



City of Milwaukee
Employees' Retirement System

Bernard J. Allen
Executive Director

David M. Silber, CFA, CAIA
Chief Investment Officer

Melody Johnson
Deputy Director

March 7, 2025

Mr. Jim Owczarski
City Clerk
Room 205, City Hall

Dear Mr. Owczarski:

Please be advised that a Special Meeting of the Annuity and Pension Board of the Employees' Retirement System has been scheduled for **Thursday, March 13, 2025 at 9:00 a.m.** *Special Notice: the meeting will be held remotely via video conference. Instructions on how to observe the meeting will be available on ERS's website (www.cmers.com) prior to the meeting.*

Please note and observe the following remote attendance etiquette to ensure a smooth and productive meeting:

- In order to cut down on background noise, participants in the meeting should put their phones on mute when they are not participating.
- At the start of the meeting, the Chairman will announce the names of the members of the Board present on the call, as well as anyone else who will be participating.
- Please request to be recognized by the Chairman if you would like to speak.
- Those participating on the call should identify themselves whenever they speak, and should ensure that the other participants on the call can hear them clearly.

The agenda is as follows:

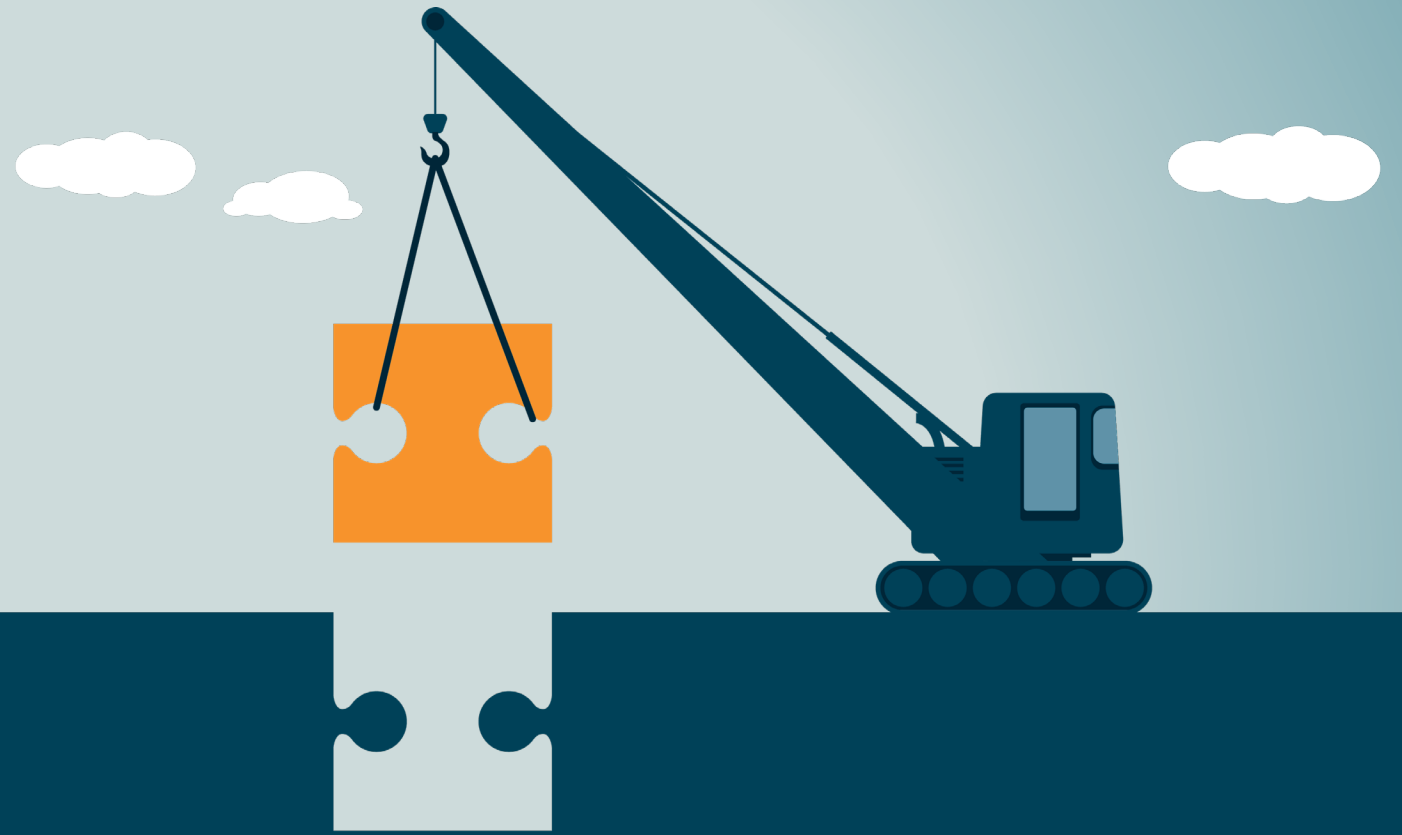
- I. Review of ERS Funding Policy with Presentation by Larry Langer and Aaron Chochon of Cavanaugh Macdonald.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bernard J. Allen", is written over the typed name and title.

Bernard J. Allen
Executive Director

BJA:jmw



City of Milwaukee Employees' Retirement System Discussion of Funding Policy

At the February 2025 Investment Committee Meeting, Investment Staff and Callan expressed concern that the asymmetric 10-year amortization of asset losses results in investment allocations with lower returns to decrease risk and upside contribution volatility

CavMac has discussed this with CMERS staff

In this presentation, CavMac has included alternative funding policies for the Board to consider to allow Callan to develop investment policies with better risk reward metrics

Excerpts from Act 12

... the required annual employer contribution shall be calculated using a 30-year amortization period and an annual investment return assumption that is the same as or less than the annual investment return assumption used by the Wisconsin Retirement System

Future unfunded actuarial accrued liability due to factors such as market returns and standard actuarial practices may be amortized on the basis of standard actuarial practices.

No trustee or administrator of a retirement system of a 1st class city shall be subject to liability for complying with this section.

- Actuarial Standard of Practice 4 (ASOP 4) allows us to not assess the 30-year amortization
 - 2.23 Prescribed Assumption or Method Set by Law—A specific assumption or method that is mandated or that is selected from a specified range or set of assumptions or methods that is deemed to be acceptable by applicable law (statutes, regulations, or other legally binding authority). For this purpose, an assumption or method set by a governmental entity for a plan that such governmental entity or a political subdivision of that entity directly or indirectly sponsors is not deemed to be a prescribed assumption or method set by law.
 - 3.24 Assessment of Assumptions and Methods Not Selected by the Actuary—For each measurement date, the actuary should assess whether an assumption or method not selected by the actuary is reasonable for the purpose of the measurement, other than 1) prescribed assumptions or methods set by law
- But we do assess the 30-year amortization and in our professional judgement it is not reasonable

- The contribution based on CavMac’s recommended 10-year amortization is around \$100 million more than the 30-year amortization amount mandated by Act 12
- While Act 12 allows CMERS to fund future changes in the UAAL over an actuarially sound period, no policy can replicate the recommended 10-year amortization period.
 - CavMac considered recognizing asset losses immediately
 - But asset gains would result in not being able to fund over 10 years

These considerations make longer amortization more palatable

- Under Act 12, tax revenues stop when CMERS is fully funded or after 30 years has passed, whichever occurs first.
 - This suggests that a longer amortization policy may not be unreasonable.
- The amortization is level dollar
 - Which means the UAAL is paid down each year (i.e., no negative amortization)
- Despite these, Act 12 falls short of standard actuarial practice

Current

Maintain current UAAL

Initial UAAL and actuarial gains over 30 years beginning January 1, 2024

No minimum amortization payment

Actuarial losses over 10 years

Lawsuit amortized over nine years

Alternate 1

Increase UAAL as of January 1, 2026 by resetting AVA to market

All UAAL over 28 years beginning January 1, 2026

Minimum amortization equal to the January 1, 2026 UAAL payment

Actuarial gains and losses over 10 years

Lawsuit amortized over 28 years

Alternate 2

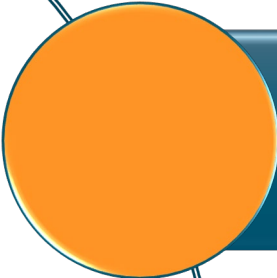
Increase UAAL as of January 1, 2026 by resetting AVA to market

All UAAL over 28 years beginning January 1, 2026

Minimum amortization equal to the January 1, 2026 UAAL payment

Actuarial gains and losses over 15 years

Lawsuit amortized over 28 years



The next four slides illustrate the impact of the policy on projected City contributions



CavMac performed a stochastic projection based on simplified projected returns and current valuation assumptions



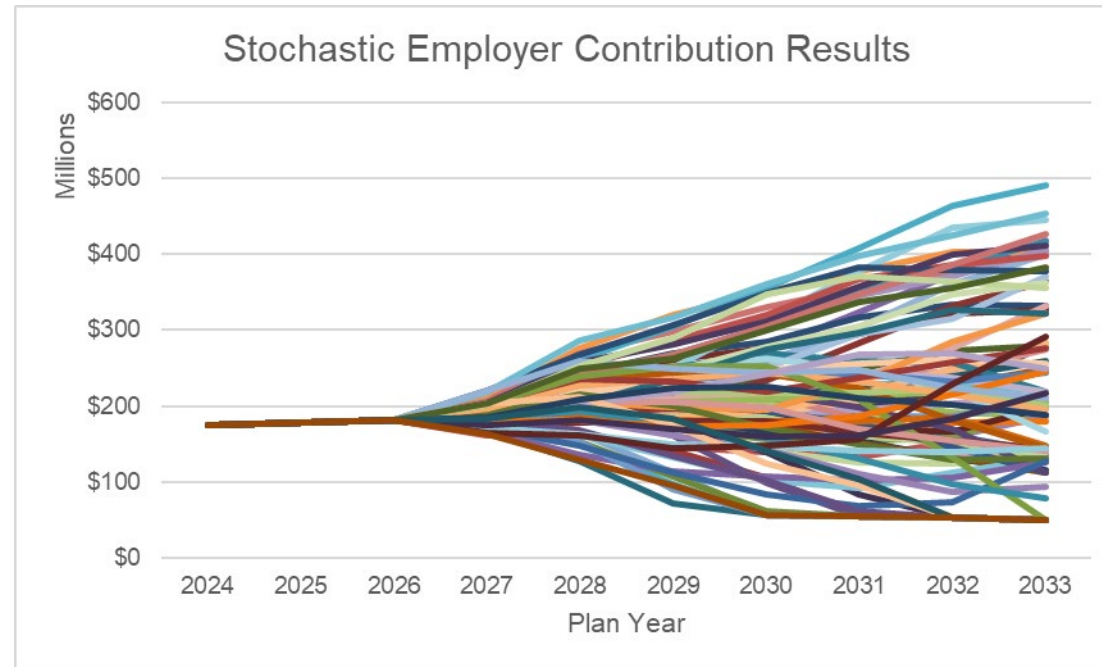
Projections of City contributions performed by Callan will differ due to modelling glide path and refined return assumptions

“Models are designed to identify anticipated trends and to compare various scenarios rather than predicting some future state of events... The projections do not predict the System’s financial condition or its ability to pay benefits in the future and do not provide any guarantee of future financial soundness of the System. Over time, a defined benefit plan’s total cost will depend on a number of factors, including the amount of benefits paid, the number of people paid benefits, the duration of the benefit payments, plan expenses, and the amount of earnings on assets invested to pay benefits. These amounts and other variables are uncertain and unknowable at the time the projections were made. Because actual experience will not unfold exactly as expected, actual results can be expected to differ from the projections. To the extent that actual experience deviates significantly from the assumptions, results could be significantly better or significantly worse than indicated in this study.”

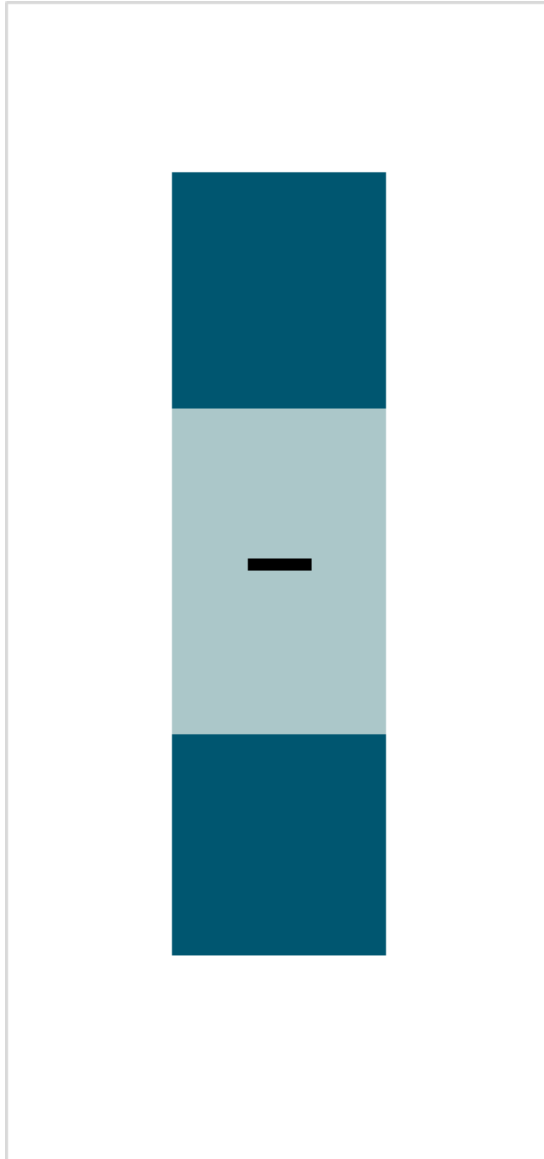
- from “Actuarial Impact of CMERS Soft Close with Future Member Participating in WRS” dated January 25, 2023



- Stochastic modeling was performed to analyze and compare the different funding policies and how contribution levels are impacted over time
- 1,000 scenarios of random asset returns were modeled over a 30-year period
 - Reflected a 6.8% return for 2024
 - Future returns are based on plan's expected risk and return
 - Expected return: 6.8%
 - Standard deviation: 12.5%
 - Measured ranges of outcomes
- Assumes all other actuarial assumption are met every year in the future
- Note that the actual Plan Year 2026 contribution amount will likely be different from the amount shown here
 - Retirement, termination, mortality and other experience different than assumed
- Recall, projections of City contributions performed by Callan will differ



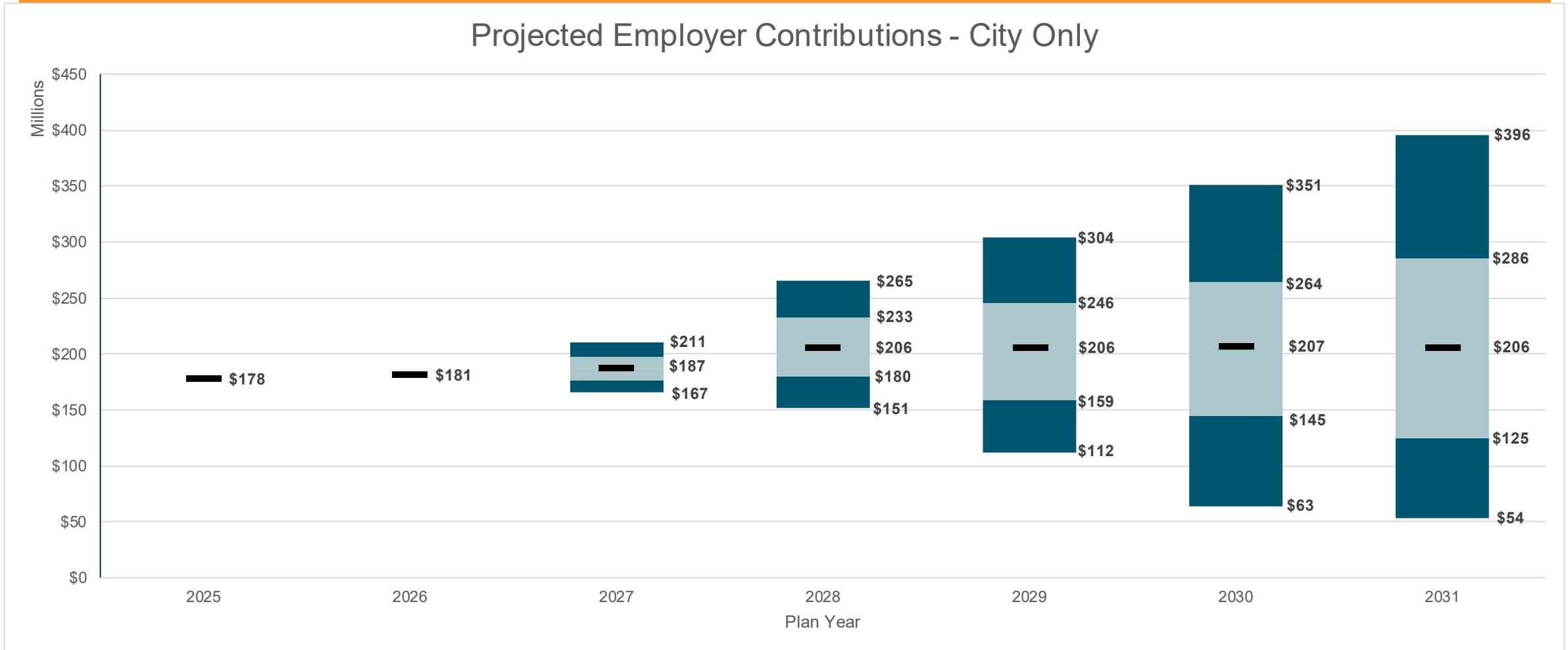
- Stochastic modeling uses “Monte Carlo” simulations to generate thousands of results for each year of the projection, based on the underlying capital market assumptions.
- Each line represents a single scenario (one set of 10-year returns)
- For analysis, results for each year are summarized, ranked and then shown as distributions (see next slide)



- 95th Percentile (5% of outcomes are above this line)
- 75th Percentile (25% of outcomes are above this line)
- 50th Percentile (50% of outcomes are above this line, 50% are below this line – referred to as the Median)
- 25th Percentile (75% of outcomes are above this line)
- 5th Percentile (95% of outcomes are above this line)

Current Funding Policy

Projected Employer Contributions - City Only



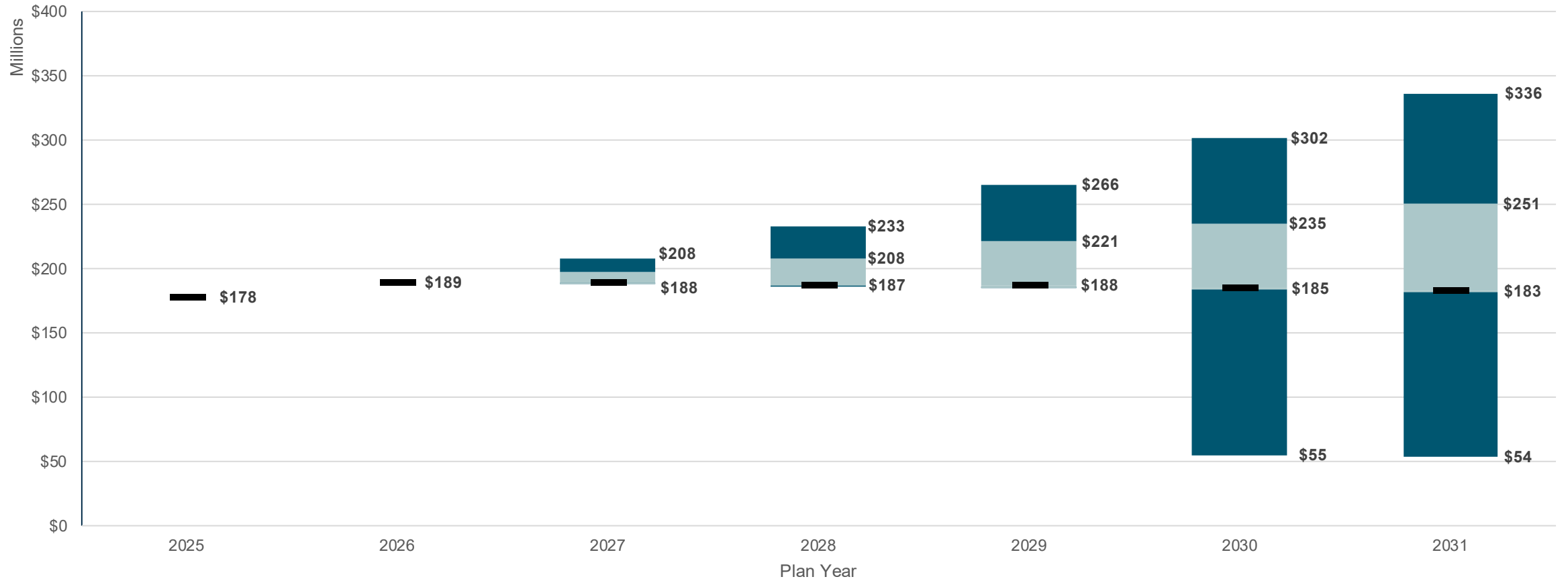
Alternative 1

Projected Employer Contributions - City Only



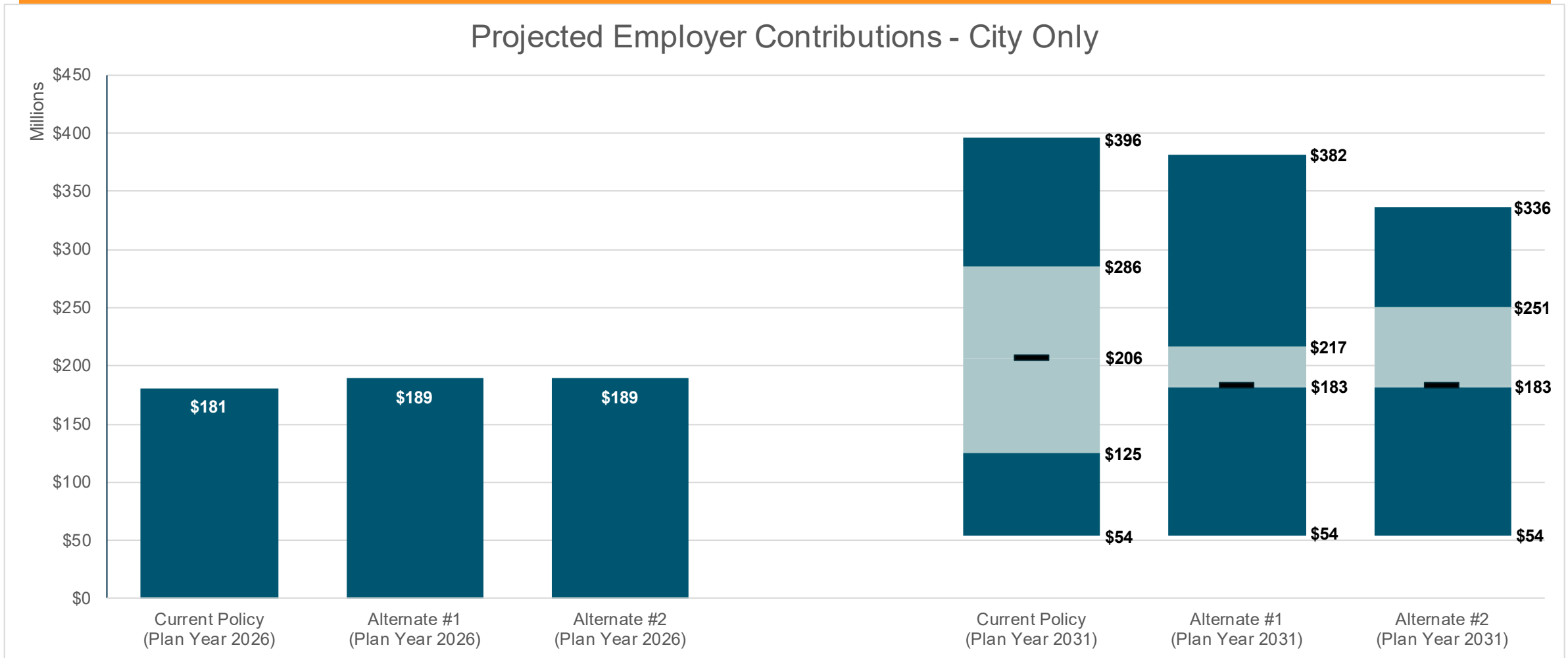
Alternative 2

Projected Employer Contributions - City Only



The comparison illustrates the difference in policies

Projected Employer Contributions - City Only



- At the median, the alternate policies result in higher City contributions now and lower City contributions later
- The alternate policies result in less variability but take longer to pay down the unfunded actuarial accrued liability

- None of these Funding Policies are reasonable in our professional judgement because the amortization period legislated under Act 12 is too long
- Standard Actuarial Practices don't exist to fix this deficiency
- Other considerations noted earlier make these Funding Policies slightly more palatable
- The Board can consider having Callan run alternatives 1 and 2 to determine if these alternatives result in a better investment universe

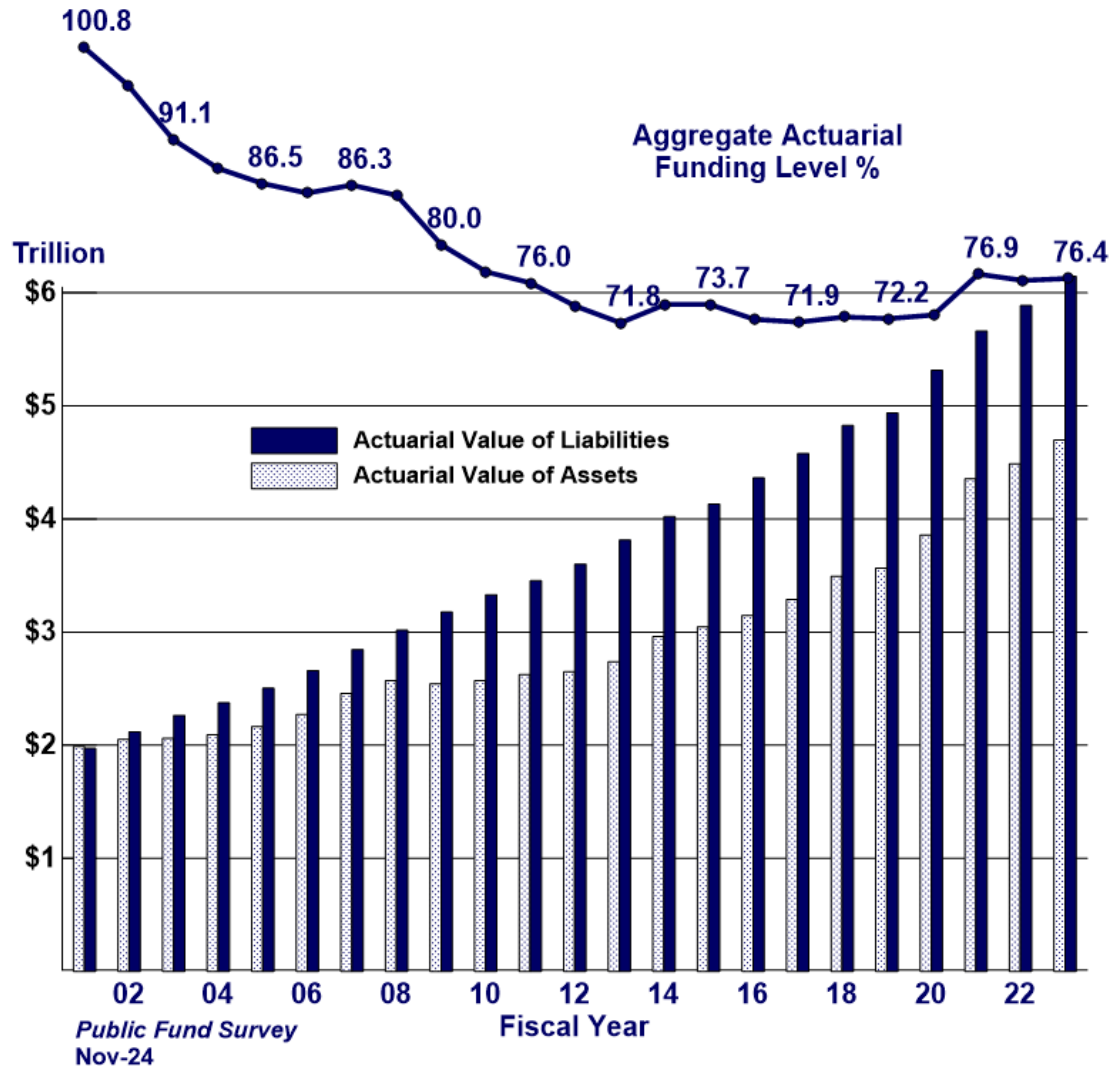
THANK
YOU



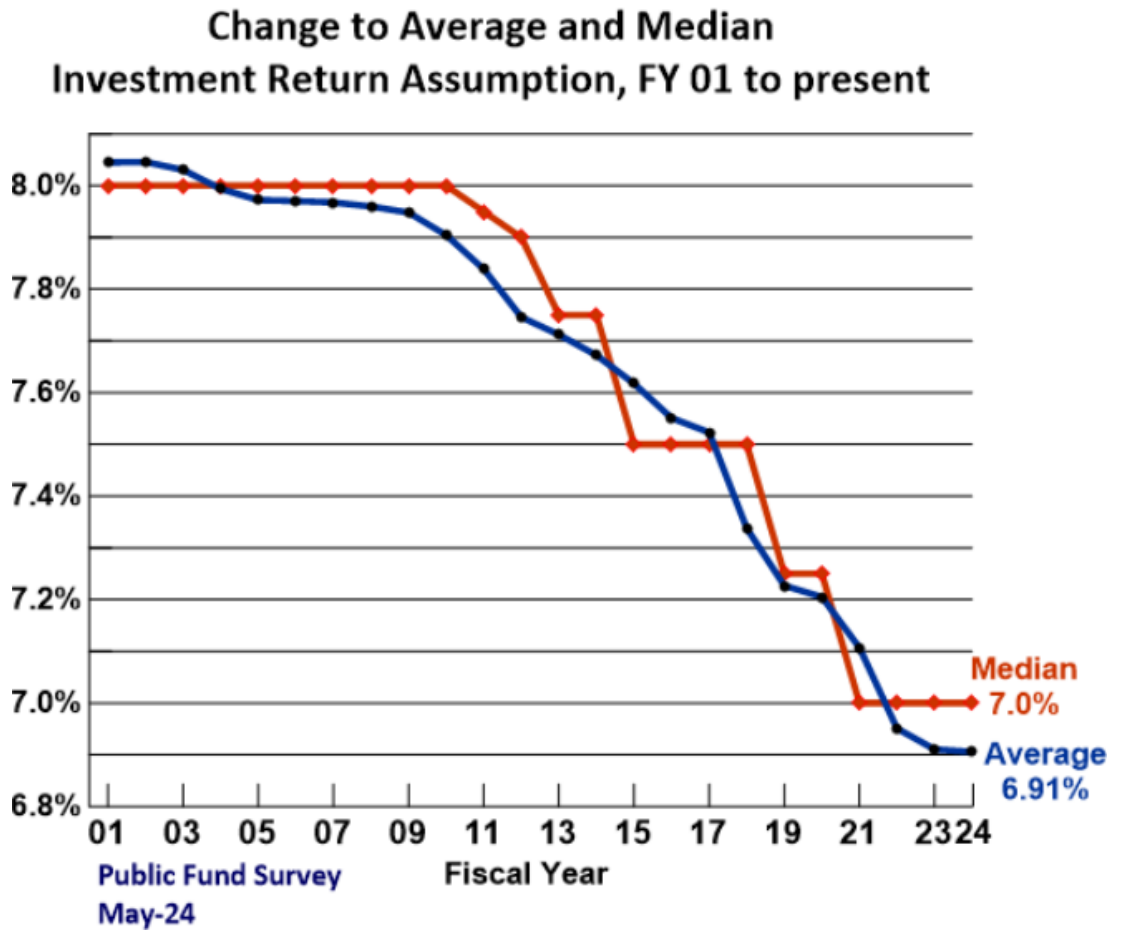
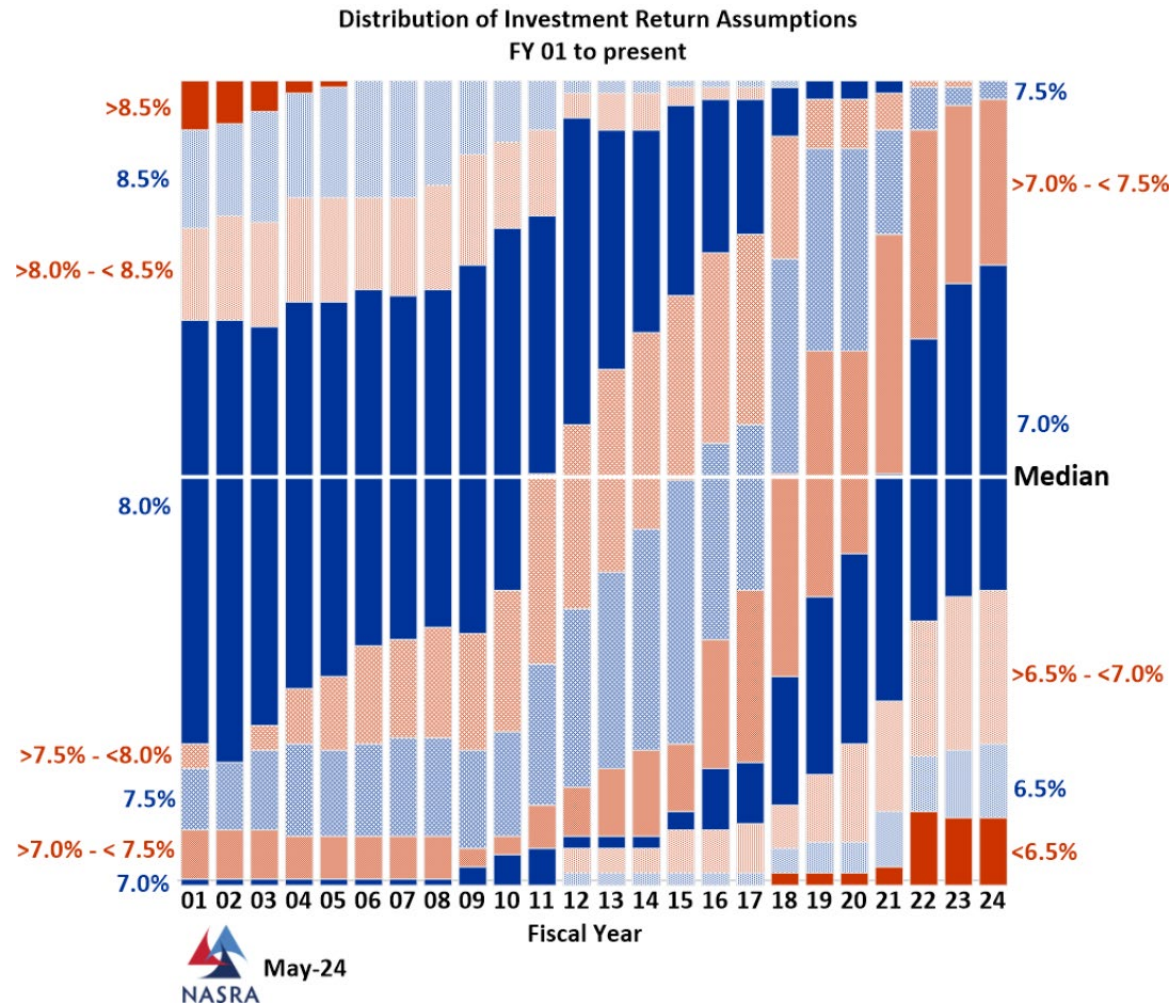
Appendix



National Funding Level Trend



National Trend in Investment Return



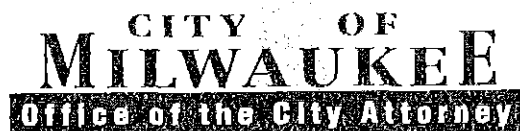
**Estimated Employer Contributions for Plan Years 2024-2028 as of January 1 Allocated by Employer
Assuming -3.20% Return During Calendar Year 2024 and 6.80% Thereafter**

	2024	2025	2026	2027	2028
1) City of Milwaukee					
a) General	48,609,007	48,996,945	53,213,629	58,560,978	67,754,275
i) Act 12 Eligible Costs	40,490,893	41,196,557	44,918,349	49,835,316	58,623,837
ii) Remaining Costs	8,118,114	7,800,388	8,295,280	8,725,662	9,130,438
b) Policemen	86,009,793	86,595,077	95,913,516	106,912,858	124,543,600
i) Act 12 Eligible Costs	62,058,018	62,432,135	71,740,108	82,575,936	99,941,115
ii) Remaining Costs	23,951,775	24,162,942	24,173,408	24,336,922	24,602,485
c) Firemen	40,444,032	42,404,793	45,105,504	50,615,070	59,132,431
i) Act 12 Eligible Costs	28,921,289	30,793,520	33,519,396	39,030,017	47,526,762
ii) Remaining Costs	11,522,743	11,611,273	11,586,108	11,585,053	11,605,669
d) Total City	175,062,832	177,996,815	194,232,649	216,088,906	251,430,306
i) Act 12 Eligible Costs	131,470,200	134,422,212	150,177,853	171,441,269	206,091,714
ii) Remaining Costs	43,592,632	43,574,603	44,054,796	44,647,637	45,338,592
2) Non-City Employers					
a) Water Dept	4,493,408	4,550,150	4,953,513	5,462,007	6,336,992
i) Act 12 Eligible Costs	709,880	750,204	619,449	497,023	389,913
ii) Remaining Costs	3,783,528	3,799,946	4,334,064	4,964,984	5,947,079
b) School Board	27,499,578	28,127,195	30,332,740	33,202,354	38,212,403
i) Act 12 Eligible Costs	4,256,982	4,767,541	3,582,967	2,514,537	1,499,490
ii) Remaining Costs	23,242,596	23,359,654	26,749,773	30,687,817	36,712,913
c) Milwaukee Technical College	259,247	214,982	227,464	240,932	267,545
i) Act 12 Eligible Costs	11,899	11,852	11,196	10,396	9,618
ii) Remaining Costs	247,348	203,130	216,268	230,536	257,927
d) Sewerage Commission	5,564,646	5,377,111	5,844,965	6,436,845	7,465,858
i) Act 12 Eligible Costs	803,341	696,006	559,046	447,294	365,921
ii) Remaining Costs	4,761,305	4,681,105	5,285,919	5,989,551	7,099,937
e) Veolia	1,408,947	1,372,756	1,519,819	1,704,095	2,009,691
i) Act 12 Eligible Costs	76,094	68,956	40,826	27,434	12,002
ii) Remaining Costs	1,332,853	1,303,800	1,478,993	1,676,661	1,997,689
f) Wisconsin Center District	981,530	1,067,095	1,112,389	1,205,017	1,373,830
i) Act 12 Eligible Costs	217,923	342,541	259,677	215,779	180,567
ii) Remaining Costs	763,607	724,554	852,712	989,238	1,193,263
g) Housing Authority	1,951,107	1,895,374	2,075,986	2,307,802	2,693,890
i) Act 12 Eligible Costs	261,874	203,726	143,726	94,852	40,459
ii) Remaining Costs	1,689,233	1,691,648	1,932,260	2,212,950	2,653,431
h) Total Non-City	42,158,463	42,604,663	46,066,876	50,559,052	58,360,209
i) Act 12 Eligible Costs	6,337,993	6,840,826	5,216,887	3,807,315	2,497,970
ii) Remaining Costs	35,820,470	35,763,837	40,849,989	46,751,737	55,862,239
3) Total System: 1d + 2h	217,221,295	220,601,478	240,299,525	266,647,958	309,790,515
i) Act 12 Eligible Costs	137,808,193	141,263,038	155,394,740	175,248,584	208,589,684
ii) Remaining Costs	79,413,102	79,338,440	84,904,785	91,399,374	101,200,831

Note: Act 12 Eligible Costs do not reflect the statutory limit equal to 90% of the 2024 Act 12 sales tax revenue, which is not known at this time. Any Act 12 Eligible Costs above the limit would directly impact the Remaining Costs.

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June 21, 2010

Bernard J. Allen
Executive Director
Milwaukee Employees' Retirement System
789 North Water Street, Suite 300
Milwaukee, WI 53202

Re: Annual Valuations of the Assets and Liabilities
of the ERS (CCFN 091274)

Dear Mr. Allen:

This opinion is in response to your letter of April 28, 2010, in which you ask whether the adoption by the Common Council and the Mayor of File No. 091274, which codified changes to the funding formula that had been adopted by the Annuity and Pension Board in August, 2009, infringes on the fiduciary responsibilities of the board, and, whether board members could be held liable in the event of fund impairment.

To answer these questions, this opinion discusses the obligations of the board, the City, and the city agencies, the City's home rule authority over the pension plan, the events leading up to the adoption of File No. 091274, IRS funding requirements, a discussion of how the issues raised by the questions asked have been addressed under Employees Retirement Income Security Act, contractual limitations on funding changes, and our conclusion.

Obligations of the Board and the City

Chapter 36, the ERS plan, creates an eight-member board consisting of three who are appointed by the President of the Common Council, three who are elected by the members of the retirement system, one who is elected by the retirees, and the Comptroller, who sits *ex officio* (by virtue of the office). The board is charged with "[t]he general administration and responsibility for proper operation of the retirement system and making effective the provisions of this act." Sec. 36-15. As explained below, this generally means the safeguarding and investment of fund assets, and the payment of expenses and benefits in accordance with the terms of the plan.

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The City and city agencies are obligated to finance their pension obligations, sec. 36-13-2-d; accordingly, the City is authorized to levy a tax on all taxable real and personal property to fund its pension contribution. Sec. 36-08-6-f. Non-taxing city agencies are required to include their pension contributions in their budgets. Sec. 36-08-6-g.

The City's Home Rule Authority over the Pension Plan

Chapter 396, Laws of 1937, which created the Employees' Retirement System, authorized the creation of several funds to hold contributions, make investments, and pay benefits and expenses. The law defined the method to be used to determine the amount of employee and employer contributions, but left the calculation of the amount of those contributions to the board and the actuary. Chapter 396, sec. 8.

Under Chapter 441, Laws of 1947, the City was given home rule power with respect to the Employees' Retirement System. Under the home rule provision, the City was empowered to amend or alter the provisions of the Employees' Retirement Act, using the method prescribed for charter ordinances under Wis. Stat. sec. 66.01, provided no amendment "shall modify the annuities, benefits, or other rights of any persons who are members of the system prior to the effective date of such amendment."¹ The board retained the responsibility for administration and the proper operation of the retirement system and for making effective the provisions of the Act.

In 1995 the Common Council amended Chapter 36 to adopt the projected unit credit method to determine the amount of the City's and city agencies' annual contributions to the fund. File No. 942017. Accordingly, the actuary is required by sec. 36-15-15 of the Charter to make an annual valuation of assets and liabilities of the pension fund by applying the projected unit credit method specified in the ordinance. The 1995 amendment, however, did not define all of the assumptions the actuary is required to make when applying that method. Those assumptions include averaging periods (smoothing) and financing (amortization) methods generally referred to as the "funding policy." The board annually approves the actuary's valuation and certifies the contributions due from the City and the city agencies. Sec. 36-08-6-e. In approving the actuary's valuation report, the board either tacitly or explicitly approves the assumptions made by the actuary in the report.

¹ The Wisconsin Court of Appeal interpreted this provision to mean ERS retirement benefits in effect when an employee becomes a member of the system were vested unless the employee agreed to a change. *Milwaukee Police Association v. City of Milwaukee*, 222 Wis.2d 259, 588 N.W.2d 636 (Ct. App. 1998); *Welter v. City of Milwaukee*, 214 Wis. 2d 485, 571 N.W.2d 459 (1997).

Events Leading Up to the Adoption of File No. 091274

In August of 2009, the Annuity and Pension Board, with the approval of the system actuary, adopted a new funding policy that changed some of the assumptions made by the actuary when applying the projected unit credit method. The actuary informed the board in writing that the proposed assumption changes were “reasonable,” and “within the bounds of responsible actuarial practice.” The actuary explained that the new policy modifies certain policy components “within actuarially sound parameters.” (Letter of August 14, 2009) A consequence of this change is a reduction the City’s and city agencies’ near term annual contributions, but delayed recognition of future increases in asset values.

In March of 2010, the Common Council amended Chapter 36 to codify the funding policy recommended by the actuary and adopted by the board. File No. 091274. The Council added the qualification that the policy could not be changed without certification by the actuary and approval by the board. The effect of the amendment is that the board would no longer have authority to change those parts of the funding policy specifically addressed in Chapter 36 by majority vote; instead, a change would require written certification from the board’s actuary that such changes comply with actuarial standards of practice, approval of the board by majority vote, a two-thirds vote of the Common Council, and approval by the Mayor.

IRS Funding Requirements

Governmental plans are exempt from the minimum funding standards imposed under section 412 of the IRS Code. 26 U.S.C. §412(h). Governmental plans are subject to the pre-ERISA funding standards. Accordingly, a governmental plan must meet the requirements of section 401(a)(7) of the Code, as in effect on September 1, 1974, in order to be treated as a qualified plan for purposes of section 401(a). *Id.* Section 401(a)(7), as in effect on September 1, 1974, did not prescribe any specific funding standards, but instead required that a plan provide that in the event of a plan termination or a complete discontinuance of contributions, the rights of employees to benefits accrued to the date of the plan termination or discontinuance of contributions, to the extent then funded, would become non-forfeitable.

As to funding, a governmental plan must be able to meet current or anticipated near-future benefit payments, and the amounts appropriated to the plan must be fully sufficient to finance current benefits as determined by actuarial standards. *Gen. Couns. Mem.* 36813 (August 16, 1976). Therefore, as long as a governmental plan provides for full

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vesting on termination or discontinuance, and as long as the plan can meet its current or near-future benefit commitments, the employer is generally free to fund benefits in any manner it chooses, provided that it actually sets aside assets for that purpose. See, e.g., Rev. Rul. 71-91, 1971 C.B. 116 (holding that a noncontributory plan that contained no funding arrangement but provided that the employer would pay the monthly pension benefit to the employee directly did not qualify under section 401(a)).

How Similar Issues have been Addressed Under ERISA

Although governmental plans such as the Employees' Retirement System are exempt from ERISA under 29 U.S.C. secs. 1002(32) and 1003(b)(1), similar principles apply under the law of trusts. Moreover, courts often look to ERISA for guidance to resolve questions concerning public pension plans. Accordingly, to answer your questions, we reviewed *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996), which discussed ERISA in a similar context.

The Lockheed Corporation adopted an early retirement program that offered increased retirement benefits for employees who chose to retire early, payable out of the plans assets. But as a condition to participate, Lockheed also required participants to waive any employment-related claims they might have against Lockheed. In other words, Lockheed arguably purchased a benefit for the corporation—releases of its potential liabilities—with retirement fund assets. The Ninth Circuit Court of Appeals had held that Lockheed had engaged in a prohibited transaction in violation of ERISA because the early retirement program used plan assets to purchase a significant benefit for Lockheed.²

The Supreme Court reversed the Ninth Circuit. It concluded that Lockheed did not act as a fiduciary when it adopted the early retirement program, and, therefore, Lockheed was not subject the prohibitions of ERISA that apply to fiduciaries. Under ERISA, the court noted, a person is a fiduciary with respect to a plan if he or she exercises any discretionary authority or control over its management, administration, the management or disposal of its assets, or renders investment advice for a fee. 29 U.S.C. sec. 1002(21) (A). Accordingly, “only when fulfilling certain defined functions, including the exercise of discretionary authority or control over plan management or administration, does a person become fiduciary under 3(21)(A).” *Id.* at 890, quoting, *Siskind v. Sperry Retirement Program Unisys*, 47 F.3d 498, 505 (1995). A fiduciary, the court explained,

² 29 U.S.C. sec. 1106(a)(1)(D) mandates, in part, that “[a] fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . transfer to, or use by or for the benefit of a party in interest, or any assets of the plan.”

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is not, strictly speaking, a person. Rather it is a status that attaches to a person who exercises certain forms of discretion, authority, or control. ERISA sec. 3(21)(A) provides that:

[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, . . . (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

This definition emphasizes the actual role and conduct of the individual, not the individual's title. Because the defined functions in the definition of fiduciary do not include plan design, an employer may decide to amend an employee benefit plan without being subject to fiduciary review. *Id.* Lockheed, therefore, the court concluded, acted as a settlor and not as a fiduciary when it amended the terms of the plan.³

ERISA sec. 408(c)(3) expressly permits a plan fiduciary to be the employer (or union, if a union sponsored plan), or one of its officers, employees, agents, or other representative. The rationale for this is plain. In the end it is the employer's or union's money that is used to pay benefits and expenses. Accordingly, an employer or union would want to maintain oversight of the plan's funds, and employers or unions would be reluctant to establish or maintain plans if they were unable to maintain oversight.

How does one distinguish between an employer's fiduciary and non-fiduciary roles? The court in *Lockheed* distinguished between an employer's plan administration, which is a fiduciary function, and plan design, which is a non-fiduciary role. The court refers to the non-fiduciary role as the settlor function, a term taken from the law of trusts, which refers to the authority of the donor of property to determine the terms of the trust. Some courts formulate the distinction as the "two-hat doctrine." ERISA requires "the fiduciary with two hats [to] wear only one at a time, and [to] wear the fiduciary hat when making fiduciary decisions." *Pegram v. Herdrich*, 530 U.S. 211, 225 (2000). Employers who act as plan administrators "assume fiduciary status only when and to the

³An employer, however, does not have a free hand in amending plans because other portions of ERISA govern plan amendments, e.g., 29 U.S.C. sec. 1054(g), amendments may not decrease accrued benefits; sec. 1085b, if an amendment results in underfunding of a defined benefit plan, the sponsor must post security for the amount of the deficiency; 1103(c)(1), "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants of the plan." The City is similarly constrained by the Chapter 441, Laws of 1947, provisions of Chapter 36, which create a contractual right to benefits, sec 36-13, and the law of trusts.

extent that they function in their capacity as plan administrators, not when they conduct business that is not regulated by ERISA.” *Barnes V. Lacy*, 927 F.2d 539, 544 (11th Cir 1991).⁴

Contractual Limitations to Funding Changes

In *Wisconsin Professional Police Association v. Lightbourn*, 2001 WI 59, 243 Wis. 2d 512, 627 N.W.2d 807, the court, in an exhaustive opinion concerning the state’s pension plan reviewed all prior applicable Wisconsin cases. The court held that participants in a public pension plan have contractual rights to their benefits, but the participants do not have “a property right to determine exactly how employers fulfill their benefit commitments . . . without showing some tangible injury.” *Id.* Par. 179. The court also held the participants have no “right in a particular regimen of employer funding . . . or the timing of employer required contributions” unless the changes threaten “the security of the trust fund.” *Id.* Par. 176.

The *Lightbourn* case does not identify what kind of changes to a funding policy would constitute a tangible injury. Nevertheless, the case supports the conclusion that a change to a public pension funding policy that is reasonable, that is within the bounds of responsible actuarial practice, and that modifies certain policy components within actuarially sound parameters, is a lawful change because it does not deprive participants of their contractual rights to benefits or cause tangibly injure to their property rights.

Our Conclusion

We will now address whether the action of the Common Council and the Mayor in adopting File No. 091274 infringed on the fiduciary responsibilities of the board, and whether the board members could be held liable in the event of impairment of the fund. Based upon the above discussion, we believe we can justifiably conclude the following:

1. The Common Council was acting as a settlor, and not as a fiduciary, when it amended Chapter 36 to adopt the new funding policy. The amendment was directed to a change in plan design, and did not involve either investment or expenditure of fund assets. We note that if the Common Council and the Mayor were held to the same standards as a fiduciary,

⁴ Accordingly, when a member of the common council, who is also a member of the pension board, votes as a common council member on changes to plan design, he or she is not acting as a plan fiduciary because he or she is not acting in his or her capacity as a plan administrator. The same is true of a member of a union board, who is also a member of the pension board, voting on the position his or her union should take on pension benefits in collective bargaining.

Bernard J. Allen
June 21, 2010
Page 7

their actions would not have raised any issues concerning breach of fiduciary duty because the changes to the funding policy codified had been approved by the system's actuary and the pension board, complied with the federal tax law, and did not violated the contractual rights of members or beneficiaries.


2. The action of the Common Council, in adopting a funding policy change that had been previously approved by the board, did not infringe upon the fiduciary responsibility of the board because the board has no fiduciary responsibilities concerning plan design. In the future, both the board and the Common Council must approve any change in the funding policy.

3. Accordingly, there is no basis for any liability of board members arising out of the Common Council's adoption of the amendment.

Very truly yours,



GRANT E. LANGLEY
City Attorney



RUDOLPH M. KONRAD
Deputy City Attorney

RMK:lmb
1054-2010-1215:158459



Whyte Hirschboeck Dudek S.C.

James W. Greer
414-978-5408
jgreer@whdlaw.com

August 19, 2009

Annuity and Pension Board
Employees' Retirement System
City of Milwaukee
Attn: Jerry Allen
789 North Water Street
Suite 300
Milwaukee, WI 53202

Re: Opinion Regarding ERS Funding Policy

To: Annuity and Pension Board

By letter dated June 24, 2009 (copy attached), we have been requested to provide the Annuity and Pension Board ("Board") of the City of Milwaukee Employees' Retirement System ("ERS" or "Plan") with an opinion regarding the following:

1. Is the ERS Board authorized to adopt the Plan's funding policy, including components related to measuring the actuarial value of assets and amortization of unfunded liability?
2. If the answer to the first question is "yes," how should the ERS Board proceed as a fiduciary to fulfill its obligation in connection with adopting the funding policy?
3. What actions would be required to remove this responsibility from the ERS Board and transfer it to the City of Milwaukee and other participating employers?

The opinions set forth herein are subject to and limited by information that has been made available to us by the City, the ERS staff and Buck Consultants, the ERS actuary. In rendering these opinions we have relied on the accuracy of the information provided to us, including the facts summarized below, and our opinions are based upon and subject to those facts.

SUMMARY OF THE FACTS

The ERS is a defined benefit retirement plan for employees of the City of Milwaukee and participating City Agencies (collectively, the "City"). The Plan was created in 1937 by the Employees' Retirement Act which is incorporated in Chapter 36 of the Milwaukee City Charter (Charter). Members of the Plan receive pension benefits which are calculated in accordance with Chapter 36.

The Plan is funded principally by tax dollars contributed by the City, and investment income from prior contributions. Chapter 36 requires the City to maintain adequate funding and reserves for the payment of the Plan's accrued liabilities. Charter §§ 36-08-6 and 36-13-4-a. The Board uses an actuary to determine the funding requirements of the Plan. Charter § 36-15-13. Each year the actuary projects the total amount of present and future benefits owed to members as a result of employee service through the date of the valuation (*i.e.*, accrued liability) based upon the number of employees, their ages and other factors. Charter § 36-15-15. The actuary then calculates the amount necessary to fund the accrued liability. If the accrued liability exceeds the value of the Plan's assets, the City must make a contribution towards the unfunded liability. If the amount of the accrued liability is less than the value of the Plan's assets, the surplus is accumulated in the Plan and the contribution required by the City is reduced or eliminated.

The Board approves the actuary's valuation and certifies the contribution due from the City each year. Charter §§ 36-08-6-e and 36-15-15. As part of this approval and certification process, the Board adopts the Plan's funding policy. The funding policy components of the annual valuation establish the methodology for the determination of an adequate funding level for the Plan.

Earlier this year, the City requested and received permission from the Board to consult with the Plan's actuary. The purpose of the consultation was to seek review by the actuary of a City proposal to modify the Plan's funding policy in order to address the current economic environment and contribution volatility. The objectives of the City's proposal were twofold: (1) to continue to finance retirement benefits in an actuarially responsible manner; and (2) to manage the volatility of contributions needed from the City to finance the Plan. The proposed funding policy called for changes to the asset corridor (*i.e.*, expand the actuarial asset variance from 10% to 20%), the asset smoothing period (*i.e.*, increase the period from 3 to 5 years), the amortization payment type (*i.e.*, change from level dollar to level percent of payroll), the amortization method (*i.e.*, change from open to closed until expected future lifetime is reached and then keep

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open), and the amortization period (*i.e.*, increase from expected future ^{walking}lifetime to 25 years).

The actuary consulted with the City and concluded in a letter dated June 26, 2009 (copy attached) that the City's proposal is "a reasonable funding policy, within the bounds of responsible actuarial practice." According to the actuary, the proposal places the Plan's funding policy more in line with the current practices of a majority of Public Employee Retirement Systems. Also according to the actuary, the existing policy is more susceptible to market swings which result in contribution volatility. This presents management and budget issues for the participating employers.

The City's funding proposal is currently under consideration by the Board. Individual Board members have met with the ERS actuary regarding the components of funding policy. The actuary has provided data comparing the existing policy with the proposed changes. The actuary sent a letter to the Board dated August 14, 2009 (copy attached) concluding that "[t]he proposed policy modifies certain policy components within actuarially sound parameters, helps maintain funding requirements and achieves a balance between being sensitive to the current economic environment and contribution volatility." A special meeting of the Board has been scheduled for August 27, 2009 to consider the City's proposal and to comply with the September 1 date for Board certification of the City's annual contribution to the Plan. (Section 36-08-6-e, Charter.)

ANALYSIS AND DISCUSSION

Question 1: Is the ERS Board authorized to adopt the Plan's policy, including components related to measuring the actuarial value of assets and amortization of unfunded liability?

We conclude the Board is not only authorized, but as a practical matter is required, to adopt the Plan's funding policy, including the components related to measuring the actuarial value of assets and amortization of unfunded liability.

The duties and responsibilities of the Board are set forth in Chapter 36 of the City Charter. The Board is charged with "[t]he general administration and responsibility for the proper operation of the retirement system and for making effective the provisions of this act . . ." Charter § 36-15-1-a. The Board is authorized to "designate an actuary who shall be the technical advisor to the board on matters regarding the operation of the funds . . . and shall perform other duties required in connection therewith." Charter § 36-15-13. Those actuarial duties include assisting the Board with the annual valuation

and determination of the contribution payable to the Plan by the City. Charter §§ 36-08-6-e and 36-15-15. Chapter 36 requires the Board to certify on or before September 1 of each year the amount payable to the retirement system by the City. Charter § 36-08-6-e. This calculation is based on the funding policy, and as a practical matter, the Board cannot approve the annual valuation or make this certification without adopting or ratifying a funding policy.

Based on the authority granted to the Board by Chapter 36, and inherent in the Board's responsibility to approve the annual valuation and determine the contribution required to satisfy employer funding obligations, we conclude that the Board is required to review and adopt a funding policy in order to satisfy its fiduciary obligations to the retirement system.

Question 2: If the answer to the first question is yes, how should the ERS Board proceed as a fiduciary to fulfill its obligation in connection with adopting the funding policy?

The ERS Board should proceed as a fiduciary to fulfill its obligation to certify on or before September 1 the amount of the contribution due from the City. The Board fulfills its fiduciary obligations by acting prudently in managing the Plan's assets and by engaging in a process that demonstrates an appropriate level of due diligence.

While governmental plans are not subject to the provisions of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §§ 1001 – 1453, the provisions of ERISA, including those related to fiduciary duties, are grounded in well-established trust principles and are instructive in guiding most governmental plans. Under ERISA a plan fiduciary must perform his or her duties in a prudent manner, *i.e.*, using the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity and familiar with such matters would use in the conduct of an enterprise of similar character and aims. Thus, an objective standard, sometimes referred to as the prudent person rule, is applied to actions taken by a plan fiduciary. This legal principle is reflected in Wisconsin case law as well. For example, in **Sensenbrenner v. Sensenbrenner**, 76 Wis. 2d 625, 635, 252 N.W.2d 47 (1977), the court stated that plan trustees must "exercise diligence, prudence, and absolute fidelity" in managing trust assets. Moreover, in accordance with tax rules applicable to the ERS, I.R.C. § 401(a)(2) ("Code"), a plan fiduciary is obligated to administer the plan for the exclusive benefit of its participants and beneficiaries.

In applying ERISA, the Department of Labor has ruled that persons who have the authority to make any decisions as to plan policy, interpretations, practices or procedures (as opposed to the performance of administrative tasks for a plan within the framework of such plan's policies, interpretations, rules, practices and procedures) are plan fiduciaries. In particular, ERISA requires that every employee benefit plan "provide a procedure for establishing and carrying out a funding policy and method consistent with the objectives of the plan and the requirements of this [title]." 29 U.S.C. § 1102 (b)(1). This provision is found within Part 4 of ERISA relating to fiduciary responsibilities. As a fundamental matter, funding policy, including any underlying funding and actuarial assumptions, refers to the method used to determine the periodic contributions that should be made to a pension plan so as to accumulate sufficient assets for paying future benefits.

Case law is consistent with the ERISA provision which places the establishment of funding policy within the purview of a fiduciary's responsibility. In **Wisconsin Professional Police Association v. Lightbourn**, 2001 WI 59, 243 Wis. 2d 512, 627 N.W.2d 807, the court addressed the issue relating to a public retirement board's authority to adjust an employer's unfunded liability balance in order to reflect changes in certain actuarial assumptions used to value the benefit liabilities under the plan. The court held, *inter alia*, that the "Board [is vested] with clear 'authority to maintain proper actuarial funding of the Wisconsin retirement system.'" **Wis. Prof'l Police Ass'n**, 243 Wis. 2d 512, ¶ 206. The court continued by stating "the Board may change actuarial rates in response to changed economic conditions upon recommendation of the actuary, or if necessary to maintain proper actuarial funding of the system." *Id.* ¶ 208. Moreover, the court held that, while participants have a property right in having their benefit commitments fulfilled, participants do not have "a property right to determine exactly how employers fulfill their benefit commitments . . . without showing some tangible injury." *Id.* ¶ 179.

The above-cited authority is instructive in interpreting Chapter 36 of the City Charter, and we recommend that the ERS Board act prudently with due diligence in proceeding with consideration of the Plan's funding policy and certification of the annual contribution due from the City. We understand that the Board's actuary has reviewed the City's proposed policy and has concluded that it is "reasonable," within the bounds of "responsible" actuarial practice, "helps maintain funding requirements and achieves a balance between being sensitive to the current economic environment and contribution volatility." We understand that individual Board members have met with the actuary in order to familiarize themselves with the proposal. We further understand that a special Board meeting has been scheduled to consider funding policy. At that meeting, the Board should act prudently through consideration of all relevant factors, including the

current funding level of the Plan, market conditions, and long range funding of the Plan sufficient to accumulate assets for paying future benefits. In this regard, although we have not found any authority specifically addressing the issue, we believe it appropriate for the Board to consider as relevant factors contribution volatility and the City's ability to manage and budget for annual contributions. We recommend that the Board then adopt a funding policy based on all of the relevant factors.

Question 3. What actions would be required to remove this responsibility from the ERS Board and transfer it to the City of Milwaukee and other participating employers?

As discussed in our response to question number 1, the Board is charged with the responsibility for determining the contribution due from the City under Chapter 36 of the City Charter. Unless or until the City amends Chapter 36, that responsibility remains with the Board. There are significant policy reasons why this responsibility should remain with the Board. To invite the City to make funding policy is to politicize the issue and subject it to election cycle pressures. Unlike the City, the Board (whose members reflect both City and plan participant interests) should be able to consider the long-term perspective and balance the Plan's need for adequate funding with the need of the participating employers to be able to reasonably manage and budget for annual contributions.

OPINIONS


Based upon our review of the facts presented to us and consideration of the provisions of Chapter 36 of the City Charter, case law, and instructive guidance found in the Code and ERISA, we conclude as follows:

1. The ERS Board is both authorized, and as a practical matter required, to adopt the Plan's funding policy, including the components related to measuring the actuarial value of assets and amortization of unfunded liability.
2. The ERS Board should proceed as a fiduciary to fulfill its obligation to adopt the Plan's funding policy and certify on or before September 1 the contribution due from the City.
3. Determination of the Plan's funding policy remains with the Board unless or until the City amends Chapter 36 to provide otherwise.

Annuity and Pension Board
August 19, 2009
Page 7

If you have any question regarding this letter or the legal opinions included above, please direct them to the undersigned.

Very truly yours,



James W. Greer

JWG/pal

Enclosures



City of Milwaukee
Employees' Retirement System

Bernard J. Allen
Executive Director

Thomas A. Rick, CFA
Chief Investment Officer

Martin Matson
Deputy Director

June 24, 2009

Attorney James W. Greer, Jr.
Whyte, Hirschboeck & Dudek, S.C.
555 East Wells Street, Suite 1900
Milwaukee, WI 53202-3819

RE: Actuarial Evaluations and Funding Policy

Dear Attorney Greer:

At its June 18, 2009 monthly meeting, the Employees' Retirement System (ERS) Annuity and Pension Board (Board), received and accepted permission from the City of Milwaukee Attorney's office, to seek outside legal counsel. The ERS is in the midst of its annual actuarial valuation. The board has a number of questions related to the valuation process as follows:

1. Is the ERS Board authorized to adopt funding assumptions, including those related to measuring the actuarial value of assets and amortization of unfunded liability?
2. If the answer to the first question is yes, how should the ERS Board proceed as a fiduciary to fulfill its obligation in connection with adopting funding assumptions?
3. What actions would be required to remove this responsibility from the ERS Board and transfer it to the City of Milwaukee and other participating employers?

Please find attached a document that references the citations from Chapter 36 of the Milwaukee City Charter.

If you have any questions, please do not hesitate to contact me at (414) 286-5454. Thank you for your assistance in this matter. Time is of the essence as the ERS Board is required to accept the annual valuation in September, and the Board's actuary needs at least 30 days lead time to produce the valuation.

Sincerely yours,

A handwritten signature in cursive script that reads "Bernard J. Allen".

Bernard J. Allen
Executive Director

BJA:mtm
enclosures

c: Annuity and Pension Board

Chapter 36/Board Rule References to Board's responsibilities with valuations

36-02-3 Actuarial Equivalent

"Shall mean a benefit of equivalent value as determined on the basis of the tables most recently adopted by the board"

36-08-6 City Contributions, 36-08-6-a Retirement Fund

"...there shall be paid annually into the retirement fund by the city and city agencies for the preceding fiscal year an amount equal to the "normal contribution" as that term is defined in subd. 1, plus the amount required to bring the expected actuarial funded status of the retirement fund, as of the date of the contribution is payable, to a percentage in excess of 100%."

36-08-6-a-1 Normal Contribution

The normal contribution for the retirement fund for the preceding fiscal year shall be the growth in actuarial accrued liability expected as a result of service in that year for all members participating in the retirement fund reduced, but not below zero, by member contributions expected to be deposited in the retirement fund under sub. 7. The actuarial accrued liability as of the valuation date shall be the portion of the total liabilities of the retirement fund that is based on service earned as of the valuation date by each active member, beneficiary and separated vested member who has not withdrawn accumulated contributions. The normal contribution shall be determined separately in respect of firemen and policemen. The determination of the normal contribution shall be based on the such interest, mortality, separation, morbidity and retirement tables as have been adopted by the board. The normal contribution shall be determined by the actuary after each valuation."

36-08-6-a-2

"Any difference between the actuarial accrued liability as defined in subd. 1, and the sum of the actuarially determined value of the assets of the retirement fund plus any unamortized bases established under this par. in prior valuations, shall be amortized over a period which will not exceed 30 years from the valuation date on which such difference is established; provided that as part of the valuation next following a fiscal year in which the city and city agency contributions are zero due to application of the 100% funded status limitation of this par. The actuary may eliminate any previously established amortization schedules and bases and shall recalculate a new "fresh start" amortization schedule. Future payroll growth may be taken into account in the amortization process."

36-15-1 Administration

"...The general administration and responsibility for the proper operation of the retirement system and for making effective the provisions of this act are hereby vested in an annuity and pension board..."

36-15-7 Officers and employees; expenses

"...(The Board) shall appoint an executive director and shall engage such actuarial and other service as shall be required to transact the business of the retirement system."

36-15-13 Actuary

"The board shall designate an actuary who shall be the technical advisor of the board on matters regarding the operation of the funds created by the provisions of this act, and shall perform such other duties as are required in connection therewith."

36-15-14 Periodic Valuations; Tables and Rates Thereon

"At least once in each 5-year period the actuary shall make an actuarial investigation into the mortality, service and compensation experience of the members and beneficiaries of the retirement system, and shall make a valuation of the assets and liabilities of the funds of the system, and taking into account the results of such investigation and valuation, the board shall adopt for the retirement system such mortality, service and other tables as shall be deemed necessary."

36-15-15 Annual Valuations

"On the basis of such tables as the board shall adopt, the actuary shall make an annual valuation of the assets and liabilities of the funds of the retirement system."

Board Rules and Regulations

I.D Mission of the Trustee/Members of the Board

"The administration and responsibility for the proper operation of the ERS are vested in the Board...."

"The purpose of the Board of Trustees is to assure the following:

I.D.4. A retirement system based on sound actuarial principles;"

II.C Duties and Responsibilities of Officers and Employees

II.C.4.A "The Executive Director shall..."

II.C.4.A.16 "direct the preparation of the records of data to serve as the basis or the actuarial report and interpret information received from the Actuary"

VII Board Members/Areas of Responsibility

VII.E Selection of Consultants/Advisors

VII.E.2 Actuary

"The board shall select an Actuary who shall be the technical advisor of the Board on matters regarding the operation of the funds created by the provisions of Chapter 36 of the Milwaukee City Charter and who shall be responsible for the actuarial operation of the ERS in accordance with the actuarial provisions of the law. The Actuary shall be directly responsible to the Board for this work."

June 26, 2009

Mr. Mark Nicolini
Budget and Management Director
Department of Administration
City Hall, Room 603
200 E. Wells St.
Milwaukee, WI 53202

Re: City of Milwaukee Employees' Retirement System – Proposed Funding Policy

Dear Mr. Nicolini:

As requested, we have reviewed you June 16th, 2009 letter on a proposed funding policy for the City of Milwaukee Employees' Retirement System and find it to be one of many existing options that is a reasonable funding policy, within the bounds of responsible actuarial practice.

The undersigned is a Member of the American Academy of Actuaries and meets the Academy's Qualification Standards to issue this Statement of Actuarial Opinion.

Please call me at (312) 846-3669 with any questions.

Sincerely,



Larry Langer, ASA, EA, MAAA
Principal, Consulting Actuary

LL:pl
12736/CxxxxRETxx-Nicolini.doc

cc: Marco Ruffini (Buck)

August 14, 2009

Annuity and Pension Board
Employees' Retirement System
City of Milwaukee
Attn: Jerry Allen
789 North Water Street
Suite 300
Milwaukee, WI 53202

Re: City of Milwaukee Employees' Retirement System – Proposed Funding Policy

Board Members:

As you are aware, Buck Consultants has reviewed the proposed funding policy for the City of Milwaukee Employees' Retirement System and finds it to be a reasonable funding policy, within the bounds of responsible actuarial practice. The proposed policy modifies certain policy components within actuarially sound parameters, helps maintain funding requirements and achieves a balance between being sensitive to the current economic environment and contribution volatility.

The undersigned is a member of the American Academy of Actuaries and meets the Academy's Qualification Standards to issue this Statement of Actuarial Opinion.

The undersigned is available for the special meeting of the Board scheduled for August 27, 2009. In the interim, if you have any questions regarding funding policy, please call me at (312) 846-3669.

Sincerely,



Larry Langer, ASA, EA, MAAA
Principal, Consulting Actuary

LL:pl
12736/C6678RET01-Prop-Fund-Policy.doc

cc: Marco Ruffini, Buck Consultants