



City of Milwaukee
Employees' Retirement System

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Re: Pension Task Force Recommendations

On behalf of the Annuity & Pension Board and as a follow-up to our conversation yesterday afternoon, ERS is requesting an amendment to the Salary Ordinance to resolve a conflict with MCC-36. MCC-36-15 provides that the administration of the ERS is vested in the Annuity & Pension Board. As such the Board is an IRS tax-qualified plan fiduciary with a duty of loyalty to exclusively serve the interests of its members and beneficiaries. This fiduciary duty under the state law of trusts requires the highest standard of care under our legal system.

Further, it is well established that ERS is a city agency under the administration of the Board (not a city department). Accordingly, ERS employees are city employees subject to the Salary Ordinance (see the attached City Attorney opinions on this point).

Over many years the realities of the employment markets have created tension for the Board's ability to faithfully administer the pension system in accordance with its fiduciary duty due to constraints of the Salary Ordinance. This situation is particularly acute with respect to the Board's obligation to prudently oversee the investment of the approximately \$6 Billion of ERS trust assets and has the potential to have profound implications for city finances if not remedied soon.

For both pension funding purposes and the ERS and city financial statements the Board adopts certain economic and demographic assumptions in order to value pension liabilities and for the independent actuary to determine the amount of contributions by the sponsoring employers that are mandated by provisions of MCC-36 and enforceable at law.

The primary ERS economic assumption is the long term expected rate of investment return on trust assets (also known as the discount rate) that is employed as a main input into determining pension liabilities and legally mandated employer contributions. The current long term expected rate of return assumption was set by the Board at 7.5% annually and is six tenths of one per cent (60 basis points in the investment trade jargon) above the latest recommendation of the ERS independent investment consultant and relies on the prospect that ERS investments overseen by the Board will outperform passive market indices for its benchmark policy portfolio solely as a result of the skill of managing the portfolio.



Further the ERS expected return assumption is high end of the spectrum of such assumptions compared to other public pension plans (see the attached latest survey of the National Association of State Pension Administrators).

The Annuity & Pension Board is not only severely hampered in attaining its investment target return in order to fulfill its fiduciary duty by operation of Salary Ordinance constraints on its ability to attract and retain in-house investment talent, but is rapidly approaching the point where it is not reasonable to continue to assume such a high rate of expected return on investments for both funding and financial statement purposes.


The financial impact on the city of even a half percent reduction in expected return would be tens of millions of dollars annually in additional mandated employer contributions beyond what is already projected to be the doubling of the city contribution each year beginning in 2023 which event was the impetus for the creation of the Mayor's Pension Task force.

The Board though charged with administering the pension system, including its investment function, by MCC-36 does not have authority to set the compensation for its Chief Investment Officer (CIO) or Deputy CIO anywhere near actual market levels given the Salary Ordinance constraints. This is the source of the conflict between the requirements of the MCC-36 charge to the Board to faithfully administer the pension system as required by state trust law fiduciary doctrine and the limits imposed by the salary ordinance.

Specifically, a 2011 salary survey commissioned by the Board and conducted by the leading public plan compensation consultant found at that time the CIO's salary was **below** the 4th quartile compared to peer pension funds and no doubt the gap compared to peers has only increased in the ensuing eleven years. Please see the attached survey schedule. Furthermore, the salary of the current incumbent has been frozen for the last four years. It should also be noted, that outsourcing the CIO function, though possible, would cost vastly more than the current in-sourced position. The current ERS investment consultant advised a few years ago the range would be between 8 and 12 million dollars annually for that firm to act as an outsourced CIO due to the risk assumed by the firm in doing so.

To remedy this conflict, ERS is requesting that the Pension Task Force recommend to the Common Council as part of its report that the Salary Ordinance be conformed to be consistent with the MCC-36 mandate for administration of the ERS by the Annuity & Pension Board and provide authority for the Board to set the pay for the ERS CIO and Deputy CIO regardless of the cap currently linked to the Mayor's salary.

Sincerely,


Bernard J. Allen
Executive Director & Secretary

Distribution of Nominal Investment Return Assumptions, FY 01 to present

