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February 23, 2010

Alderman Michael Murphy
Alderman, 10th District
Room 205 – City Hall

Re: Charter Ordinance Relating to Annual Valuations of the
Assets and Liabilities of the Employees' Retirement System

Dear Alderman Murphy:

Common Council File 091274, proposed substitute B, contains a charter ordinance amendment relating to annual valuations of the assets and liabilities of the Employees' Retirement System (ERS). You ask whether the Common Council may legally adopt this file. For the reasons stated below, we conclude that it may.

The Annuity and Pension Board's actuary is required by sec. 36-15-15 of the Charter to make an annual valuation of assets and liabilities of the pension fund. The annual valuation determines the City's and city agencies' annual contributions to the fund. Section 36-08-6 specifies that the actuary is required to use the projected unit credit method to make the valuation. The board's actuary has used the projected unit credit method annually since 1995, when the method was adopted by the Common Council in Charter Ordinance file #942017.

That Charter Ordinance, however, does not state all of the assumptions the actuary does make to apply the method. Those assumptions concern 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 adopts the funding policy applied by the actuary in the report.

In August of 2009, the Annuity and Pension Board (board), with the approval of its actuary, adopted a new funding policy that governed the 2009 valuation. Prior

to its adoption, the board's actuary informed the board in writing that the proposed funding policy is "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, attached hereto.)

The new funding policy provides as follows:

1. The actuary shall employ a 5-year asset smoothing period and an asset valuation corridor that allows for a variation between the market value and actuarial value of assets of 20%.
2. The actuary shall calculate amortization of the unfunded liability based on a level percent of payroll amortization.
3. The actuary shall apply a closed amortization method to a 24-year amortization period until the amortization period is reduced to the expected future working lifetime of the active system's population, calculated separately for police, fire and general city members.

By adopting the proposed amendment, the funding policy, which was approved by the board's actuary and adopted by the board, will be codified as part of Chapter 36. The charter ordinance also provides that the board's actuary must certify that the annual valuation conforms to Actuarial Standards of Practice and that no changes will be made to the funding policy described in the amendment without written certification from the board's actuary that the changes comply with Actuarial Standards of Practice.

The effect of this change is that any future changes to the funding policy, which would require "written certification from the board's actuary that such changes comply with Actuarial Standards of Practice," would have to be made by the Common Council via an amendment to the charter ordinance. 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 in those funding policies, because they are in a charter ordinance, would require a two-thirds vote of the Common Council.

The Wisconsin Legislature, in granting the City home-rule authority over its pension plan, empowered the City to amend the law governing the pension system, 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.” Sec. 36-14. Although the proposed amendment does not change the benefits of any member, it raises the question whether a change in the funding policy could in some cases violate the participants’ property rights to their benefits by undermining the financial stability of the pension fund.

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.

The Employees’ Retirement System is, for the most part, not governed by the Employees’ Retirement Income Security Act (ERISA). Nevertheless, courts often look to ERISA for guidance to resolve questions concerning public pension plans. A number of cases filed under ERISA have held that when an employer exercises discretionary authority and control over an activity covered by the statute, the employer becomes a fiduciary for purposes of those acts only. *Siskind v. Sperry*

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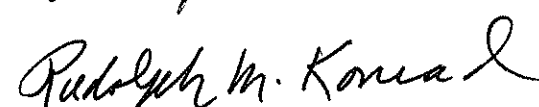
Retirement Program, Unisys, 47 F.3d 498, 505 (2d Cir. 1995); *Amato v. Western Union International*, 773 F.2d 1402, 1416 (2d Cir. 1985). There is, therefore, support for the conclusion that the Common Council acts as a fiduciary when it adopts a funding policy.

Accordingly, the proposed ordinance contains two safeguards to ensure fiduciary standards are met when the Common Council acts. First, the charter ordinance provides that the board's actuary must certify that the annual valuation conforms to Actuarial Standards of Practice; and, second, that no changes shall be made to the funding policy described in the amendment without written certification from the board's actuary that the changes comply with Actuarial Standards of Practice.

Very truly yours,



GRANT F. LANGLEY
City Attorney



RUDOLPH M. KONRAD
Deputy City Attorney

RMK:lmb
enclosure
1033-2010-482:155367



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