greater ability to maximize retirement security for its employees.

For more information, please contact:

Jennifer Gonda, Legislative Fiscal Manager – Senior
(414) 286-3492 or jgonda@milwaukee.gov

Overview of the laws governing the Milwaukee Employees' Retirement System (MERS)

State Statute 62.36 and the other statutes referenced within govern the Milwaukee Employees' Retirement System (MERS). This set of laws is referred to as the Insurance Laws of 1969 (or Basket Clause laws). This combination of State Statutes limits what MERS can invest in outside of publicly traded US and Canadian Stocks and Bonds. Subject to the limitations imposed by the State Insurance Code / Basket Clause laws, MERS has adopted (by city charter) the prudent investor rule as its fiduciary standard. MERS seeks to have the state laws amended so that the fiduciary standard of prudent investor is the sole and complete fiduciary guidance. This would align MERS with the vast majority of its peers. In a study of 115 public funds for the Alaska Permanent Fund, the consulting firm RV Kuhns noted that nearly 70% were under the prudent investor rule as their sole policy.

Amongst its peers, Milwaukee ERS is one of the top 3 best funded public retirement systems in the United States.

- As of 12/31/04 MERS is funded at 116.7% (assets / liabilities).
- Over market cycles, MERS has outperformed its benchmark and surpassed most of its peers.

Annualized Returns Period Ending 12/31/04				
MERS	1 Year	3 Year	5 Year	Inception to Date (1/79)
Returns Gross of Fees	12.9%	9.4%	5.8%	11.0%
Returns Net of Fees	12.6	9.1	5.6	10.4
Benchmark	11.0	6.9	2.4	9.8
Median in Mercer Public Fund Universe of \$1+ Billion Funds	13.0	8.4	3.9	N/a
Ranking in Universe (Lower Number is Better Ranking)	53 rd	24 th	9 th	N/a

Milwaukee ERS is a well-performing pension fund trying to look ahead for possible future limitations and roadblocks.

- The combination of State Statutes affecting MERS is for the most part static and has not been updated since 1969. Therefore, MERS has been and will continue to be challenged with maintaining a modern investment portfolio under antiquated laws. The governing statutes have not been updated to reflect the advancements within the investment industry.
- MERS faces several conundrums with the limits of the State Statutes:
 - At present, MERS allocation appears to fit within these limitations.
 - At some point in the reasonably near future, MERS will forgo investment opportunities due to the restrictions imposed by the state laws.
 - MERS' staff monitors the portfolio against the State Statutes using reasonably defined classifications for security types developed after 1969. MERS has taken a fairly conservative approach to security classification and built in a margin of safety by limiting how much we hold outside of US and Canadian stocks and bonds.

Milwaukee ERS is the Second Largest Public Pension Plan in Wisconsin

System	Assets as of 12/31/04	Fiduciary Standard	Wisconsin Statutes	Last updated for investment/securities definitions	Board Composition
State of Wisconsin Investment Board (SWIB)	\$74.7 Billion	Basically, the prudent expert standard, similar to ERISA. State law includes approved investment list that is very broad and covers most modern investment products (see below for description).	Section 25.15	2005	<p>4 Governor Appointee with at least 10 years investment experience.</p> <p>1 Governor Appointee with at least 10 years financial experience and who works for a local government participant in the Local Government Investment Pool.</p> <p>1 Additional Governor Appointee.</p> <p>1 Educator participant appointed by Teachers Retirement Board.</p> <p>1 Non-Educator participant in WRS appointed by WRS.</p> <p>1 Secretary of Department of Administration or designee.</p> <p>9 Total Members</p>
City of Milwaukee (MERS)	\$4.4 Billion	Within the limitations of State Statutes, MERS applies the prudent investor standard (City Charter Chapter 36.09(1). For MERS' experts, there is wording with the same impact as the prudent expert language requiring him to use his expertise.	Insurance Laws / State Basket Clauses -- 62.36 and other statutes it references apply.	1972	<p>3 City Residents Appointed by Common Council President.</p> <p>1 City Comptroller, Ex-Officio.</p> <p>3 Elected by the Active Employee Members of MERS.</p> <p>1 Elected by the Retiree Members of MERS.</p> <p>8 Total Members</p>

Prudent Investor Rule is the preferred investment policy for 115 Peer Public Retirement Systems

Prudent Investor Rule	69.7%
State Legal List	12.6%
Prudent Investor & State Legal List (Combination)	6.7%
Other Miscellaneous Restrictions	7.6%
Social Investment Restrictions	3.4%

Source: RV Kuhns Study for the Alaska Permanent Fund 2/17/05

General Description of Common Fiduciary Standards

Standard	Fiduciary Level of Responsibility
ERISA	Federal legislation for Corporate Pension Plans incorporating the Prudent Expert Standard and administered by the Department of Labor. Large body of law and regulation. Disputes are resolved via the Department of Labor.
Prudent Expert	Incorporates the tenets of the Prudent Investor Standard and explicitly requires those with specialized knowledge and expertise use their knowledge. Fiduciaries must discharge their duties "...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims..."
Prudent Investor	Invests with context of whole portfolio taking into account risk and return. "The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust. This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust."
Prudent Man	Prudence is determined at the individual investment level with the pursuit being the preservation of capital and regularity of income. Since this standard looked at individual investment products, it was the genesis for the legal lists and basket clause laws that were used historically.

The Prudent Investor Rule's Underlying Premise

The Prudent Investor Rule's underlying premise is that the primary responsibility of fiduciaries is to ensure the estimated risk and return of the *total portfolio* is appropriate in light of risk tolerances and the particular objectives served by the assets. This focus on the best estimates of the total portfolio's long-term behavior along with the development of modern portfolio theory has fundamentally changed the foundation for "prudent" fiduciary behavior. The key outcome of these twin developments is that properly diversified mixes of various asset classes—some of which may exhibit high volatility when viewed *individually* – when combined in a total portfolio are more likely to achieve given return expectations with less risk or, conversely, yield higher expected returns for the same amount of risk as a portfolio built on a "restrictive list" basis using only low volatility instruments. In current law embodying this emphasis on the whole portfolio rather than individual investment categories, the fiduciary is said to have "a duty to evaluate investments *in the context of the portfolio as a whole*" while the duty to select reasonable levels of risk are targeted to the fund and diversification itself becomes a fiduciary obligation.

In practical terms, this means that for a fund, such as the Alaska Permanent Fund confronted with an obligation to maximize the Fund's value and produce income for current and future generations of Alaskans, the optimal course of action may well be to employ a highly varied mix of investment classes, some of which exhibit high volatility (i.e., risk). The rationale proceeds as follows:

- Faced with the obligations related to return, principal protection and income, the Fund's fiduciaries will obviously want to seek to meet them while avoiding any unwarranted risk (particularly risk that does not bring with it the prospect of increased return).
- Broadly diversifying the Fund's investments among asset classes is the only mechanism that can simultaneously reduce total portfolio risk for a given level of expected return.
- Successful diversification is put into practice by finding the best mix of assets that together are likely to meet the Fund's return expectations but, also together, yield a pattern of returns over time that exhibit as little volatility as possible.
- A minimum risk, diversified portfolio is achieved by combining investment classes whose returns are at least partially uncorrelated with one another, that is their returns rise and fall over time in different patterns.
- Yet, achieving that minimum risk, diversified portfolio may well *require* the use of individual investment classes that, individually, exhibit above average volatility, *if* the fluctuations in their returns follow a markedly different pattern

RV Kuhns 2/17/05 Report to Alaska Permanent Fund Corp.

than the other investment classes used in the mix and thus, tend to smooth the overall returns achieved by the portfolio.

- Moreover, both the expected returns of all asset classes and their correlation with the other classes may change over time, albeit usually slowly. This requires that in executing their duties, fiduciaries such as those overseeing the Permanent Fund be able to gradually adjust the portfolio mix potentially using at various points in time all available asset classes.

The relevant point for Alaska Permanent Fund is that it is quite possible that either now or at some point in the future, the inability to access a broader range of asset classes may result in the creation of a Fund that contains either excess risk or unnecessarily lower long-term returns. Whether that point is likely now, as opposed to later, is the subject of the analysis in Tab IV.

RVK:hrs 2/17/05 Report to Alaska Permanent Fund Corp
4

The Rate of Adoption of the Prudent Investor Rule by Public Funds

The shift to assessing and controlling risk at the total portfolio level rather than by limiting investment to specific investment classes deemed to be of low risk has been extremely rapid. Most States and Territories in the United States of America have adopted the Uniform Prudent Investor Act that codifies this total portfolio focus into the list of duties required of fiduciaries.

STATE/TERRITORY ADOPTIONS* of the PRUDENT INVESTOR ACT

Alaska	Maryland **	Pennsylvania
Arizona	Michigan	Rhode Island 6.2
Arkansas	Minnesota	South Carolina
California	Missouri 5.8	South Dakota 5.5
Colorado	Montana 2.7	Tennessee
Connecticut	Nebraska 6.1	Texas
District of Columbia 2.6	Nevada	Utah
Hawaii 8.5	New Hampshire 4.3	U.S. Virgin Islands
Idaho 7.9	New Jersey	Vermont 2.6
Illinois	New Mexico	Virginia
Indiana	North Carolina	Washington
Iowa	North Dakota	West Virginia 5.8
Kansas 10.4	Ohio	Wisconsin
Maine 8.1	Oklahoma	Wyoming 4.9
Massachusetts	Oregon	

Numbers are in Billions for states' ERS Funds.

2003-05
WI Act 2
Toms
AB167

* Source is National Conference of Commissioners on Uniform State Laws

** Substantially Similar

Adopting the Prudent Investor Rule would align the Alaska Permanent Fund with a broad and still growing majority of states across the United States.

RV Kuhns 2/17/05 Report to Alaska Permanent Fund Corp

In addition, RVK reviewed its own proprietary public fund universe data and updated it by polling a wide range of public funds, including pension funds and permanent funds. The results of our review are shown below.

Public Fund Investment Policies

Prudent Investor Rule	69.7%
State Legal List	12.6%
Prudent Investor & State Legal List (Combination)	6.7%
Other Miscellaneous Restrictions	7.6%
Social Investment Restrictions	3.4%

When comparing the Alaska Permanent Fund to its peer group (115 U.S. Public Funds), a large majority of the Fund's peers has adopted the Prudent Investor Rule (69.7%). Only 12.6% of peer funds are constrained to follow their state's statutory list, while 6.7% of peers have adopted both the Prudent Investor Rule and their respective state's statutory list. Thus, adoption of the Prudent Investor Rule would place the Alaska Permanent Fund firmly in the mainstream with the majority of public funds.

RV Kuhns 2/17/05 Report to Alaska Permanent Fund Corp

Summary and Conclusions Regarding the Case for the Prudent Investor Rule in Alaska

Based on our research, analyses, and underlying assumptions, we conclude the following regarding the application of the Prudent Investor Rule to the Alaska State Permanent Fund:

Comparison to Peers

If the Alaska Permanent Fund were to adopt the Prudent Investor Rule as the foundation for managing its total portfolio, it would join a broad and still growing number of states, pension plans and special purpose funds. Indeed, the use of the Prudent Investor Rule is now a "best practice" in constructing portfolios to seek desired returns while controlling risk.

Effect on the Permanent Fund's Expected Risk and Return

Our analysis suggests that adoption of the Prudent Investor Rule would make possible the construction of portfolios that offer either the prospect of moderately greater expected long-term returns or the pursuit of current return expectations with reduced long-term risk.

The Ability of the Permanent Fund to Sustain Distributions Over the Long-term

The Monte Carlo analysis reviewing the outcomes of many possible future risk/return paths suggests that portfolios made possible only by adoption of the Prudent Investor Rule have notably higher probabilities of sustaining current distributions in the 4.0% to 5.0% range than is likely the case under current policy.

We would also note, however, that based on RVK's current assumptions, there is a meaningful probability that the Permanent Fund's portfolio returns *alone* might not be sufficient to support annual distributions in the 4.0% to 5.0% range under either a "restricted list" or Prudent Investor Rule regime.

The Ability of the Permanent Fund to Preserve the Real Value of the Corpus

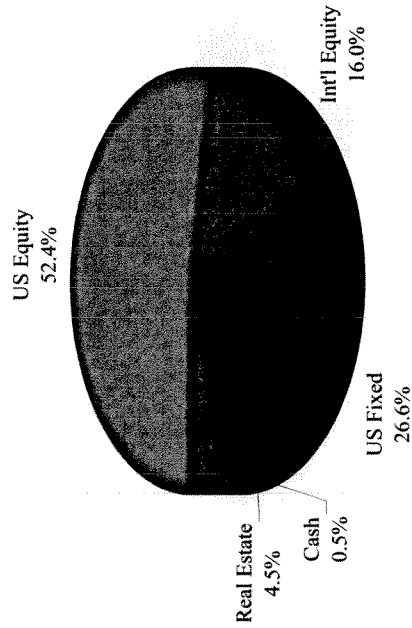
Our analysis suggests, once again, that adoption of the Prudent Investor Rule would raise the likelihood that the real value of the Fund could be preserved over the long-term by enabling portfolios using a wider array of asset classes. But, again, we note that if preservation of the real value of the Fund is viewed as solely a function of portfolio returns and annual distribution levels, then the relationship between them becomes

RV Kuhns 2/17/05 Report to Alaska Permanent Fund Corp

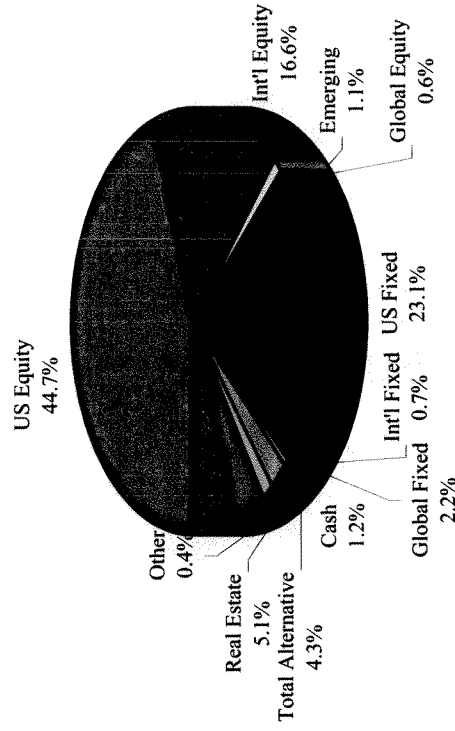
critical. Should those levels exceed the real returns earned by the portfolio over time – a plausible outcome the higher distribution requirements are set – the real value of the corpus will gradually decline.

Asset Allocation
Milwaukee ERS vs Weighted Average
 Period Ending
 June 30, 2004

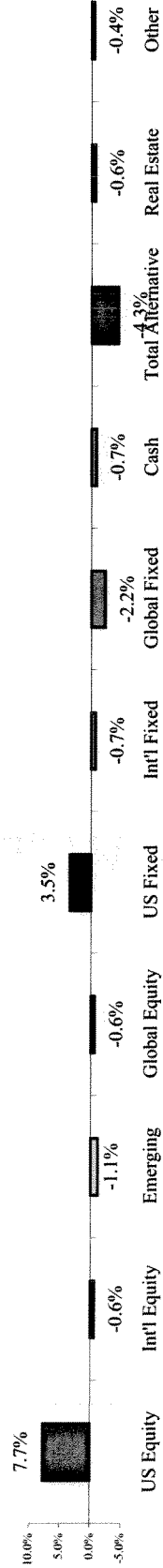
Milwaukee ERS



All Funds

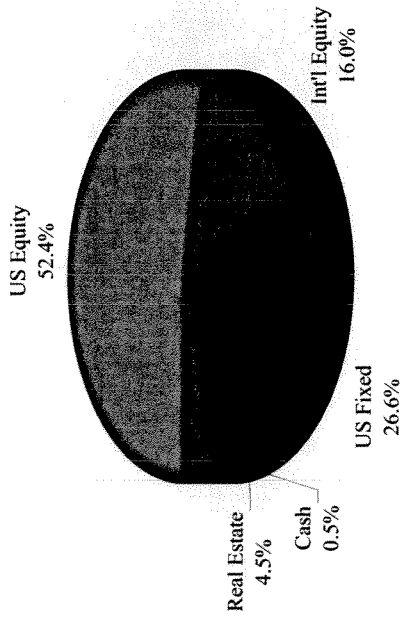


Variance

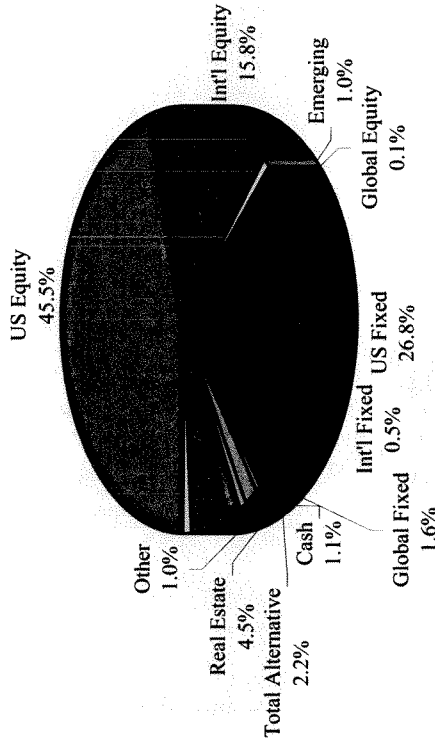


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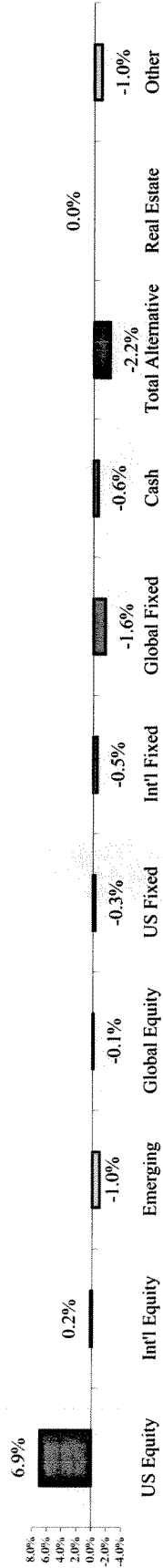
Milwaukee ERS



\$1B - \$5B



Variance



CITY OF MILWAUKEE

Form CA-43

GRANT F. LANGLEY
City Attorney

RUDOLPH M. KONRAD
PATRICK B. McDONNELL
LINDA ULISS BURKE
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HAZEL MOSLEY
STUART S. MUKAMAL
THOMAS J. BEAMISH
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G. O'SULLIVAN-CROWLEY
KATHRYN M. ZALEWSKI
MEGAN T. CRUMP
ELOISA DE LEÓN
ADAM STEPHENS

Assistant City Attorneys

September 28, 2005

Ms. Anne M. Bahr
Executive Director and Secretary
Milwaukee Employees' Retirement System
Room 603 - City Hall

Ms. Jennifer A. Shannon, CFA
Chief Investment Officer
Milwaukee Employees' Retirement System
Room 603 - City Hall

Re: State Statute Review

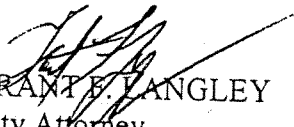
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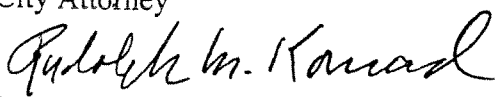
Dear Ms. Bahr and Ms. Shannon:

Pursuant to your request dated September 20, 2005, I am enclosing a proposed amendment to Wis. Stat. § 62.63(3).

The city has the power to prescribe the manner of investment by the ERS Board through its home rule authority. The city has exercised this authority by adoption of Charter § 36-09-1, which adopts the prudent-investor standard. The difficulty posed by Wis. Stat. § 62.63(3) lies in the fact that it delineates the legal investments available to the Board in implementing § 36-09-1 of the Charter. This is inconsistent with the prudent-investor standard used in § 36-09-1 and in Wis. Stat. § 881.01. Under the prudent-investor standard, any kind of investment meeting the prudent-investor standard is permitted. The proposed amendment permits any investment consistent with the prudent-investor standard.

Very truly yours,


GRANT F. LANGLEY
City Attorney


RUDOLPH M. KONRAD
Deputy City Attorney

RMK:lmb
enclosure
1054-2005-2553:97273

Analysis:

Chapter 396 Laws of Wisconsin of 1937 created the Employees' Retirement System of the City of Milwaukee. Chapter 441 Laws of Wisconsin of 1947 declared the legislative policy that all future amendments and alterations to the Employees' Retirement Act are matters of local affair and government and not matters of statewide concern and empowered the City of Milwaukee to amend the Act through the adoption of Charter Ordinances under Section 66.0101. Nevertheless the legislature has specified the lawful investments for the Retirement System in Section 62.63(3)

In 1995 the City of Milwaukee enacted a Charter Ordinance adopting the provisions of the Uniform Prudent Investor Act promulgated by the National Conference of Commissioners on Uniform State Laws to govern the manner of investment by the retirement board of the Employees' Retirement System. The analysis accompanying this legislation recognized that legislature's delineation of lawful investments was inconsistent with provisions of the Uniform Prudent Investor Act and recommended elimination of the limitations on the types of legal investments contained in Section 62.63 (3). This legislation implements the recommendation. It authorizes the retirement board to invest in any type of investment consistent with the standards of Section 881.01.

Body

62.63 (3) is amended to read:

62.63 (3)

(3) Investment of retirement funds. The board of a retirement system of a 1st class city, whose funds are independent of control by the investment board, may invest and reinvest funds from the system in excess of the amount of cash required for current operations, ~~in loans, securities and any other any kind of property or type of investments authorized for investment of the public trust fund under 25.17 (3)(e) to (g), (4), (7), (8) and (15) but is exempt from the operations of ch~~ consistent with the standards of 881.01. ~~In addition to all other authority for the investment of funds granted to the retirement board of a 1st class city whose funds are independent of the control of the investment board, the retirement system board of the city may invest its funds in accordance with 206.34, 1969 stats. In making investments under this subsection, the board of a retirement system of a 1st class city may invest in shares of investments authorized under this subsection.~~

→ insurance statutes.



State of Wisconsin
2005 - 2006 LEGISLATURE

LRB-3912/1

RAC: n:...

SON

JLD

2005 BILL

- gen. cat.

1 AN ACT ...; relating to: investment of funds by the City of Milwaukee Employees'
2 Retirement System.

CMERS

(CMERS)

Analysis by the Legislative Reference Bureau

Current law restricts the manner in which the City of Milwaukee Employees' Retirement System may invest its funds. This bill authorizes City of Milwaukee Employees' Retirement System to invest funds of the system in the manner provided under the Uniform Prudent Investor Act, which took effect in Wisconsin on April 30, 2004.

Generally, under the Uniform Prudent Investor Act, a fiduciary must do all of the following:

1. Invest and manage assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the estate, trust, conservatorship, or guardianship.
2. Evaluate *an* investment and management decisions about individual assets, not in isolation but in the context of the portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the estate, trust, conservatorship, or guardianship.
3. Consider a number of specific circumstances relevant to the estate, trust, conservatorship, or guardianship or its beneficiaries.
4. Make a reasonable effort to verify facts relevant to the investment and management of assets.

plain

BILL

For further information see the *local* fiscal estimate, which will be printed as an appendix to this bill.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

1 **SECTION 1.** 62.63 (3) of the statutes is amended to read:

2 **62.63 (3) INVESTMENT OF RETIREMENT FUNDS.** The board of a retirement system
3 of a 1st class city, whose funds are independent of control by the investment board,
4 may invest funds from the system, in excess of the amount of cash required for
5 current operations, in ~~loans, securities and any other investments authorized for~~
6 ~~investment of funds of the public employee trust fund under s. 25.17 (3) (a) and (4).~~
7 ~~The independent retirement system board is subject to the conditions imposed on the~~
8 ~~investment board in making the investments under s. 25.17 (3) (e) to (g), (4), (7), (8)~~
9 ~~and (15) but is exempt from the operation of ch. 881. In addition to all other authority~~
10 ~~for the investment of funds granted to the board of a retirement system of a 1st class~~
11 ~~city whose funds are independent of the control of the investment board, the~~
12 ~~retirement system board of the city may invest its funds in accordance with s. 206.34,~~
13 ~~1969 stats. In making investments under this subsection, the board of a retirement~~
14 ~~system of a 1st class city may invest in shares of investments authorized under this~~
15 ~~subsection the same manner as is authorized for investments under s. 881.01.~~

History: 1999 a. 150 ss. 15, 569, 571, 574, 575.

(END)

Northrop, Lori

From: Petri, Tom
Sent: Tuesday, November 08, 2005 2:20 PM
To: LRB.Legal
Subject: Draft review: LRB 05-3912/1 Topic: Investment options for City of Milwaukee Employees' Retirement System

It has been requested by <Petri, Tom> that the following draft be jacketed for the SENATE:

Draft review: LRB 05-3912/1 Topic: Investment options for City of Milwaukee Employees' Retirement System