

**EMPLOYEES' RETIREMENT SYSTEM
OF THE CITY OF MILWAUKEE**

**Basic Financial Statements
and Additional Information for the
Year Ended December 31, 2011 and
Independent Auditors' Report**

Employees' Retirement System of the City of Milwaukee

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EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

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POLICEMAN'S ANNUITY AND BENEFITS FUND – THE CITY OF MILWAUKEE

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INTRODUCTORY SECTION

Bernard J. Allen
Executive Director

Thomas Rick, CFA
Chief Investment Officer

Beth Conradson Cleary
Deputy Director



Executive Directors Letter of Transmittal

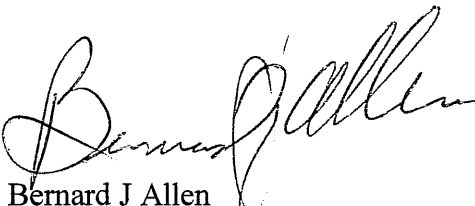
June 20, 2012

On behalf of the Annuity and Pension Board of the Employees' Retirement System (ERS) of the City of Milwaukee, I am pleased to present the Basic Financial Statements for the ERS for the year ending December 31, 2011. The ERS provides retirement and disability benefits, counseling and other services to approximately 27,000 members. The Employees' Retirement System was created under Chapter 396 of the Laws of Wisconsin of 1937 and the City of Milwaukee Charter, Chapter 36. This report fulfills the legal reporting requirements of those laws.

It is the responsibility of ERS management to present fairly all-financial information in conformity with generally accepted accounting principles. The ERS has internal controls in place that provide reasonable assurance that the financial statements are free from errors. An independent audit of the ERS' books and records allows the independent auditor to reasonably confirm that the statements are free from material misstatement. The independent auditor's report is found within the Financial Section of this report.

The ERS actuarial funding level decreased from 112.8% at January 1, 2010 to 104.4% at January 1, 2011 due to the effects of the increased 5 year smoothing of losses from the 2008 market correction. The funded status of the ERS is measured by comparing the actuarial value of plan assets with the actuarial accrued liability. The "Schedule of Funding Progress" included in this report shows historical trend information about the system's actuarial value of assets, actuarial accrued liability and actuarial funded status.

Lastly, I would like to acknowledge the staff of the ERS for rising to meet all challenges we have faced and for their continuing dedicated effort in providing superior customer service to all of our members.



Bernard J. Allen
Executive Director

List of Principal Officials

Annuity & Pension Board Members

Michael Daun

Acting City Comptroller

Ex-Officio Member

Larry Holland

Retired

Appointed by the President of the Common Council

John Barmore, Board Vice Chairman

Milwaukee Fire Department

Elected Representative – Active

Alderman Michael J. Murphy

10th Aldermanic District

Appointed by the President of the Common Council

William C. Carey

Elected Representative - Retiree

Gust Petropoulos

Milwaukee Police Department

Elected Representative – Active

Konrad Ellenberger

Milwaukee Police Department

Elected Representative – Active

Ronald Walter

Milwaukee Bucks, Inc.

Appointed by the President of the Common Council

Employees' Retirement System Administrative Personnel

Bernard J. Allen

Executive Director and Secretary

James F. Klajbor

Acting City Treasurer

Custodian of Funds

Martin Matson

Deputy Director

Grant F. Langle y

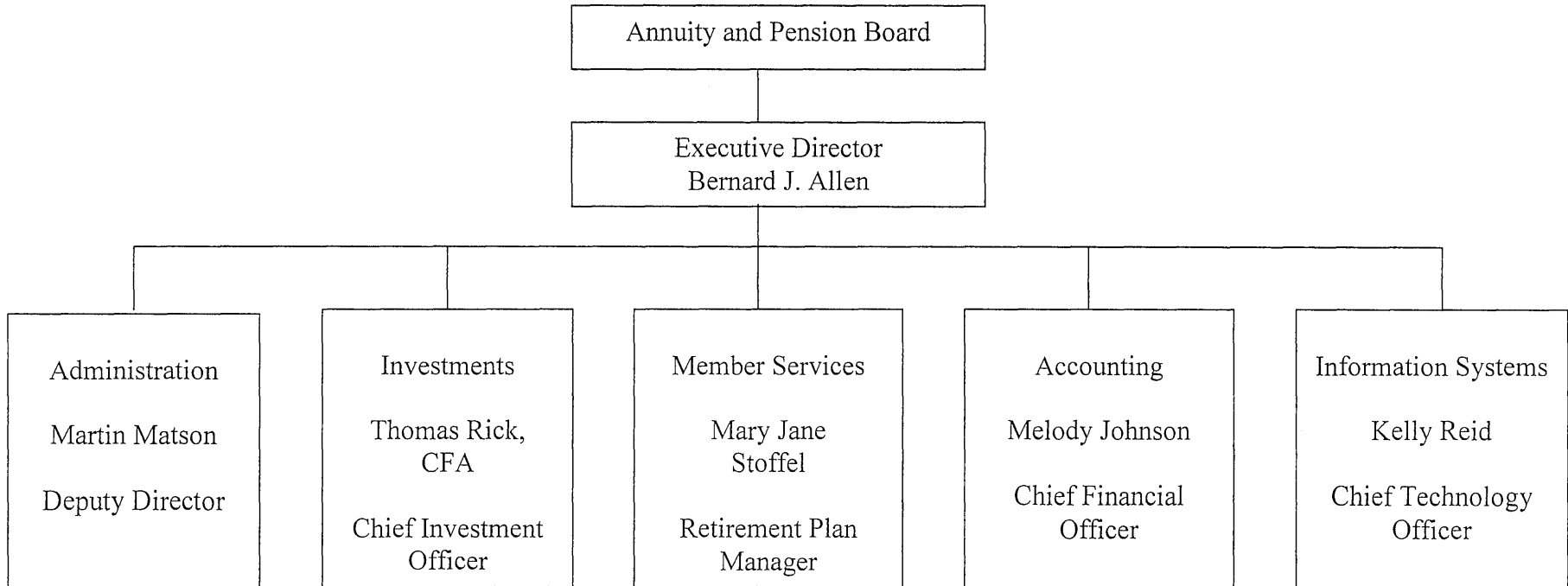
City Attorney

Legal Advisor

Thomas Rick, CFA

Chief Investment Officer

Employees' Retirement System Organization Chart



FINANCIAL SECTION



Baker Tilly Virchow Krause, LLP
115 S 84th St, Ste 400
Milwaukee, WI 53214-1475
tel 414 777 5500
fax 414 777 5555
bakertilly.com

Independent Auditors' Report on Financial Statements

To the Annuity and Pension Board of the Employees'
Retirement System of the City of Milwaukee:

We have audited the accompanying basic financial statements of the Employees' Retirement System of the City of Milwaukee (the "Retirement System") as of December 31, 2011, and for the year then ended as listed in the Table of Contents. These financial statements are the responsibility of the Retirement System's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

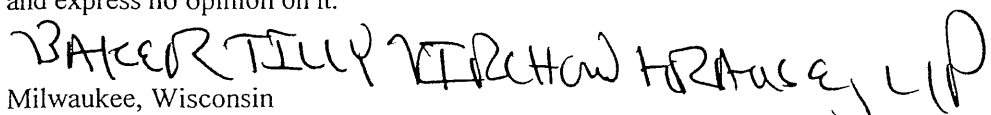
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Retirement System as of December 31, 2011, and the changes in the plan net assets of the Retirement System for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2012 on our consideration of the Retirement System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over the financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, and the Schedules of Funding Progress and Employer Contributions as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in appropriate operational, economical, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The additional information on pages 49 and 50 is not a required part of the basic financial statements of the Retirement System. This additional information is also the responsibility of the Retirement System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the additional information. However, we did not audit the information and express no opinion on it.


Milwaukee, Wisconsin
June 20, 2012

Management's Discussion and Analysis Section

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

MANAGEMENT'S DISCUSSION AND ANALYSIS

To help facilitate a better understanding of the Employees' Retirement System of the City of Milwaukee (ERS) financial condition as of December 31, 2011, the results of operations for the year then ended and the fiscal policies that govern its significant business operations, management has prepared this narrative analysis. This narrative is intended to supplement the audited financial statements and, as such should be read in conjunction with these statements, which are presented later in this document.

The ERS is primarily responsible for administering retirement and disability benefits for employees of the City of Milwaukee, Milwaukee Metropolitan Sewerage District, Wisconsin Center District, Veolia Water Milwaukee LLC, Milwaukee Housing and Redevelopment Authorities, non-certified staff of Milwaukee Public Schools and some employees of the Milwaukee Area Technical College. The ERS pension trust fund is a defined benefit pension plan that provides a monthly benefit to retirees after reaching a minimum retirement age depending upon employment history.

The provisions of Chapter 396, laws of Wisconsin 1937, initially created the ERS. Funds have been established to comply with the legislation governing the ERS. In April of 2000, the Common Council of the City of Milwaukee adopted legislation (commonly referred to as the Global Pension Settlement or GPS) increasing benefits to current and future retirees in exchange for allowing for changes in the administration of the ERS including allowing for the use of ERS funds to pay for the cost of plan administration. Members enrolled prior to June 28, 2000 can elect whether to consent to GPS and accept its provisions, while members enrolled on or after that date are automatically subject to the provisions of GPS.

A Discussion of Funds within the ERS Plan

Global Combined Fund

The Global Combined Fund is used to provide retirement and disability benefits to all members who consented to GPS and all members enrolled on or after June 28, 2000. Approximately 98.1% of the total membership is accounted for in the Global Combined Fund.

Employers' Reserve Fund

Agencies participating in the ERS may voluntarily contribute to the Employers' Reserve Fund. Agencies with funds on deposit in the Employers' Reserve Fund may use these funds to offset contributions required of them by adopting a formal resolution directing such a transfer.

Securities Lending Fund

Northern Trust, the custodian for ERS, administers the securities lending program. In this program, ERS lends out securities and receives collateral from the borrowers in the form of either cash or high quality securities and charge the borrowers a fee.

Revenues generated from securities lending are deposited in the Securities Lending Fund and are restricted to pay expenses in connection with the administration and operation of the ERS. Revenues not expended by the close of the calendar year next following the calendar year in which it is deposited are transferred to the Retirement Fund.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

Non-Consenter Funds

The Non-Consenter Funds provide retirement and disability benefits for all members who have not consented to GPS. The benefits paid from these funds do not include enhanced benefits provided by GPS.

- **Retirement Fund:** The Retirement Fund provides for retirement and ordinary disability (non-work related disability) benefits for non-consenting members enrolled prior to February 1, 1996.
- **Combined Retirement Fund:** The Combined Retirement Fund provides for retirement and disability benefits (both ordinary and duty related) for non-consenting members enrolled on or after February 1, 1996.
- **General Employees' Duty Disability Fund:** The General Employees' Duty Disability Fund provides for duty disability benefits for non-consenting general (non-fire and police) members enrolled prior to February 1, 1996.

Dormant Non-Consenter Funds

A dormant fund has no members currently associated with it and as a result, no member balance amounts. Although these funds are not currently disclosed on the financial statements it is remotely possible that current non-consenting members could qualify for these funds in the future. As a result, the board has not officially closed the following 2 funds:

- **Firemen and Policemen's Duty Disability Fund:** The Firemen and Policemen's Duty Disability Fund provides for duty disability benefits for non-consenting fire and police members enrolled prior to February 1, 1996. As of December 31, 2004 all former members have consented to the global settlement and all remaining balances were transferred to the Global Combined Fund. This fund, although still active, is not likely to ever be used again.
- **Firemen's Heart and Lung Fund:** Accounts for fire heart and lung duty disability benefits of non-consenters. As of December 31, 2002 all former members have either consented to the global settlement or are deceased. This fund, although still active, is not likely to ever be used again.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiduciary Funds

Fiduciary Funds are used to report assets held in a trustee capacity for others and therefore cannot be used to support the primary governments own interests.

- **Policeman's Annuity and Benefit Fund:** As discussed in Note 11, on December 14, 2005, the Policeman's Annuity and Benefit Fund (PABF) board adopted a resolution to dissolve and to liquidate all assets of the fund and transfer the assets and full administrative control to the ERS. All assets of the PABF were transferred to the system's custodian, Northern Trust, in early 2006 and the ERS board assumed custodial authority and responsibility for the fund's assets as of January 3, 2006. These resources are disclosed in the financial records as a separate fiduciary fund and valuations are prepared by the ERS actuary. The only re-occurring revenues to the fund are in the form of an annual tax levy. The levy for 2011, to be collected in early 2012 amounts to \$208,956. The benefits paid during 2011 were to some 70 annuitants and widows. Benefit payments amounted to \$765,365. Due to the materiality level of this fiduciary fund, it has not been included in the Analysis of Financial Position and Results of Operations section of this Management Discussion & Analysis.

Financial Highlights

- Total assets of the ERS decreased by \$180.850 million or 3.9% during 2011. The decrease was primarily due to increased benefit payments in conjunction with flat investment returns during 2011.
- As members of the plan consent to the Global Pension Settlement, their member balances are transferred from the appropriate "Non-consenter" fund to the Global Combined Fund. Total member balances transferred for 2011 amounted to \$2.138 million.
- As of January 1, 2011, the date of the latest actuarial valuation, the ERS actuarially funded ratio was 104.4%, a decrease from the January 1, 2010 funding level of 112.8%. This decrease is due to the effects of the increased 5 year smoothing of losses from the 2008 market correction. The funded ratio based on the market value of assets increased to 97.2% as of January 1, 2011 from 94.2% as of January 1, 2010.
- In 2011, Northern Trust, ERS' custodian, reported a decrease of 1.1% annual gross of fees total fund return while in 2010 the return was 14.2%. As of December 31, 2011, the fund's 5-year performance ranks in the bottom quartile of the Callan Associates database. This database consists of public employee pension total funds including both Callan clients and surveyed non-client funds

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements

The Financial Statements of the ERS are comprised of the following components: 1) fund financial statements, 2) notes to basic financial statements, 3) required supplementary information, and 4) additional information. Collectively, this information presents the net assets held in trust for pension benefits for all funds under ERS administration. It should be noted that currently, the ERS board is responsible for the administration of the plan assets of the Employees' Retirement System and the Policeman's Annuity and Benefit Fund. The latter is disclosed discreetly as a fiduciary fund on these statements.

- 1) Fund Financial Statements.** Fund Financial Statements consist of the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets.

Statement of Plan Net Assets contains cash balances, investments itemized by category and accounts receivable with a total of all assets. Liabilities include benefits payable, reimbursements due to the City for costs to administer the plan and amounts for investment purchases that have been initiated but not settled at year-end to arrive at total liabilities. The total assets minus the total liabilities equals end of year net assets held in trust for pension benefits equal to that found on the Statement of Changes in Plan Net Assets.

Statement of Changes in Plan Net Assets reflects all contributions and net investment performance in the additions section and all expenses and benefit payments in the deductions section. Fund balance transfers are also shown as increases or decreases in fund balance to arrive at the end of year net assets held in trust for pension benefits. The Statement of Changes in Plan Net Assets explains the reasons why the net assets available for pension benefits changed from one year to the next.

- 2) Notes to Basic Financial Statements.** The financial statement notes provide additional information that is essential to understanding the data provided in the fund financial statements. Information in the notes is described below.

- Note 1: Provides a general description of the ERS as well as an overview of some of the common benefits available to various groups of members.
- Note 2: Summarizes significant ERS accounting policies.
- Note 3: Describes consent status changes in relation to the Global Pension Settlement.
- Note 4: Summarizes employer transactions in the Employers' Reserve Fund.
- Note 5: Summarizes the funding status of the ERS, actuarial assumptions, and employer contributions to the plan.
- Note 6: References ten-year historical trend information found within the Required Supplementary Information section.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

2) Notes to Basic Financial Statements (cont.)

- Note 7: Discusses expenses paid as a part of administering the ERS including manager fees and administrative costs.
- Note 8: Discusses the ERS' tax status per Internal Revenue Service determination letter.
- Note 9: Discusses ERS investments and the associated types of risk that the system is exposed to. It also discusses securities lending requirements and amounts on loan.
- Note 10: Describes the contingencies involving the ERS.
- Note 11: Describes the transfer of fiduciary responsibility of the Policeman's Annuity and Benefit Fund to the ERS.
- Note 12: Describes the required actuarial contributions due from the member agencies.
- Note 13: Subsequent Events

3) Required Supplementary Information. The required supplementary information consists of the Management's Discussion and Analysis, as well as the Schedule of Funding Progress, the Schedule of Employer Contributions, and the Notes to Required Supplementary Information. These schedules give an indication of the actuarial performance of the fund and the health of the system.

4) Additional Information. Additional information includes the Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets for all of the Non-Consenter retirement and disability funds individually.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

Analysis of Financial Position and Results of Operations

| Changes in Assets <i>(Dollars in Thousands)</i> | | | Total |
|---|---------------------|---------------------|-------------------|
| | 2011 | 2010 | Percentage |
| | | | Change |
| Assets | | | |
| Cash and Cash Equivalents | \$ 136,544 | \$ 113,590 | 20.2% |
| Investments | 3,921,205 | 4,189,413 | -6.4% |
| Receivables | 108,402 | 31,802 | 240.9% |
| Software Devel & Equip (net) | 5,238 | 7,251 | -27.8% |
| Securities Lending Collateral | 280,908 | 291,091 | -3.5% |
| Total Assets | <u>\$ 4,452,297</u> | <u>\$ 4,633,147</u> | <u>-3.9%</u> |
| Liabilities | | | |
| Benefits Payable | \$ 111 | \$ 95 | 16.8% |
| Due to City of Milwaukee | 1,351 | 2,305 | -41.4% |
| Investments Purchased | 157,450 | 16,160 | 874.3% |
| Derivative Liabilities | 1,937 | - | N/A |
| Securities Lending Obligation | 280,908 | 291,091 | -3.5% |
| Total Liabilities | <u>\$ 441,757</u> | <u>\$ 309,651</u> | <u>42.7%</u> |
| Net Assets Held In Trust For Pension Benefits | <u>\$ 4,010,540</u> | <u>\$ 4,323,496</u> | |

Presented here are the amounts of total assets for 2011 and 2010 respectively. Cash and investments decreased by approximately \$245.254 million. This decrease is primarily due to benefit payments in conjunction with flat investment returns during 2011.

Accounts receivable increases are primarily traceable to the increase in investment sales initiated at the end of 2011, but not settled until the beginning of 2012. The payables increase is primarily traceable to increased investment purchases that were initiated at the end of 2011, but not settled until the beginning of 2012.

In 2003 the ERS began to capitalize its hardware and software development costs for the ERS's new pension payment system, "MERITS". In August of 2006, the system was placed in service. All development costs were capitalized and the applicable useful life of MERITS was determined to be 8 years. By 2014, all capitalized costs associated with the development and implementation of MERITS will be fully depreciated. The current year's computer equipment capitalization was \$96,383. All maintenance expenses will be expensed in the year they are incurred.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

Analysis of Financial Position and Results of Operations

| Analysis of Operations <i>(Dollars in Thousands)</i> | | | Total Percentage Change |
|--|---------------------|---------------------|--|
| | <u>2011</u> | <u>2010</u> | |
| Additions | | | |
| Employer Contributions | \$ 17,350 | \$ - | N/A |
| Member Contributions | 35,325 | 35,699 | -1.0% |
| Investment Income (Loss) | (141,146) | 489,720 | -128.8% |
| Interest & Dividends | 88,550 | 81,277 | 8.9% |
| Less: Investment Expense | (15,336) | (13,196) | -16.2% |
| Total Net Additions (Deductions) | <u>\$ (15,257)</u> | <u>\$ 593,500</u> | <u>-102.6%</u> |
| Deductions | | | |
| Administrative Expenses | \$ 12,134 | \$ 13,275 | -8.6% |
| Benefits Paid | 283,128 | 268,940 | 5.3% |
| Refund of Contributions | 2,437 | 2,769 | -12.0% |
| Total Deductions | <u>\$ 297,699</u> | <u>\$ 284,984</u> | <u>4.5%</u> |
| Net increase (decrease) in assets held in trust | | | |
| for pension benefits | \$ (312,956) | \$ 308,516 | |
| Less Transfer from City Reserve | 0 | (7,000) | |
| Assets held in trust for benefits | | | |
| Beginning of year: | 4,323,496 | 4,021,980 | |
| End of year: | <u>\$ 4,010,540</u> | <u>\$ 4,323,496</u> | |

Actuarially determined contributions were not required of the City or any other participating agency in 2011. Effective January 1, 2010, any new employees were required to pay their own 5.5% contributions to the system. Net investments returned a loss of \$67.932 million in 2011 compared to a gain of \$557.801 million in 2010. This occurred because most of the financial markets experienced gains in 2010 rather than relatively flat performance in 2011. During 2011, the City of Milwaukee made a voluntary contribution to the employer reserve fund of \$17,350,000 to offset future actual and actuarial contribution costs.

Benefits paid increased to \$283.128 million in 2011 from \$268.940 million in 2010 due in large part to pension escalators and a larger population of retirees. Administrative expenses decreased by 8.6% in 2011 when compared to 2010. This occurred due to decreases in operating expenses of the plan.

The January 1, 2011 actuarial valuation also reallocated assets from the non-consenter funds to the Global Combined Fund as of January 1, 2011 for those individuals who were non-consenters as of January 1, 2011 and who then subsequently consented to GPS during 2011. The amount of \$2.138 million was transferred to the Global Combined Fund for this reallocation of assets.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

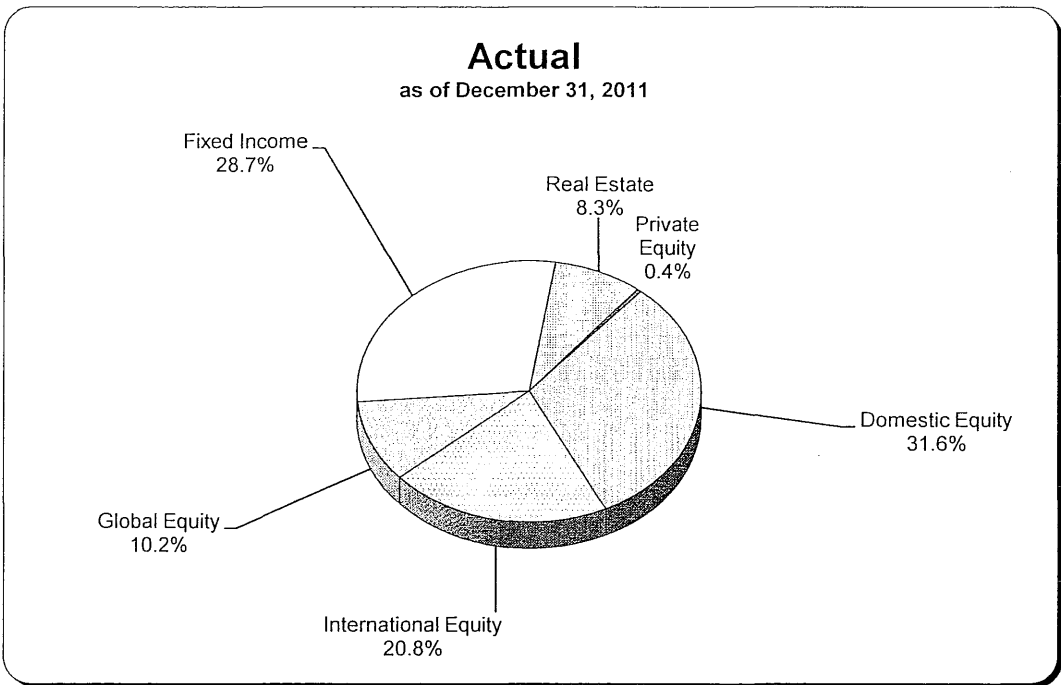
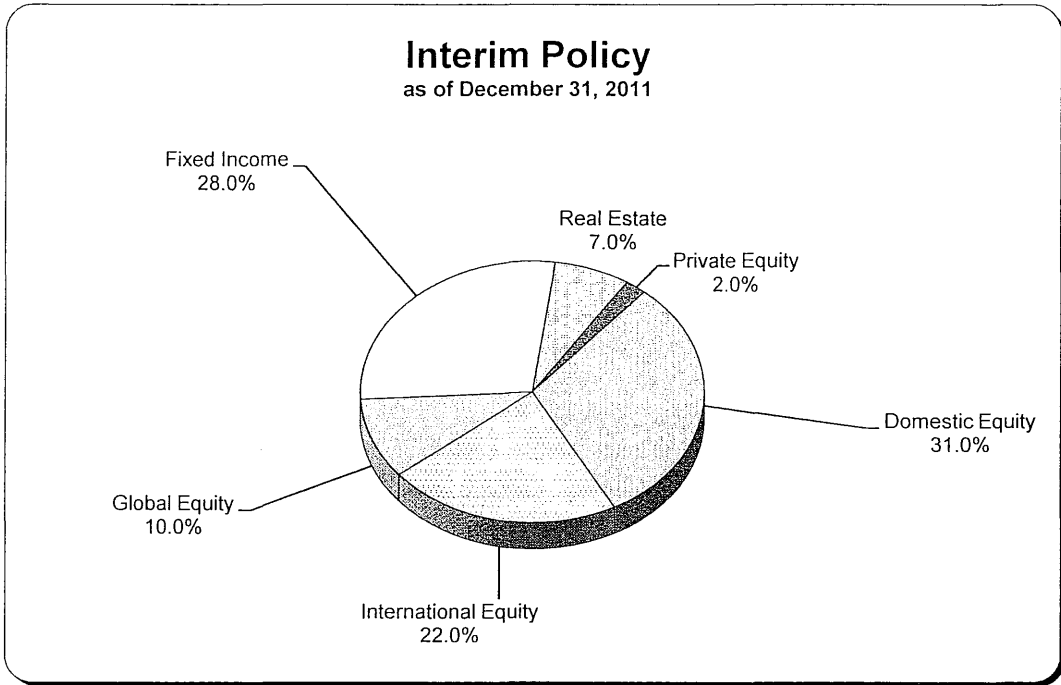
Analysis of Investment Position and Strategies

ERS has one strategic asset allocation for all of its funds. Resources of all the ERS funds are pooled together and invested consistent with this strategy. The employer reserve fund for the City of Milwaukee, however, follows the City's investment guidelines. The return from investments is allocated to the individual funds based on fund balances at the beginning of the year. The table below reports returns for 2011 and 2010 categorized by asset class with the corresponding benchmark results (real estate results are lagged by one quarter). Callan Associates, ERS' consultant in 2011, provided the real estate data and Northern Trust, ERS' custodian, reported the data for the other asset classes and benchmarks listed below. In 2011, the total fund produced a negative return and underperformed its reference benchmark. Within the Fund, Domestic, International, Global and Private Equity produced negative returns and, with the exception of International Equity, underperformed their respective benchmark. Fixed Income produced a positive return but slightly underperformed its benchmark. Real estate produced a positive return and outperformed its benchmark.

| <u>Asset Class</u> | <u>Benchmark</u> | <u>2011 Returns</u> | | <u>2010 Returns</u> | |
|----------------------|--------------------------------|---------------------|------------------|---------------------|------------------|
| | | <u>Gross</u> | <u>Benchmark</u> | <u>Gross</u> | <u>Benchmark</u> |
| Domestic Equity | (Russell 3000 Index) | -2.4% | 1.0% | 19.1% | 16.9% |
| International Equity | (MSCI EAFE Index) | -11.9% | -12.1% | 14.1% | 7.8% |
| Global Equity | (MSCI World Index) | -8.9% | -5.5% | - | - |
| Fixed Income | (Barclays Capital Aggregate) | 7.4% | 7.8% | 9.8% | 6.5% |
| Real Estate | (NCREIF Property Index) | 18.5% | 16.1% | 2.9% | 5.8% |
| Private Equity | (Cambridge Private Equity Inde | -3.1% | 5.4% | - | - |
| Total Fund | (Reference Index) | -1.1% | 0.5% | 14.2% | 11.6% |

As of December 31, 2011, the Fund's actual asset allocation was within the interim allocation tolerance ranges established by the Board in the 3rd Quarter of 2010.

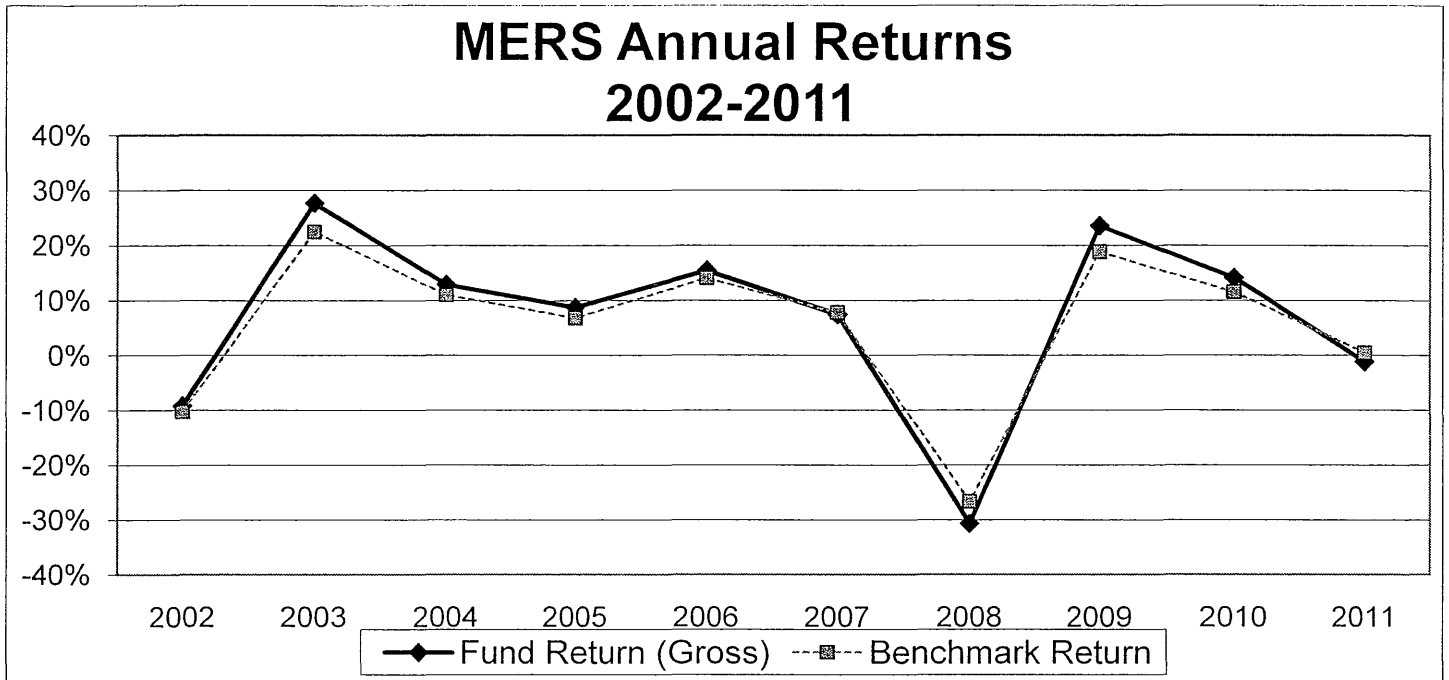
EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS



(See Independent Auditors' Report)

**EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Over the ten-year period ending December 31, 2011, the Fund returned 5.5% annually gross of fees while the benchmark returned 4.7%.



Requests for Information

Members of the retirement board and the senior management of the ERS are fiduciaries of the pension fund and, as such, are charged with the responsibility of ensuring that the system's assets are used exclusively for the benefit of the plan participants and their beneficiaries. This financial report is designed to provide an overview of ERS finances and to demonstrate accountability for resources entrusted to the system for the benefit of the stakeholders. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

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

(See Independent Auditors' Report)

Basic Financial Statements as of and for the Year Ended December 31, 2011

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

**STATEMENT OF PLAN NET ASSETS
AS OF DECEMBER 31, 2011
(in thousands)**

| | Employees' Retirement System Funds | | | | | Fiduciary Fund | | Total |
|--|------------------------------------|-------------------------------|-------------------------|-------------------------|----------------------------------|--|----|-----------|
| | Global Combined Fund | Non-consumer Retirement Funds | Employers' Reserve Fund | Securities Lending Fund | Total Employees' Retirement 2011 | Total Policemans' Annuity & Benefit 2011 | | |
| ASSETS: | | | | | | | | |
| SHORT TERM CORPORATE NOTES, CERTIFICATES OF DEPOSITS, COMMERCIAL PAPER | \$ 114,394 | \$ 1,835 | \$ 18,365 | \$ 1,950 | \$ 136,544 | \$ (636) | \$ | 135,908 |
| INVESTMENTS (Notes 2 and 9): | | | | | | | | |
| Bonds and collateralized mortgage obligations | 876,529 | 3,959 | 2,251 | - | 882,739 | 323 | | 883,062 |
| Common and preferred stocks | 1,400,604 | 6,325 | 3,597 | - | 1,410,526 | 516 | | 1,411,042 |
| Barclay Bond Index Funds | 230,975 | 1,043 | 593 | - | 232,611 | 85 | | 232,696 |
| DFA Small Cap Fund | 163,115 | 736 | 419 | - | 164,270 | 60 | | 164,330 |
| Northern Trust Company Collective Equity Index Fund | 716,594 | 3,237 | 1,840 | - | 721,671 | 264 | | 721,935 |
| Russell 1000 Alpha Value Fund | 161,837 | 730 | 416 | - | 162,983 | 60 | | 163,043 |
| Derivative investments | (4) | - | - | - | (4) | - | | (4) |
| Real estate investments | 327,751 | 1,481 | 842 | - | 330,074 | 121 | | 330,195 |
| Private equity investments | 16,220 | 74 | 41 | - | 16,335 | 6 | | 16,341 |
| Total investments | 3,893,621 | 17,585 | 9,999 | - | 3,921,205 | 1,435 | | 3,922,640 |
| RECEIVABLES: | | | | | | | | |
| Employer (Note 2) | (111) | - | - | - | (111) | - | | (111) |
| Member (Note 2) | 1,618 | - | - | - | 1,618 | - | | 1,618 |
| Interest, dividends and foreign tax recoverable (Note 2) | 14,980 | 67 | 38 | - | 15,085 | - | | 15,085 |
| Investments sold | 91,164 | 412 | 234 | - | 91,810 | - | | 91,810 |
| Tax Levy (Note 11) | - | - | - | - | - | 209 | | 209 |
| Total receivables | 107,651 | 479 | 272 | - | 108,402 | 209 | | 108,611 |
| Software development and equipment (net of depreciation) (Note 2) | 5,238 | - | - | - | 5,238 | - | | 5,238 |
| Securities lending collateral (Note 9) | - | - | - | 280,908 | 280,908 | - | | 280,908 |
| Total assets | 4,120,904 | 19,899 | 28,636 | 282,858 | 4,452,297 | 1,008 | | 4,453,305 |
| LIABILITIES: | | | | | | | | |
| Benefits payable | 111 | - | - | - | 111 | - | | 111 |
| City of Milwaukee (Note 7) | 1,351 | - | - | - | 1,351 | - | | 1,351 |
| Securities lending obligation (Note 9) | - | - | - | 280,908 | 280,908 | - | | 280,908 |
| Derivative liabilities | 1,924 | 8 | 5 | - | 1,937 | 1 | | 1,938 |
| Investments purchased | 156,343 | 706 | 401 | - | 157,450 | - | | 157,450 |
| Total liabilities | 159,729 | 714 | 406 | 280,908 | 441,757 | 1 | | 441,758 |
| NET ASSETS HELD IN TRUST FOR PENSION BENEFITS | | | | | | | | |
| | \$ 3,961,175 | \$ 19,185 | \$ 28,230 | \$ 1,950 | \$ 4,010,540 | \$ 1,007 | \$ | 4,011,547 |

(A schedule of funding progress and a schedule of employer contributions are included in this report).
The accompanying notes are an integral part of the basic financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

**STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands)**

| | Employees' Retirement System Funds | | | | | Fiduciary Fund | Total |
|--|------------------------------------|--------------------------------|-------------------------|-------------------------|----------------------------------|--|---------------------|
| | Global Combined Fund | Non-consenter Retirement Funds | Employers' Reserve Fund | Securities Lending Fund | Total Employees' Retirement 2011 | Total Policemans' Annuity & Benefit 2011 | Total |
| ADDITIONS: | | | | | | | |
| Contributions: | | | | | | | |
| Employer (Note 5) | \$ - | \$ - | \$ 17,350 | \$ - | \$ 17,350 | \$ - | \$ 17,350 |
| Member | 34,996 | 329 | - | - | 35,325 | - | 35,325 |
| Tax levy | - | - | - | - | - | 230 | 230 |
| Total contributions | <u>34,996</u> | <u>329</u> | <u>17,350</u> | <u>-</u> | <u>52,675</u> | <u>230</u> | <u>52,905</u> |
| Investment income (loss): | | | | | | | |
| Net depreciation in fair value of investments | (140,154) | (632) | (360) | - | (141,146) | (52) | (141,198) |
| Interest, dividends and other investment income | <u>85,289</u> | <u>385</u> | <u>219</u> | <u>2,657</u> | <u>88,550</u> | <u>31</u> | <u>88,581</u> |
| Total investment income (loss) | <u>(54,865)</u> | <u>(247)</u> | <u>(141)</u> | <u>2,657</u> | <u>(52,596)</u> | <u>(21)</u> | <u>(52,617)</u> |
| Less investment expense (Note 7) | <u>(14,629)</u> | <u>-</u> | <u>-</u> | <u>(707)</u> | <u>(15,336)</u> | <u>(5)</u> | <u>(15,341)</u> |
| Net investment income (loss) | <u>(69,494)</u> | <u>(247)</u> | <u>(141)</u> | <u>1,950</u> | <u>(67,932)</u> | <u>(26)</u> | <u>(67,958)</u> |
| Total additions (deductions) | <u>(34,498)</u> | <u>82</u> | <u>17,209</u> | <u>1,950</u> | <u>(15,257)</u> | <u>204</u> | <u>(15,053)</u> |
| DEDUCTIONS: | | | | | | | |
| Administrative expenses (Note 7) | 11,022 | - | - | 1,112 | 12,134 | 16 | 12,150 |
| Benefits paid | 282,932 | 196 | - | - | 283,128 | 765 | 283,893 |
| Refunds of contributions | <u>2,355</u> | <u>82</u> | <u>-</u> | <u>-</u> | <u>2,437</u> | <u>-</u> | <u>2,437</u> |
| Total deductions | <u>296,309</u> | <u>278</u> | <u>-</u> | <u>1,112</u> | <u>297,699</u> | <u>781</u> | <u>298,480</u> |
| NET INCREASE (DECREASE) BEFORE TRANSFERS | (330,807) | (196) | 17,209 | 838 | (312,956) | (577) | (313,533) |
| TRANSFERS (Notes 3, 4 and 11) | <u>2,138</u> | <u>(2,138)</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| NET INCREASE (DECREASE) IN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS | (328,669) | (2,334) | 17,209 | 838 | (312,956) | (577) | (313,533) |
| Net assets held in trust for pension benefits: | | | | | | | |
| Beginning of year | <u>4,289,844</u> | <u>21,519</u> | <u>11,021</u> | <u>1,112</u> | <u>4,323,496</u> | <u>1,584</u> | <u>4,325,080</u> |
| End of year | <u>\$ 3,961,175</u> | <u>\$ 19,185</u> | <u>\$ 28,230</u> | <u>\$ 1,950</u> | <u>\$ 4,010,540</u> | <u>\$ 1,007</u> | <u>\$ 4,011,547</u> |

The accompanying notes are an integral part of the basic financial statements.

Notes to the Basic Financial Statements

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

1. DESCRIPTION OF RETIREMENT SYSTEM

The following brief description of the more common provisions of the Employees' Retirement System of the City of Milwaukee (the "Retirement System" or "ERS") is provided for financial statement purposes only. The provisions described reflect changes to the Retirement System enacted in 2000 as part of what is known as the Global Pension Settlement ("GPS"). GPS increased benefits to all members who consented to the settlement in exchange for allowing the City to make certain changes in plan administration, including allowing the use of Retirement System assets to pay for all costs to administer the System. Over 98.1% of the existing members have consented to GPS and are accounted for in the Global Combined Fund. Members who have not consented are accounted for in one or more of the non-consenter funds. Participants should refer to (Chapter 36 of the City of Milwaukee Charter) for more complete information.

The Retirement System was established pursuant to the Retirement Act (Chapter 396 of the Laws of Wisconsin of 1937) to provide the payment of retirement and other benefits to employees of the City of Milwaukee (the "City"). Chapter 441 of the Laws of Wisconsin of 1947 made the benefits contractual and vested. The Retirement System is a multi-employer plan, which also provides benefits to employees of the Milwaukee Metropolitan Sewerage District, the Wisconsin Center District, Veolia Water Milwaukee LLC, Milwaukee Housing and Redevelopment authorities, non-certified staff of Milwaukee Public Schools and some employees of the Milwaukee Area Technical College (the "Agencies"). City employees comprise approximately 55.8% of the active participants in the Retirement System.

Full-time employees, part-time employees who are eligible under adopted rules and regulations, and elected officials who have evidenced their intent to join are members of the Retirement System.

Plan members are required to contribute, or have contributed on their behalf, a percentage of pensionable earnings equal to 5.5% for general city employees, and 7% for police officers, fire fighters, and elected officials, respectively. Pensionable earnings are essentially comprised of amounts paid as the regular base salary and specifically excludes overtime. The City and other participating city agencies fund these member contributions on behalf of each participating employee hired prior to January 1, 2010. After January 1, 2010, some employee groups are required to make their own pension contributions. Contributions of one dollar per year per member are made by police officers on their own behalf. In addition, contributions of one dollar of each police officer's longevity pay per year, excluding sergeant of police, detective lieutenant and ranks above same, are made by police officers on their own behalf.

In addition to the above percentage contributions, additional contributions are required of general city employees who are enrolled as active members after January 1, 2000. To participate in the Global Combined Fund, each new member is required to contribute 1.6% of his or her pensionable earnings for a period of eight years. These contributions are taken to fund the improved escalator benefits resulting from the GPS for these new members.

Chapter 36 was amended so that various groups of represented and non-represented City employees hired on or after January 1, 2010 shall contribute 5.5% of their earnable compensation. These new employees are exempt from the 1.6% contribution requirements mentioned above.

EMPLOYES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

1. DESCRIPTION OF RETIREMENT SYSTEM (cont.)

The 2011 Wisconsin Act 10, also known as the governor's Budget Repair Bill, created Wis. Stat. 62.623 (Payment of contributions in an employee retirement system of a first class city), which requires certain members to pay employee required contributions (5.5%) and prohibits their employer from making the contributions on their behalf. In particular, the employee required contributions applies to city agency members and not to city employees. (This discrepancy exists due to the fact that city members hired prior to January 1, 2012, have contractual vested rights enumerated within Chapter 36, whereas Chapter 36 merely grants city agency employers the discretion to either pay or not pay all or part of the members' contribution. The state law takes away this discretion.)

Section 36-08-7-m was amended to allow that any general city employees required to contribute 5.5% of their earnable compensation no longer are subjected to the 1.6% contribution requirement.

Chapter 36 was amended so that non-represented firefighters and police officers hired on or after October 3, 2011 shall contribute 7% of their earnable compensation to the plan.

The GPS provides that members enrolled through June 28, 2000, must provide written consent to the ERS in order to be eligible for the benefit enhancements of GPS. Members enrolled after June 28, 2000, are automatically participants in the Combined Fund.

Since the January 1, 2011 actuarial valuation was completed, 20 individuals who were eligible for ERS benefits as of June 28, 2000, and who had not consented to GPS, have now consented. The January 1, 2012 valuation reflects the impact of this change.

On an annual basis, the City and city agencies are required to contribute amounts determined actuarially in the annual valuation. The contributions required are limited by ordinance to an amount which brings the expected actuarial funded status of the fund, as of the date the contributions are payable, to a percentage not more than 100%.

The normal retirement benefit is a monthly pension for the life of the member. A service retirement allowance is payable to any member who elects to retire after attaining the minimum service retirement age 60, for general employees and age 57 for police officers and firefighters. General City employees who have attained age 55 and completed 30 years of creditable service are eligible for service retirement. Police officers of any age with 25 years of creditable service and firefighters who have attained age 49 and completed 22 years of creditable service are eligible for service retirement.

For general employees, the amount of a member's service retirement allowance is equal to 2% of final average salary (the highest average of earnable compensation during any 3 years preceding retirement, death or termination) for each year of creditable service. The service retirement allowance for general employees who retire after January 1, 1989 cannot exceed 70% of final average salary. For police officers and firefighters, the retirement allowance is 2.5% of the final average salary (computed on the year of creditable service during which earnable compensation was highest) for each year of creditable service.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

1. DESCRIPTION OF RETIREMENT SYSTEM (cont.)

The retirement allowance for firefighters hired after March 1, 1989 and police officers hired after July 1, 1989 is limited to 90% of final average salary (excluding any imputed service credit provided under the GPS). For elected officials of the City of Milwaukee, the retirement allowance is 2.6% of final average salary for each year of creditable service prior to January 1, 1996. After January 1, 1996, the retirement allowance is 2.0% of final average salary for the mayor and 2.5% of final average salary for all other elected officials for each year of creditable service.

Chapter 36 of the Milwaukee City Charter provides for escalators to nearly all retirees. General City employees participating in the Global Combined Fund retiring on a service retirement allowance on or after January 1, 2000 are eligible for a pension escalator of 1.5% on the second, third and fourth anniversaries of their retirement and 2% on each anniversary thereafter. Police officers and firefighters participating in the Global Combined Fund retiring on a service retirement allowance on or after January 1, 2000 are eligible for a pension escalator based upon the percentage increase in the prior year's Consumer Price Index-All Urban Consumers (CPI-U) effective with their first anniversary and each anniversary thereafter. The percentage increase is determined annually by measuring the change in the Index from November of one year to November of the following year. This escalator is guaranteed to be at least two percent but is capped at three percent.

Rules governing escalators provided to retirees retiring prior to January 1, 2000 (before the Global Pension Settlement), differ from those described herein. In addition, a one-time "catch up" adjustment was provided in January of 1996 to employees who retired on a service retirement allowance on or before September 30, 1987 to partially offset the increase in inflation. For a complete description of the escalator rules, see Chapter 36 of the Milwaukee City Charter. The Retirement System also provides for ordinary and duty disability benefits as well as ordinary and duty death benefits.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of Accounting - The financial statements are prepared using the accrual basis of accounting. Retirement and other contributions are recorded when due. Investment income is recognized when earned and expenditures are recorded when incurred.
- b. Contributions - The Retirement System records employee contributions as earned. Contributions earned but not yet received from the City, participating city agencies and members are reflected as contributions receivable.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

At January 1, 2011, the number of participants in the Retirement System was as follows:

| | |
|--|----------------------|
| Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them | <u>15,726</u> |
| Current Employees: | |
| Vested | 9,311 |
| Nonvested | <u>1,936</u> |
| Total Current Employees | <u>11,247</u> |
| Total Participants | <u><u>26,973</u></u> |

- c. *Investments* - Investments of the Retirement System are recorded at fair value as determined by quoted prices in active markets. Short-term investments are reported at cost, which approximates fair value. Receivables and payables relating to investment transactions entered into prior to year-end, but not completed until after year-end, are recorded as assets or liabilities.

Real estate consists of equity and debt participation in diversified real estate investments. The majority of properties in the portfolio are offices, industrial warehouses, multi-family and retail. The real estate investments are carried at market value, which approximates fair value, as of December 31, 2011. An annual review performed by independent professional appraisers is used to assess the market value.

Private equity consists of equity and debt participation in diversified private equity investments. The majority of investments in the portfolio consist of buyouts and venture capital. The private equity investments are carried at market value, which approximates fair value, as of December 31, 2011.

The Retirement System has investments in certain derivatives, including interest rate, credit, index and currency futures; bond futures; deliverable and non-deliverable forward contracts; bond forwards; and to-be-announced (TBA) securities. These investments are made in compliance with the Annuity and Pension Board Investment Policy and Guidelines. Additional information on the Retirement System's derivative use, including the Notional and Contractual Amounts, Market Value and Unrealized Gains and Losses of the holdings, can be found in Note 9.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

All investments are made in accordance with the provisions of Section 36-09 of Chapter 36 of the Milwaukee City Charter. In accordance with these provisions, the several funds of the Retirement System are invested within the requirements of ss. 40.03(1)(n) and 62.63 (3) Wisconsin Statutes. The Retirement System did not invest more than 61.9% of the total assets, as measured by their cost, in stocks of corporations.

The Retirement System has investments in certain financial instruments such as U.S. Treasury Strips, collateralized mortgage obligations and asset backed securities. These investments are made in compliance with the Annuity and Pension Board Investment Policy and Guidelines. The Retirement System's investment managers may temporarily invest small amounts of available cash in short-term investments prior to purchasing securities consistent with their investment strategy.

The Retirement System's international equity managers may invest in warrants and foreign exchange forward contracts as a hedge to foreign currency fluctuations. These investments are not significant to the financial position of the Retirement System and are carried at fair value.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall *market* volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of net assets available for benefits.

- d. *Investment Income* - Dividends and interest are recorded as earned. All dividend and interest income, and all realized investment gains and losses, are allocated to the individual funds based on fund balances at the beginning of the year.
- e. *Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
- f. *Capitalization* - The Retirement System capitalizes hardware and software development costs to better allocate these costs over their useful lives. Amounts spent for hardware (including, but not necessarily limited to servers, printers, monitors, disk drives, network infrastructure, switches) are capitalized in a yearly hardware pool and depreciated over a life of three years. One half a year's depreciation is expensed in the year of acquisition. Amounts spent toward the development of a new Pension Management Information System have been capitalized as Software Development costs. The system went live in 2006. The new system will be depreciated over its estimated useful life of eight years. As of December 31, 2011, the total cost of the Retirement System's hardware and software development costs totaled \$16.842 million. The total accumulated depreciation totaled \$11.604 million with \$2.109 million of deprecation being recognized during 2011, which is included in Administrative Expenses in the accompanying Statement of Changes in Plan Net Assets.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

- g. *Funded Status and Funding Progress- Employees' Retirement System* - As of January 1, 2011, the most recent actuarial valuation date for the Retirement System, the plan was 104.4% funded on an actuarial basis. The actuarial accrued liability for benefits was \$4.447 billion, and the actuarial value of assets was \$4.641 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$538.218 million.

The Schedule of Funding Progress, presented as Required Supplementary Information (RSI) following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Additional information as of the latest actuarial valuation is as follows:

| | |
|-------------------------------|--------------------------------------|
| Valuation Date | January 1, 2011 |
| Actuarial Cost Method | Projected Unit Credit |
| Amortization Method | Closed – Level Percent of Pay |
| Remaining Amortization Period | 23 years as of January 1, 2011 |
| Asset Valuation Method | 5-year smoothed market, 20% corridor |

Actuarial Assumptions:

| | |
|-----------------------------|--|
| Investment Rate of Return | 8.5% |
| Projected Salary Increases | General City 3.5% - 8.5% Police & Fire 4% - 15.4% |
| Assumed Wage Inflation Rate | Pay assumed to grow at 3% per year |
| Cost of Living Adjustments | Vary by Employee Group as explained in summary of plan provisions |
| Mortality Table | For regular retirees and for survivors, the RP-2000 Mortality Table with mortality improvements projected to the year 2005 for males, and the UP-94 Mortality Table, with mortality improvements projected to the year 2000 for females. |

- h. *Funded Status and Funding Progress- Policemen's' Annuity and Benefit Fund* - As of January 1, 2011, the most recent actuarial valuation date for the Policemen's Annuity and Benefit Fund, the fund was 53.8% funded on an actuarial basis. The actuarial accrued liability for benefits was \$2.946 million, and the actuarial value of assets was \$1.584 million.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

The Schedule of Funding Progress, presented as Required Supplementary Information (RSI) following the notes to the financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Additional information as of the latest actuarial valuation is as follows:

| | |
|-------------------------------|---|
| Valuation Date | January 1, 2011 |
| Actuarial Cost Method | Projected Unit Credit |
| Amortization Method | Open – Level Dollar |
| Remaining Amortization Period | 10 Years |
| Asset Valuation Method | Market Value |
| Actuarial Assumptions: | |
| Investment Rate of Return | 8.5% |
| Projected Salary Increases | None |
| Assumed Wage Inflation Rate | 3.0% |
| Group Size - Growth Rate | Zero - The Plan is Closed |
| Mortality Table | For regular retirees and for survivors, the RP-2000 Mortality Table with five years of projected improvements for males, and the UP-1994 Mortality Table, with six years of projected improvements for females. |

3. CONSENT STATUS CHANGES

Members who have not consented to the GPS are comprised of those who have objected to the settlement as well as those who never responded at all. The previous deadline to consent of April 24, 2004 has been extended indefinitely to those who have not responded. Often, non-responders are members with vested rights who separated from service years ago. These members often express an interest in consenting to GPS at the time they are applying for benefits.

As of the January 1, 2011 actuarial valuation, 468 Retirement System members were identified as being non-consenting. Of this number, 135 were active members, 307 were inactive members, and 26 were benefit recipients. During 2011, 20 of these members elected to consent to the GPS resulting in a transfer of \$2.138 million to the Global Combined Fund from the non-consenter funds.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 2011

4. EMPLOYERS' RESERVE FUND

The City of Milwaukee and other agencies participating in the Retirement System may voluntarily contribute to the Employers' Reserve Fund established in Section 36-08-8 of Chapter 36. This enables agencies to participate in the earnings of the investments of the Retirement System. Agencies having such funds on deposit may use them to offset required contributions by adopting a formal resolution directing such a transfer. As of December 31, 2011, the City of Milwaukee is the only agency choosing to participate in this fund. During 2011, the City of Milwaukee utilized none of their reserve and contributed an additional \$17.350 million to their reserve balance.

5. FUNDING STATUS AND PROGRESS

The pension benefit obligation was determined as part of an actuarial valuation at January 1, 2011. Significant actuarial assumptions used in the January 1, 2011 valuation include (a) a rate of return on the investment of present and future assets of 8.5% per year compounded annually, (b) projected salary increases of between 3.5% and 8.5% for General City and between 4.0% and 15.4% for Fire and Police employees per year compounded annually, (c) normal retirement ages ranging from ages 44 to 70, depending on the class of employee, and (d) for regular retirees and for survivors, the RP-2000 Mortality Table with mortality improvements projected to the year 2005 for males, and the UP-94 Mortality Table, with mortality improvements projected to the year 2000 for females. The excess of net assets available for projected benefits over the present value of the accrued pension benefit obligation as of January 1, 2011 was as follows (in thousands):

| | |
|---|---------------------|
| Net assets available for benefits (actuarial basis) | <u>\$ 4,641,425</u> |
| Pension benefit obligation: | |
| Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits | \$ 2,835,309 |
| Current employees: | |
| Member contributions | 556,261 |
| Employer financed portion | 1,055,978 |
| Reserve for adverse experience | 193,877 |
| Total pension benefit obligation | <u>\$ 4,641,425</u> |

The Retirement System's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. Employer contribution rates are determined using the projected unit credit method. Employer contributions are funded based on an actuarial valuation report. The significant actuarial assumptions used to compute the contribution requirements are the same as those used to compute the pension benefit obligation.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

5. FUNDING STATUS AND PROGRESS (cont)

The GPS, effective January 1, 2000, merged funding for duty disability and retirement benefits for consenting Retirement System members in the Global Combined Fund resulting in no employer contribution being due for this group for 2011. Employer contributions for non-consenting members were not required for 2011. This amount was determined in accordance with existing statutory requirements using the projected unit credit method as of January 1, 2011. All actuarial computations were made by an independent consulting actuary to satisfy the requirements of 36.08(2) of the Milwaukee Charter.

6. TEN-YEAR HISTORICAL TREND INFORMATION

Ten-year historical trend information is designed to provide information about progress made in accumulating sufficient assets to pay benefits when due. A schedule of funding progress and a schedule of employer contributions is included in this report.

7. EXPENSES

Under the Milwaukee City Charter, as provided in the GPS, all administrative and investment expenses of the Retirement System are the direct obligation of the Global Combined Fund. Expenses are normally paid through the City of Milwaukee accounting system and reimbursed by the Retirement System to the City. Money manager fees of \$10.867 million, real estate manager fees of \$3.762 million, and administrative expenses of \$8.913 million were charged to the Global Combined Fund in 2011.

In addition, the Annuity and Pension Board authorized the payment of \$1.112 million of administrative costs from the Securities Lending Fund during 2011. This reduced the amounts needed from the Global Combined Fund to fund the costs to administer the Retirement System (see Note 9).

8. INCOME TAX STATUS

The Retirement System obtained its latest determination letter on July 13, 2006, in which the Internal Revenue Service ("IRS") stated that the Retirement System, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code. In January 2009, as part of the regular IRS 5 year cycle, the Retirement System filed for an IRS determination letter. The Retirement System's management believes that the plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been reflected in the accompanying basic financial statements.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS

Deposits and Custodial Credit Risk

Custodial credit risk is the risk that, in the event a financial institution or counterparty fails, the Retirement System will not be able to recover the value of its deposits, investments, or securities. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the Retirement System's name, and held by the counterparty. As of December 31, 2011, no investments or securities were exposed to custodial credit risk. The Retirement System is exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by federal depository insurance. This amount was \$2.721 million as of December 31, 2011.

Investment Policies

The Retirement System was established to provide for the present and future retirement, disability, and death and survivor benefit payments for all city and city agency employees. All of the funds of the Retirement System taken in the aggregate constitute a special trust subject to applicable local, state, and federal laws, including but not limited to sections 36-15, 36-09-1, and 36-09-6 of the Milwaukee City Charter. As of December 31, 2011, the fair market carrying value of the investments are as follows (in thousands):

| <u>Investment Type</u> | <u>Carrying Value</u> <u>2011</u> |
|---|--------------------------------------|
| Common Stock | \$ 1,381,561 |
| Preferred Stock | 17,363 |
| Convertible Equity | 101 |
| Corporate Convertible Bonds | 12,017 |
| Barclays Lehman Intermediate Aggregate Index Fund | 232,696 |
| Northern Trust S&P 500 Index Fund | 721,935 |
| DFA Small Cap Fund | 164,330 |
| Barclays Russell 1000 Alpha Tilts Fund | 163,043 |
| Government Bonds | 241,178 |
| Government Agencies | 44,359 |
| Municipal/Provincial Bonds | 32,571 |
| Corporate Bonds | 406,549 |
| Gov Mortgage Backed Sec | 102,895 |
| Comm Mortgage Backed Sec | 14,240 |
| Asset Backed Securities | 23,820 |
| Non-Gov Backed C.M.O.S. | 3,456 |
| Other Fixed Income | 13,996 |
| Real Estate Investments | 330,195 |
| Private Equity | 16,340 |
| Derivative Investments | (4) |
| Total Investments | \$ <u><u>3,922,640</u></u> |

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS (cont.)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Retirement System's investment guidelines limit how much each fixed income manager may deviate duration from their respective benchmarks. Duration is the approximate percentage change in price for a 100-basis-point change in yield. Depending on the investment manager, the duration of the Retirement Systems active fixed income managers must either be between 80% and 250% of the duration of the Barclays Capital Aggregate Index, +/- 2 years of the Barclays Capital Aggregate Index, or +/- 2 years of the Citigroup World Government Bond Index, depending on the manager. As of December 31, 2011, the segmented time distribution of the various investment types of debt securities for the Retirement System is as follows (in thousands):

| | 2011 | | | | |
|-----------------------------|---------------------|-------------------------|-------------------|-------------------|-------------------|
| <u>Investment</u> | <u>Fair Value</u> | <u>Less than 1 Year</u> | <u>1-5 Years</u> | <u>6-10 Years</u> | <u>10+Years</u> |
| Government Bonds | \$ 321,060 | \$ 6,244 | \$ 201,083 | \$ 51,035 | \$ 62,698 |
| Government Agencies | 59,697 | 10,376 | 48,571 | 750 | - |
| Municipal/Provincial Bonds | 32,571 | - | 25,394 | - | 7,177 |
| Corporate Bonds | 464,214 | 3,968 | 183,849 | 102,935 | 173,462 |
| Gov Mortgage Backed Sec | 190,353 | - | 87,928 | 24,813 | 77,612 |
| Gov-Iss Comm Mort | - | - | - | - | - |
| Comm Mortgage Backed Sec | 19,929 | - | 5,690 | 1,698 | 12,541 |
| Asset Backed Securities | 24,480 | - | 19,931 | 3,868 | 681 |
| Non-Gov Backed C.M.O.S. | 3,455 | - | 136 | - | 3,319 |
| Corporate Convertible Bonds | 12,018 | - | 293 | 1,940 | 9,785 |
| Short-Term Bills and Notes | 38,011 | 38,011 | - | - | - |
| Short-term Investment Funds | 40,673 | 40,673 | - | - | - |
| Totals | <u>\$ 1,206,461</u> | <u>\$ 99,272</u> | <u>\$ 572,875</u> | <u>\$ 187,039</u> | <u>\$ 347,275</u> |

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS (cont.)

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment or deposit. ERS investment guidelines allow foreign currency contracts for defensive hedging purposes. One manager's guidelines also allow for active investment in currency futures, currency forwards, and currency options. In addition, the guidelines recommend adequate diversification by country and currency. As of December 31, 2011, the Retirement System's exposure to foreign currency risk, expressed in U.S. Dollars, is as follows (in thousands):

| <u>Foreign Currency</u> | <u>Fair Market Value</u> |
|-----------------------------|------------------------------|
| Australian dollar | \$ 7,897 |
| Brazilian real | 20,112 |
| British pound sterling | 241,275 |
| Canadian dollar | 61,713 |
| Chilean peso | (42) |
| Czech koruna | (55) |
| Danish krone | 5,545 |
| Euro | 287,639 |
| Hong Kong dollar | 12,195 |
| Indian rupee | 1,724 |
| Indonesian rupiah | 7,809 |
| Japanese yen | 212,303 |
| Malaysian ringgit | 1,838 |
| Mexican peso | 10,386 |
| New Zealand dollar | 28,405 |
| Norwegian krone | 14,593 |
| Polish zloty | 1,021 |
| Singapore dollar | 7,693 |
| South Korean won | 11,069 |
| Swedish krona | 13,320 |
| Swiss franc | 41,053 |
| Turkish lira | (233) |
| Total | \$ <u><u>987,260</u></u> |

Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of the Retirement System's investment in a single issuer. As of December 31, 2011, the Retirement System did not hold any investments in any one issuer that would represent 5% or more of plan assets. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from this requirement.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011**

9. INVESTMENTS (cont.)

Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Retirement System's investment guidelines require its fixed income managers to have an Investment Grade average portfolio. The Retirement System's active fixed income managers are allowed to hold a maximum of 20% of their respective portfolio's market value in issues rated B- or B3, and an additional 5% may be invested in non-rated issues. The quality ratings of investments in fixed income securities of the Retirement System as described by Standard & Poors (S&P) as of December 31, 2011 are as follows (in thousands):

| <u>Investment Type</u> | <u>AAA</u> | <u>AA</u> | <u>A</u> | <u>BBB</u> | <u>BB</u> | <u>B</u> | <u>CCC</u> | <u>US Government Guaranteed</u> | <u>Not Rated Quality Rating Not Available</u> |
|-------------------------------|------------------|-------------------|-------------------|-------------------|------------------|------------------|--------------|-------------------------------------|---|
| Asset Backed Securities | \$ 14,424 | \$ 3,534 | \$ - | \$ 147 | \$ - | \$ - | \$ - | \$ - | \$ 6,375 |
| Comm Mortgage Backed Sec | 8,222 | 5,690 | 3,981 | 2,036 | - | - | - | - | - |
| Corporate Bonds | 2,899 | 64,103 | 122,911 | 157,351 | 50,377 | 61,398 | - | - | 5,174 |
| Corporate Convertible Bonds | - | - | 8,151 | 916 | 291 | 2,659 | - | - | - |
| Government Agencies | 750 | 57,243 | - | - | - | - | - | - | 1,704 |
| Government Bonds | 23,991 | 89,315 | 10,526 | 6,188 | - | - | - | 52,800 | 138,241 ** |
| Gov Mortgage Backed Sec | - | 87,863 | - | - | - | - | - | 102,490 | - |
| Municipal/Provincial Bonds | 11,360 | 14,034 | - | - | 7,177 | - | - | - | - |
| Non-Gov Backed C.M.O.S. | 1,603 | - | - | - | - | - | 64 | - | 1,789 |
| Short-Term Bills and Notes | - | - | - | - | - | - | - | 38,012 | - |
| Short-term Investment Funds * | - | - | - | - | - | - | - | 40,673 | - |
| Total Value by Rating | <u>\$ 63,249</u> | <u>\$ 321,782</u> | <u>\$ 145,569</u> | <u>\$ 166,638</u> | <u>\$ 57,845</u> | <u>\$ 64,057</u> | <u>\$ 64</u> | <u>\$ 233,975</u> | <u>\$ 153,283</u> |

Note: The Retirement System held no investments in the C or D quality rating at the end of 2011.

* FDIC cash balances are invested in the Short-term Investment Fund by the Retirement Systems custodian, The Northern Trust Company. This Fund is not rated by Standard & Poors.

**\$116,932 of the amount listed on the table as Government Bonds Not Rated is Rated Investment Grade by Moody's.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS (cont.)

Derivatives

The ERS' Statement of Investment Policy written objectives and guidelines governing the investment of Fund assets allows investment managers to use forward contracts and derivatives traded on a recognized derivatives exchange for hedging and efficient portfolio management purposes if the Board approves their use within the individual manager's written guidelines. No assets shall be committed to futures, options, options on futures, forwards and other derivatives unless approved by the Board.

Prohibited investments include mortgage interest only (IO), principal only (PO), inverse floaters or other CMO derivatives that have uncertain or volatile duration or price movement.

In 2011, the Fund's separate account investment managers utilized currency forwards, bond forwards, bond futures, currency options, interest rate futures and options on a bond futures contract. Currency forwards are necessary to purchase or sell non-U.S. securities. Bond forwards and futures are sometimes more liquid and easier to trade than the respective underlying security and can allow an investment manager to reduce the costs of constructing an efficient portfolio. A long position in an options contract can result in a more efficiently constructed portfolio because it can provide exposures, for example currency or duration exposure, with substantially reduced downside risk because the maximum loss possible is equal to the price of the option premium.

Currency Forwards

A foreign currency forward is a contractual agreement between two parties to pay or receive amounts of foreign currency at a future date in exchange for another currency at an agreed upon exchange rate. The Retirement System's International Equity and Global Equity managers entered into foreign exchange positions, such as forward and spot contracts, to hedge foreign currency exposure or obtain a currency for a pending cash transaction. The Fund's Global Fixed Income manager entered into currency forward and spot contracts for the purposes of achieving a positive return in addition to the reasons stated above. The majority of the contracts are short-term in duration and mature within 90 days. However, as of December 31, 2011, some contract positions had longer durations that did not exceed 3 years.

Bond Forwards

A bond forward is a non-standardized contractual agreement between two parties to buy or sell a pre-determined amount of a bond at a future date in exchange for a price agreed upon today. The Retirement Systems Global Fixed Income manager entered into bond forward contracts for the purposes of hedging and achieving a positive return. The Fund's bond forward contracts held as of December 31, 2011 had maturities of up to 10 years.

Bond and Interest Rate Futures

A futures contract is a standardized contractual agreement between two parties, made through an organized exchange, to buy or sell a pre-determined amount of a bond at a future date in exchange for a price agreed upon today. The counterparty credit risk for a futures contract is generally less than privately negotiated forward contracts because the organized exchange acts as a clearinghouse that typically settles net changes to futures contract values daily. The Fund's Global Fixed Income manager entered into bond and interest rate futures contracts for the purposes of hedging and achieving a positive return. All of the Fund's futures contracts held as of December 31, 2011 were short-term in duration with maturities less than 90 days.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS (cont.)

Currency Options

An option contract provides one party the right, but not the obligation, to buy or sell a specific amount of a specific security or index at a fixed price within a predetermined time period for a nonrefundable fee. The Fund's Global Fixed Income manager uses currency options to employ currency hedging strategies. All of the Fund's currency options contracts held as of December 31, 2011 had expiration dates less than 180 days.

Option on a Bond Futures

An option contract on a bond future provides one party the right, but not the obligation, to buy or sell a pre-determined amount of a bond futures contract (defined above) within a predetermined time period for a nonrefundable fee. The Fund's Global Fixed Income manager uses options on bond futures to adjust duration exposure. All of the Fund's options contracts on Bond Futures contracts held as of December 31, 2011 had expiration dates less than 90 days.

The following table summarizes the aggregate notional or contractual amounts for the ERS' separate account managers as of December 31, 2011 (in thousands):

| | December 31, 2011 | | |
|--|----------------------------|--------------|--------------------|
| | Notational/ Contractual | Market | |
| | <u>amounts</u> | <u>Value</u> | <u>Gain/(Loss)</u> |
| Futures contracts – long | \$ 45,527 | \$ 45,527 | \$ - |
| Futures contracts – short | 46,274 | 46,368 | (94) |
| Foreign exchange forward spot contracts receivable | 71 | 71 | - |
| Foreign exchange forward spot contracts payable | 71 | 71 | - |
| Options – calls purchased | 66 | 2 | (64) |
| Foreign exchange forward long-term receivable | 125,101 | 125,013 | 88 |
| Foreign exchange forward long-term payable | 125,101 | 124,681 | (420) |

The total exposure of all hedges is limited to 100% of the total portfolio value, at market. Shorting currency exposure in countries without any underlying security exposure is prohibited.

The ERS is also exposed to market risk, the risk that future changes in market conditions may make an instrument less valuable. Exposure to market risk is managed through the limits placed on an investment manager within the Statement of Investment Policy.

The ERS is exposed to credit risk in the event of non-performance by counterparties to financial instruments. Typical counterparties for ERS are major financial institutions and broker-dealers. A counterparty's financial condition, cash on hand, and general credit worthiness is evaluated prior to entering into a transaction. In addition, ratings agencies' evaluations are reviewed.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2011

9. INVESTMENTS (cont.)

The following table summarizes the counterparty credit risk amounts for the ERS' for derivatives as of December 31, 2011 (in thousands):

| <u>Investment Type</u> | <u>A</u> | <u>Exchange</u> <u>Traded</u> | <u>Not Rated</u> <u>Quality Rating</u> <u>Not Available</u> |
|----------------------------|-------------|----------------------------------|---|
| Assets | | | |
| Options | | | |
| Foreign Exchange Contracts | \$ 2 | \$ - | \$ - |
| Interest Rate Contracts | - | 1 | - |
| Forwards | | | |
| Interest Rate Contracts | - | - | 628 |
| Foreign Exchange Contracts | - | - | 973 |
| Liabilities | | | |
| Forwards | | | |
| Interest Rate Contracts | - | - | (2,566) |
| Foreign Exchange Contracts | - | - | (716) |
| Total Value by Rating | <u>\$ 2</u> | <u>\$ 1</u> | <u>\$ (1,681)</u> |

Securities Lending

In November 1993, the Retirement System began generating revenue through securities lending. Eligible securities are loaned out through the Retirement System's custodian, The Northern Trust Company. The Retirement System earns a daily fee for all securities out on loan. The Retirement System incurs a reduction in earnings for an indemnification agreement with the custodian. Each security loan is initially collateralized by securities or cash for at least 102% of its market value. All collateral is held by the custodian. Revenue earned from securities lending is to be used to offset expenses of the Retirement System. If the revenues are not expended within one calendar year following receipt, all remaining amounts are distributed to the Non-Consenter Retirement Fund. For the year ended December 31, 2011, the Retirement System earned revenue from securities lending of \$2.657 million, and paid custodian fees of \$706,837. The fund also disbursed \$1.112 million to offset some of the retirement systems administrative costs. As of December 31, 2011, the fair value of securities on loan was \$273.289 million. The value of collateral held for securities on loan was \$280.908 million as of December 31, 2011 which consisted of approximately 40.0% U.S. Equities, 25.8% U.S. Government fixed obligations, 12.8% Global Equities, 17.8% U.S. Corporate Fixed securities, and 3.6% other securities.

The two main risks in securities lending are counterparty risk and collateral investment risk. Counterparty risk is the risk that the borrower defaults on a loan and is unable to return a security. ERS' contracts with Northern Trust indemnify ERS of any losses it suffers from its securities lending program due to counterparty default. Collateral investment risk is the risk that an investment in a collateral option becomes impaired or decreases in value. ERS is responsible to refund any losses to the borrower as a result of losses in the collateral pool. As of December 31, 2011, the ERS' collateral pool was trading at or near fair market value with no impairments.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

10. CONTINGENCIES

The Retirement System is involved in certain litigation and disputes arising during the normal course of operations. Management does not believe the settlement of such matters will have a material impact on the Retirement System's basic financial statements.

11. FIDUCIARY RESPONSIBILITY OF THE POLICEMEN'S ANNUITY & BENEFIT FUND

On December 14, 2005, the Policemen's Annuity and Benefit Fund ("PABF") board adopted a resolution to dissolve and to liquidate all assets of the fund and transfer the assets and full administrative control to the ERS. Charter Ordinances ss. 35-01-3-b and 36-15-1-e, enacted under common council file #050744, and transferred the administrative and managerial responsibilities of the PABF to the ERS authorizing the ERS Annuity and Pension Board to invest the assets of the PABF and to manage its operations. All assets of the PABF were transferred to the systems custodian, Northern Trust, in early 2006 and the ERS board assumed custodial authority and responsibility for the fund's assets as of January 3, 2006. These resources are disclosed in the financial records as a separate fiduciary fund.

The plan's funding policy is specified in the Milwaukee City Charter, Chapter 35, as amended by Charter Ordinances, Numbers 356 and 357. The annual requirement consists of an amount sufficient to amortize the present value of benefits to all active and retired employees less the value of actuarial assets in the Fund by a series of level payments over the remainder of the funding period. File numbers 950930 and 970052 provide that the Board shall adopt the assumptions which the actuary uses in the annual valuation and tax levy certification. This contribution will comply with GASB, which requires that the annual required contribution of the employer (ARC) should be actuarially determined and have a provision for amortizing the unfunded liability. In general, GASB allows an amortization period of up to 40 years, but 10 years is appropriate for this Fund. The tax levy for 2011 (to be collected in early 2012) would amount to \$208,956 plus budgeted administrative expenses.

As of December 31, 2011, the composition of the fund consisted of 23 annuitants and 47 widows. Once all annuitants and widows are deceased the fund is to be closed and any remaining monies are to be remitted back to the City of Milwaukee.

12. ACTUARIALY REQUIRED CONTRIBUTIONS FROM MEMBER AGENCIES

The Retirement System requires regular payroll contributions from its agencies and members for all active employees covered by the plan on an ongoing biweekly basis. When market conditions yield positive market returns these contributions allow the plan to remain at a 100% funded status. When market conditions produce unfavorable or negative market returns, member organizations are required to fund any shortfall to maintain the plan at a 100% funded status.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2011

13. SUBSEQUENT EVENTS

The Retirement System has evaluated subsequent events occurring through June 20, 2012, the date the financial statements were available to be issued for events requiring recording or disclosure in the Retirement System's financial statements. Due to the impact of the flat market returns during 2011 and the continued smoothing of market losses from the 2008 financial market downturn, additional contributions as calculated by the plan actuary in the January 1, 2012 actuarial valuation, amounted to \$73,298,000, which is due and payable on January 31, 2013. Management feels that no other material events occurred that would require disclosure.

REQUIRED SUPPLEMENTARY INFORMATION

(See Independent Auditors' Report on Page 8)

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
Required Supplementary Information
Schedule of Funding Progress
(in thousands)

| Actuarial Valuation Date Beginning of Fiscal Year | (1) Actuarial Value of Assets | (2) Actuarial Accrued Liability (AAL) | (3) Assets less Actuarial Accrued Liability (EAAL) (1) - (2) | (4) Funded Ratios (1) / (2) | (5) Annual Covered Payroll | (6) EAAL as a Percentage of Covered Payroll (3) / (5) |
|---|--|---|--|--------------------------------------|-------------------------------------|---|
| 2011 | \$ 4,641,425 | \$ 4,447,548 | \$ 193,877 | 104.4 % | \$ 538,218 | 36.0 % |
| 2010 | 4,814,402 | 4,269,324 | 545,078 | 112.8 % | 553,846 | 98.4 % |
| 2009 | 4,076,297 | 4,113,089 | (36,792) | 99.1 % | 536,558 | (6.9)% |
| 2008 | 5,192,000 | 3,958,061 | 1,233,939 | 131.2 % | 532,412 | 231.8 % |
| 2007 | 4,899,721 | 3,846,481 | 1,053,240 | 127.4 % | 528,854 | 199.2 % |
| 2006 | 4,556,371 | 3,706,198 | 850,173 | 122.9 % | 515,934 | 164.8 % |
| 2005 | 4,112,558 | 3,523,179 | 589,379 | 116.7 % | 505,609 | 116.6 % |
| 2004 | 3,909,085 | 3,370,923 | 538,162 | 116.0 % | 486,384 | 110.6 % |
| 2003 | 3,689,981 | 3,204,248 | 485,733 | 115.2 % | 480,800 | 101.0 % |
| 2002 | 4,242,333 | 3,091,511 | 1,150,822 | 137.2 % | 466,757 | 246.6 % |

Analysis of the dollar amounts of actuarial value of assets, actuarial accrued liability, and assets in excess of actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides one indication of the Retirement System's funding status on a going concern basis. Analysis of this percentage over time indicates whether the Retirement System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Retirement System. Trends in funded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the assets in excess of actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the Retirement System's progress made in accumulating sufficient actuarial value of assets to pay benefits when due. Generally, the larger this percentage, the stronger the Retirement System.

See independent auditors' report and notes to required supplementary information.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
Required Supplementary Information
Schedule of Employer Contributions

| Year Ended December 31 | Annual Required | | | Percentage Contributed | Voluntary Contributions Employers' Reserve Fund * | Total All Contributions |
|---------------------------|-------------------------|---------------------------|-------------------|---------------------------|--|-------------------------------|
| | Member Contributions | Employer Contributions | Total Required | | | |
| 2011 | \$ 35,325,090 | \$ - | \$ 35,325,090 | 100% | \$ 17,350,000 | \$ 52,675,090 |
| 2010 | 35,698,219 | - | 35,698,219 | 100% | - | 35,698,219 |
| 2009 | 35,894,509 | 60,098,000 | 95,992,509 | 100% | - | 95,992,509 |
| 2008 | 33,896,622 | - | 33,896,622 | 100% | - | 33,896,622 |
| 2007 | 33,021,527 | - | 33,021,527 | 100% | - | 33,021,527 |
| 2006 | 31,979,995 | - | 31,979,995 | 100% | - | 31,979,995 |
| 2005 | 32,084,484 | 47,000 | 32,131,484 | 100% | - | 32,131,484 |
| 2004 | 30,699,729 | 46,000 | 30,745,729 | 100% | 5,450,000 | 36,195,729 |
| 2003 | 31,054,000 | 78,000 | 31,132,000 | 100% | - | 31,132,000 |
| 2002 | 28,970,054 | 32,000 | 29,002,054 | 100% | 3,179,000 | 32,181,054 |

* Employer voluntary contributions have only been permitted since the Global Pension Settlement became effective.

See independent auditors' report and notes to required supplementary information.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE
Notes to Required Supplementary Information

This information presented in the required supplementary schedules was based on the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation is as follows:

| | |
|-------------------------------|--|
| Valuation Date | January 1, 2011 |
| Actuarial Cost Method | Projected Unit Credit |
| Amortization Method | Closed – Level Percent of Pay |
| Remaining Amortization Period | 23 years as of January 1, 2011 |
| Asset Valuation Method | 5-year smoothed market, 20% corridor |
| Actuarial Assumptions: | |
| Investment Rate of Return | 8.5% |
| Projected Salary Increases | General City 3.5% - 8.5% Police & Fire 4% - 15.4% |
| Assumed Wage Inflation Rate | Pay assumed to grow at 3% per year |
| Cost of Living Adjustments | Vary by Employee Group as explained in summary of plan provisions |
| Mortality Table | For regular retirees and for survivors, the RP-2000 Mortality Table with mortality improvements projected to the year 2005 for males, and the UP-94 Mortality Table, with mortality improvements projected to the year 2000 for females. |

See independent auditors' report and notes to required supplementary information.

POLICEMAN'S ANNUITY AND BENEFITS FUND – THE CITY OF MILWAUKEE
Required Supplementary Information
Schedule of Funding Progress

| Actuarial Valuation Date Beginning of Fiscal Year | (1) Actuarial Value of Assets | (2) Actuarial Accrued Liability (AAL) | (3) Assets less Actuarial Accrued Liability (EAAL) (1) - (2) | (4) Funded Ratios (1) / (2) | (5) Annual Covered Payroll | (6) EAAL as a Percentage of Covered Payroll (3) / (5) |
|---|--|---|--|--------------------------------------|-------------------------------------|---|
| 2011 | \$ 1,584,173 | \$ 2,945,917 | \$ (1,361,744) | 53.8 % | \$ 894,264 | (152.3)% |
| 2010 | 1,935,745 | 3,686,621 | (1,750,876) | 52.5 % | 1,049,503 | (166.8)% |
| 2009 | 2,147,172 | 4,295,606 | (2,148,434) | 50.0 % | 1,276,716 | (168.3)% |
| 2008 | 4,779,417 | 5,049,363 | (269,946) | 94.7 % | 1,354,412 | (19.9)% |
| 2007 | 5,585,697 | 5,956,976 | (371,279) | 93.8 % | 1,514,653 | (24.5)% |
| 2006 | 5,977,606 | 8,241,433 | (2,263,827) | 72.5 % | 2,006,273 | (112.8)% |

Analysis of the dollar amounts of actuarial value of assets, actuarial accrued liability, and assets in excess of actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability provides one indication of the Policemen's Annuity and Benefit Fund funding status on a going concern basis. Analysis of this percentage over time indicates whether the Fund is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the Fund. Trends in funded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the assets in excess of actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the Fund's progress made in accumulating sufficient actuarial value of assets to pay benefits when due. Generally, the larger this percentage, the stronger the Fund.

See independent auditors' report and notes to required supplementary information.

POLICEMAN'S ANNUITY AND BENEFITS FUND – THE CITY OF MILWAUKEE
Notes to Required Supplementary Information

This information presented in the required supplementary schedules was based on the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation is as follows:

| | |
|-------------------------------|---|
| Valuation Date | January 1, 2011 |
| Actuarial Cost Method | Projected Unit Credit |
| Amortization Method | Open – Level Dollar |
| Remaining Amortization Period | 10 Years |
| Asset Valuation Method | Market Value |
| Actuarial Assumptions: | |
| Investment Rate of Return | 8.5% |
| Projected Salary Increases | None |
| Assumed Wage Inflation Rate | 3.0% |
| Group Size - Growth Rate | Zero - The Plan is Closed |
| Mortality Table | For regular retirees and for survivors, the RP-2000 Mortality Table with five years of projected improvements for males, and the UP-1994 Mortality Table, with six years of projected improvements for females. |

See independent auditors' report and notes to required supplementary information.

ADDITIONAL INFORMATION

(See Independent Auditors' Report on Page 8)

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

STATEMENT OF PLAN NET ASSETS

AS OF DECEMBER 31, 2011

(in thousands)

NON-CONSENTER RETIREMENT FUNDS

| | Retirement Fund | Combined Retirement Fund | General Employees' Duty Disability Fund | Firemen and Policemen's Duty Disability Fund | Firemen's Heart and Lung Fund | Firemen and Policemen's Survivorship Fund | Total |
|--|--------------------|-----------------------------|---|--|-------------------------------------|--|------------------|
| ASSETS: | | | | | | | |
| SHORT TERM CORPORATE NOTES, CERTIFICATES OF DEPOSITS, COMMERCIAL PAPER | \$ 1,484 | \$ 339 | \$ 12 | \$ - | \$ - | \$ - | \$ 1,835 |
| INVESTMENTS (Notes 2 and 9): | | | | | | | |
| Bonds and collateralized mortgage obligations | 3,393 | 537 | 29 | - | - | - | 3,959 |
| Common and preferred stocks | 5,421 | 858 | 46 | - | - | - | 6,325 |
| Barclay Bond Index Funds | 894 | 141 | 8 | - | - | - | 1,043 |
| DFA Small Cap Fund | 631 | 100 | 5 | - | - | - | 736 |
| Northern Trust Company Collective Equity Index Fund | 2,774 | 439 | 24 | - | - | - | 3,237 |
| Russell 1000 Alpha Value Fund | 626 | 99 | 5 | - | - | - | 730 |
| Derivative investments | - | - | - | - | - | - | - |
| Real estate investments | 1,269 | 201 | 11 | - | - | - | 1,481 |
| Private equity investments | 63 | 10 | 1 | - | - | - | 74 |
| Total investments | 15,071 | 2,385 | 129 | - | - | - | 17,585 |
| RECEIVABLES AND OTHER: | | | | | | | |
| Employer (Note 2) | - | - | - | - | - | - | - |
| Member (Note 2) | - | - | - | - | - | - | - |
| Interest, dividends and foreign tax recoverable (Note 2) | 58 | 9 | - | - | - | - | 67 |
| Investments sold | 353 | 56 | 3 | - | - | - | 412 |
| Total receivables | 411 | 65 | 3 | - | - | - | 479 |
| Total assets | 16,966 | 2,789 | 144 | - | - | - | 19,899 |
| LIABILITIES: | | | | | | | |
| Benefits payable | - | - | - | - | - | - | - |
| City of Milwaukee (Note 7) | - | - | - | - | - | - | - |
| Securities lending obligation (Note 9) | 7 | 1 | - | - | - | - | 8 |
| Derivative liabilities | 605 | 96 | 5 | - | - | - | 706 |
| Total liabilities | 612 | 97 | 5 | - | - | - | 714 |
| NET ASSETS HELD IN TRUST FOR PENSION BENEFITS | \$ 16,354 | \$ 2,692 | \$ 139 | \$ - | \$ - | \$ - | \$ 19,185 |

See independent auditors' report.

EMPLOYEES' RETIREMENT SYSTEM OF THE CITY OF MILWAUKEE

**STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2011
(in thousands)**

NON-CONSENTER RETIREMENT FUNDS

| | Retirement Fund | Combined Retirement Fund | General Employees' Duty Disability Fund | Firemen and Policemen's Duty Disability Fund | Firemen's Heart and Lung Fund | Firemen and Policemen's Survivorship Fund | Total |
|---|--------------------|-----------------------------|---|--|-------------------------------------|--|-----------|
| ADDITIONS: | | | | | | | |
| Contributions: | | | | | | | |
| Employer (Note 5) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Member | 210 | 119 | - | - | - | - | 329 |
| Total contributions | 210 | 119 | - | - | - | - | 329 |
| Investment income (loss): | | | | | | | |
| Net depreciation in fair value of investments | (542) | (85) | (5) | - | - | - | (632) |
| Interest, dividends and other investment income | 330 | 52 | 3 | - | - | - | 385 |
| Total investment loss | (212) | (33) | (2) | - | - | - | (247) |
| Less investment expense | - | - | - | - | - | - | - |
| Net investment loss | (212) | (33) | (2) | - | - | - | (247) |
| Total additions (deductions) | (2) | 86 | (2) | - | - | - | 82 |
| DEDUCTIONS: | | | | | | | |
| Benefits paid | 177 | 19 | - | - | - | - | 196 |
| Refunds of contributions | 80 | 2 | - | - | - | - | 82 |
| Total deductions | 257 | 21 | - | - | - | - | 278 |
| NET INCREASE (DECREASE) BEFORE TRANSFERS | (259) | 65 | (2) | - | - | - | (196) |
| TRANSFERS (Note 3, 4 and 11) | (1,954) | (169) | (15) | - | - | - | (2,138) |
| NET DECREASE IN NET ASSETS HELD IN TRUST FOR PENSION BENEFITS | (2,213) | (104) | (17) | - | - | - | (2,334) |
| Net assets held in trust for pension benefits: | | | | | | | |
| Beginning of year | 18,567 | 2,796 | 156 | - | - | - | 21,519 |
| End of year | \$ 16,354 | \$ 2,692 | \$ 139 | \$ - | \$ - | \$ - | \$ 19,185 |

See independent auditors' report.