Wisconsin Coalition of Annuitants

Minutes of Meeting November 17, 2010

The meeting was held at the Wisconsin Professional Police Association Building, 304 Coyier Lane Madison and was called to order by Chair Jim Palmer at 9:30am.

MEMBERS & ALTERNATES PRESENT: O. Berge, WARSDA; V. Cutler, UWMRFA; B. Fendel, AFSCME; E. Frank, DNR; B. Frantz, DOT; J. Grosklaus, West Allis; P. Hellmuth, UWMRA; R. Hoessel, DOT; C. Howard, WEAC-R; A. Hubbard, WSAA; D. Kratz, CORR; A. Lee, WSAA; J. Maydak, West Allis; J. Miller, DNR; J.Munro, WARSDA; J. Palmer, WPPA; D. Rohweder, ESP, W. Rowe, ACE; B. Schaefer, SEA; J. Stoddard, CORR; J. Vreeland, Wauwatosa; J. Zwadzich, SWIB.

GUESTS: S. Drew, W. Ford, G. Hanson, R. Wojciak

Introduced was recent retiree Bill Ford, the former Legislative Council representative to the WCOA, and Phil Hellmuth a former WCOA director and representing the UWMRA

EXCUSED: J. Calkins, J. Egan, J. Elmer, J. Skiles, A. Wallace

MINUTES of the October meeting were approved as mailed.

GUEST: Gail Hanson, Deputy Executive Director, SWIB

Ms. Hanson provided two handouts on the Dodd-Frank Wall Street Reform and Consumer Protection Act. One addresses her topic <u>Regulatory Reform and Impacts on SWIB</u> and the other is an article from BlackRock (investment manager) on Financial Regulatory Reform which is one of the briefest summaries available with other summaries having hundreds of pages.

The legislation of over 2300 pages was signed into law on July 21, 2010, and expands government regulations in response to the overall credit crisis. The legislation requires considerable rule-making by the SEC, FDIC and others which will be time-consuming. SWIB will be tracking the rule-making process.

The bill has three primary interests for SWIB. Prior to the bill passage SWIB and the WCOA wrote letters and contacted legislators expressing concerns with the various bill provisions.

1) Corporate Governance. Corporate governance reforms have been a concern for SWIB for a number of years. Of particular concern are corporate proxy procedures for electing directors who in term are responsible for addressing poor management. Presently options for proxy votes are either for the slate of directors or to withhold your vote. Corporations were able to justify board appointments without considering withheld votes. Proxy access provisions of this bill allow the SEC to establish rules permitting the shareholders access to the ballot. The SEC rules allow shareholders that have held a minimum of 3% of the shares for three years to nominate directors to the ballot. This is not a provision that would be used often but when a director is not qualified or not listening to the shareholders removal is possible. Presently the SEC rules are being challenged in court so it may be some time before this provision will be used.

The “Say on Pay” provision is a non-binding vote by shareholders on executive compensation which is a carryover from TARP executive payments and would include all companies publicly traded. A similar provision exists for a non-binding vote on “golden parachute”. Company parachute packages are described in SEC filings and occasionally included in proxy statements. An example of “parachute” enhancement is the recent Caterpillar purchase of Bucyrus and the previously structured payout for Tim Sullivan the CEO. In certain cases these parachute provisions are excessive and a concern to shareholders.

Clawbacks were part of the Sarbanes-Oxley Act of 2002 and required CEOs and CFOs to repay companies when there was executive misconduct. Clawbacks again surfaced during the TARP payments. The Dodd-Frank Act is broader and reaches back three years covering all corporations.

Increased disclosures regarding degree of separation of CEO and board Chairperson is good governance. Also proxy information showing the relationship between the CEO and Chairperson serving on other boards and their pay and compensation along with their performance.

2) Derivatives regulation. The legislation requires transparency and disclosure, along with registration and reporting at the time of execution, of derivatives transactions. The intent is to understand the risk involved and identify who is holding which side of each transaction. As an example: AIG’s financial difficulties were not at the insurance company but at the holding company when they became involved in credit default swaps (CDS). When the bond market values dropped AIG’s volume of bond CDS's sold could not be satisfied with their reserves. No one had any idea of the volume or concentration of their CDS’s.

There also is mandatory clearing on parties involved in ownership. In the past it was difficult to track ownership of the derivatives.

Margin requirements of having a reserve for all “swaps” and related products is additional protection for market participants.

Business conduct rules is another protection, however, the rules need to be written. Several school districts in Wisconsin lost a majority of their investment with a business that was investing beyond their knowledge base. Municipalities and other public entities need to have an advisor that is knowledgeable for their investments and looking out for the investors’ interest. SWIB has staff that maintains good business conduct and look out for the investment through degree of exposure and risk management. One concern expressed is that this legislation may increase the cost for SWIB of using foreign exchange and other derivative contracts.

3) Impact on the Fixed Income Market of “too big to fail”, gives the FDIC resolution authority on any systemically important financial institution. Under this authority the percent of recovery for each investor would be independently determined by the FDIC. This means that one investor could receive $.10 on the dollar and another might receive $.40 on a dollar. This is designed to prevent some banks from going under and certain other investors from taking the brunt of the loss. FDIC's concern is for banks, not pension funds. This is a negative for SWIB and other bondholders when each is treated differently. It changes the rules for purchasing bonds when considering a possible failure and not knowing the amount of recovery.

Credit rating agency reforms are designed to monitor those agencies that issued bond ratings, as a number of AAA ratings on mortgage backed securities proved unmerited. SWIB does not hold mortgages, and credit reviews are performed internally by SWIB.

Several other significant provisions in the bill include:

1) Monitoring for potential risks will be by a Financial Stability Oversight Council composed of nine members chaired by the treasury and made up of chairpersons of other committees. This committee will have governance over financial institutions, and major companies that have economic importance. The basic premise is that the chairs of these powerful committees would work together and prevent any domino effect in the financial world.

2) Securitization Reform will require that firms bundling loans will have to retain 5% of the risk.

3) Consumer and investor protection will have an Independent Bureau of Consumer Financial Protection as a division of the Federal Reserve. This bureau will issue regulations on mortgages, credit cards and other credit products to clarify the language to prevent consumers from just signing on the dotted line and not reading the small print. Investor protections under consideration include expanding fiduciary responsibility to brokers and advisors, meaning they must provide the best product for an individual's investment. Presently, some brokers are able to sell any suitable product and may sell those that have the most profit for themselves and not in the best interest of their clients.

Whistleblower awards have been increased up to 30% of the federal fines with the intent that employees report misconduct.

4) Volcker Rule addresses banks and financial institutions that have government backing by the FDIC. It would limit the risk of banks owning risky investments and trading derivatives in their own account which may ultimately increase the loss the FDIC bears upon failure. This legislation has a prohibition on proprietary trading and limits of 3% of capital in hedge funds and private equity funds.

5) Capital requirements provide different definitions of capital and will require investment diversification.

Three additional areas that SWIB is following are;

1) "Pay to Play" is to restrict investment advisors from making campaign contributions and then the elected officials using their influence in directing them to public investments. For two years following a political contribution of more than $350 the advisor is restricted from receiving fees from the advised investment. SWIB currently has a control through the use of a log that is provided to the Audit Committee and discloses any advisor that is referred to them by an elected or appointed official. Hedge funds have been the main area of "pay to play" and any SWIB advisors are required to have a full disclosure that they have not given anything of value to the trustees or the decision-makers at SWIB and soon to be added key state officials.

2) International Accounting Standards (IAS) are not the same as the US Generally Accepted Accounting Principles (GAAP). The SEC is in charge of establishing standards that could allow the use of international standards by U.S. companies. Some companies are presently permitted to use the IAS when filing in the US. A question was asked regarding Islamic currency standards and Ms. Hanson indicated that is also being studied as part of the international standards.

3) "Proxy Plumbing" is a concern for shareholders. Due to the complexity of the voting process it is questioned if the individual ballot is really counted. SWIB as a large shareholder wants its proxy votes counted.

Question: With all the different federal agencies involved, who will do the enforcing of the rules so that a financial melt down could be prevented. With major industries contacting and financing politicians will the rules be enforced? Ms. Hanson indicated that public pension plans may be at a disadvantage in their advocacy with politicians as they are not able to pay sizable contributions like many industries. We can all be advocates with congressional representatives should we have concerns regarding regulatory enforcement.

Question: Will there be changes in this law with the recent elections? A number of provisions of the financial reform bill were written with the assistance of people in effected industries, so there is not expected to be major changes. The SEC will be making the rules to implement the legislation.

Question: Is there any organization that represents public pension plans and by numbers and investments could have an influence on the legislators and SEC rule making? Ms. Hanson indicated that she is a board member of the Council of Institutional Investors (CII) headquartered in Washington DC. A volunteer board of 15 directors is from public, union and corporate pension funds and advocates for corporate governance.

The WCOA thanked Ms Hanson for her attendance and sharing of information.

GUEST: Sandy Drew, Legislative and Beneficiary Liaison, SWIB

The SWIB returns the end of October 2010 and were Core fund 9.0% trailing the benchmark of 9.3% and the Variable Fund was 8.6% ahead of the benchmark of 8.5%. Total assets in the WRS were $77.28 billion. The returns so far in November are flat.

Ms Drew provided a list of the Senate and Assembly membership. The Senate is now made up of 19 Republicans and 14 Democrats. The Assembly has 60 Republicans, 25 new to the Assembly, 38 Democrats and one independent. This is the first time since the 90s that Republicans control both houses and the governor's office. This also means changes in leadership and committee chairs. SWIB and ETF will be busy educating elected officials on the various components of the WRS and how we differ from other states. The only committee that has appointments is the joint finance committee.

Issues expected to be priorities are economic development based on the Wisconsin Prosperity Strategy report which has been gathering information from listening sessions and has numerous public and private members. The report initially asked SWIB to create a venture capital portfolio and waive fiduciary responsibility. The final report requests that SWIB consider an increase in funds available for venture capital. At present 30% of SWIB's venture capital is in Wisconsin but 30% of venture capital opportunities are not in Wisconsin and therefore the fund lacks the diversification. Other issues are employee contribution to the pension fund which has been proposed at 3% for new hires. Also, employees contributing to health plans and the creation of a defined contribution plan will be issues. There also is the idea of allowing non-government employees and their employers to invest with SWIB. Numerous other possible changes and requests will be forthcoming.

A question was asked regarding the makeup of the SWIB board and any changes that may occur within the next four years. The nine members are appointed for six-year terms with three members' terms expiring this year, and the DOA secretary position changing. Of the six public members appointed by the governor 4 must have at least 10 years of investment experience and one with at least 10 years of financial experience and a participant in a local government investment pool.

Also provided was a handout from the PEW Center ranking Wisconsin's WRS as one of the best in the nation.

The question was asked regarding the difference between a defined contribution and defined benefit plan. The National Institute of Retirement Securities, states that for every dollar of retirement income a defined benefit plan is 46% cheaper than a defined contribution plan for three reasons. Administratively it costs less to do a DB plan, active investment results in greater returns, and a DB plan has pooled longevity for those who would out live their DC plan.

The WCOA again thanked Sandy Drew for her participation.

LEGISLATIVE REPORT: None

CORRESPONDENCE: None

OLD BUSINESS: WCOA Officer installation in January 2011

NEW BUSINESS: Sari King gave a presentation to one our member organization and it was well accepted. Members should contact Sari King or Sandy Drew for organization presentations.

TREASURER'S REPORT: No change, balance $5339.01 The treasurer requested an update on billing information for each of the organizations.

NEXT MEETING: December 15, 2010 9:30 am, WI. Professional Police Association Building.
The meeting adjourned at 11:45am
Respectfully submitted – Dick Kratz